Jovo Ateljević · Jelena Trivić *Editors*

Economic Development and Entrepreneurship in Transition Economies

Issues, Obstacles and Perspectives

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ISBN 978-3-319-28855-0 ISBN 978-3-319-28856-7 (eBook)
DOI 10.1007/978-3-319-28856-7

Library of Congress Control Number: 2016933864

Printed on acid-free paper

This Springer imprint is published by Springer Nature
The registered company is Springer International Publishing AG Switzerland

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Introduction to “Economic Development and Entrepreneurship in Transition Economies”

Jovo Ateljević and Jelena Trivić

The entrepreneurial view is highly westernised, which probably reflects the traditional schools related to Entrepreneurship. Reading an increasing number of books in this field one would think that there is no entrepreneurship beyond the West. It is really not enough to say that different cultures provide different contexts for entrepreneurship, as this would also be too simplified. In fact, entrepreneurial activities are booming in the so-called ‘second or third world’—particularly those economies that are going through transition. However, transition country conditions, including the role of governments and entire institutional contexts, increasingly differ from the western environment. This book, as well as the REDETE conference itself, is an attempt to contribute a better understanding of entrepreneurship in transition economies. According to Stiglitz (1999) the last century has been marked by two great economic experiments. The first one was the outcome of the Soviet Union that started in 1917, and the second was the moving back from centrally planned economies, in which state ownership prevailed, to a market economy where private ownership prevails. Simply put, the process of transition is defined as a manner of moving from a centrally planned to a market oriented economy. A more precise definition is the “reform process in countries that have made the decision to move from a planned socialist system to a private market economy, one in which private ownership predominates and most resources are allocated through markets” (Fischer and Gelb 1991). According to the IMF (2000) and some authors (Fischer and Gelb 1991; Havrylyshyn and Wolf 1999; Žarković 2012) the main aspects of the transition process which more or less prevail in all transition countries are: (1) Liberalization, (2) Macroeconomic stabilization, (3) Privatization and (4) Legal and institutional reforms.

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_1

According to North (1990, p. 3) institutions are the rules and regulations (or humanly devised constraints) that structure political, economic, and social interaction. They consist of both formal rules (constitutions, laws, property rights) and informal constraints (sanctions, taboos, customs, tradition and codes of conducts). Their purpose is to define the rules by which the game is played, monitored and enforced. As Kolodko (1999, p. 2) claims: "A market economy requires not only liberal regulation and private ownership, but also adequate institutions". Inadequate institutions are the main obstacle that entrepreneurs face within transitional economies. Indeed, one of the fundamental errors of almost all transitional economies is blindly leaving the economy to the market.

A society cannot expect to achieve desirable economic growth by prescribing dislocated theories that may not achieve the same results in transition country contexts. There is no single way or path, strategy or program for achieving successful economic development. Furthermore, economic development is not the same as economic growth. Economic growth, commonly measured by the GDP rate of growth, is only one aspect of economic development. According to Todaro and Smith (2009), economic development is a multi-dimensional process involving changes in social structures, popular attitudes, and national institutions, as well as the acceleration of economic growth, the reduction of inequality, and the eradication of poverty. When creating policies, directions and programs in transitional economies, one should always take into account the social, political, technological, historical, and every other important aspect of the state or society. This is one of the basic postulates of developmental economics.

Contextually, entrepreneurship in transition economies certainly has some different characteristics, obstacles but also perspectives compared to developed western economies. Entrepreneurship has become a widely researched topic among scholars, mostly because it's one of the key segments of economic development. Generally, entrepreneurial culture in most transitional economies requires a radical shift: from *pushing* the strongest or most loyal entrepreneurs to the *cultivation* of entrepreneurs. The question of cultivating entrepreneurs is highly related to an issue of the quality of human capital. In this respect, the role of local communities or the paradigm of "local economic development" is a crucial step in the formation of entrepreneurs. Besides financial investments, investment in knowledge and innovation, as well as creation of better business framework is one of the backbones of economic development. A healthy institutional environment is particularly essential in transition economies.

There is a broad consensus amongst academics, policy makers and practitioners that a fundamental cause of difficulties experienced by most economies in transition has been that reform has not been accompanied by the creation of new private businesses, and particularly SMEs. This is especially evident in states created in Europe after the dissolution of the Soviet Union where many barriers, which have been inherited from the old system, remain in place, inhibiting entrepreneurial progress in the country despite a favourable political and economic environment. Most governments in transition economies have failed to create adequate conditions (e.g., tax system, bodies of law, efficient administration, and education) favourable for SMEs and the growth of entrepreneurial activities.

1 The Book Background

This book is one of the spin offs of the REDETE 2014 conference (*Researching Economic Development and Entrepreneurship in Transition Economies*) which was held in April 2014. The REDETE conference continues to be one of the major forums for entrepreneurship and economic development in transition countries. Last year, the conference attracted over 200 participants from 25 countries. We had the opportunity to hear over 70 presentations and listen to seven prominent keynotes from leading European universities. Research papers presented during these proceedings ranged from economic macro environment; international business, FDI; government role in the economy; business strategy and corporate governance; business innovation ICT and technology transfer, academic spin-offs; SMEs management, financing, business risk; new business model; entrepreneurial capacities—human capital, and other and other related topics addressing an increasing number of issues that transition economies face. Furthermore, researching economic development and entrepreneurship in transition countries is increasingly challenging methodologically and contextually, as a result of differences between countries. The REDETE forum provides space for upcoming researchers that ate committed to these challenges in terms of applying methodologies that better fit conditions in different transitional settings. The Forum therefore provides more room for new ideas while addressing economic problems in transition countries where mainstream methodological approaches are often not suitable. It was encouraging to see innovation in that context through a number of the papers presented. This is important in a broader sense as economy or economics is an exceptionally powerful tool for understanding society. One of the important features of the REDETE conference is the participation of a growing number of younger researchers and we do our best to make their research visible by helping them to find the right publishing venues.

One wish of the editors of this book was to publish some of the conference papers in an international monograph that is of higher rank than conference proceedings, as some papers deserved greater international credit and recognition.

2 Structure of the Book

Structurally, the book is composed of three sections, which are *business environment in transition economies, entrepreneurship and transition experience, and particular fields of entrepreneurship development*.

In the first chapter *Is culture an underpinning or undermining factor in the business environment of the transitional countries?*—the author analyzes an institutional stickiness in the business environment from a comparative perspective between 'post transition countries' versus developed countries. Culture as a key transaction cost in countries of transition, is examined and quantified, which contributes to the so called "interaction thesis". By examining and expanding several theoretical concepts, this chapter strives to contribute to the "institutions matter (in transition, too)" stream, and more precisely to the "culture matters (a lot)" stream. This is followed by a chapter called *Restrictive external factors and their influence to the business environment in the Republic of Srpska,* where authors observe the influence of administrative and regulatory burdens onto the business success of companies in the Republic of Srpska. The survey was conducted in the first half of 2013 based on a research sample of 150 companies from the Republic of Srpska. In their results authors indicate that 68 % of these companies consider that the administrative obstacles enhance additional financial costs. Furthermore, they find that a sizeable 40 % of the companies consider that governmental regulations represent an obstacle in doing business. The aim of the chapter is to help adopt solutions for improving the macro-economic situation in the RS, which would be a good start for creating new and empowering existing companies. In the next chapter, *Assessing the impact of public financial support to small and medium enterprises—an empirical study from the republic of Srpska, BiH,* author theoretically and empirically analyzes the impact of public sector financial support policies on the development of small and medium sized enterprises (SMEs) and entrepreneurship in transitional countries. Through empirical research, on the case study of Republic of Srpska Investment-Development Bank, the author explores the impact of IRBRS loans on selected business performance indicators: operating revenue, export and employment of SME borrowers. The empirical results, based on quantitative data research for 120 SMEs in the Republic of Srpska in the period from 2007 to 2012, showed that the Republic of Srpska Investment-Development Bank had a positive impact on operating revenue, exports and, especially, on the employment of SME borrowers. Fourth chapter in this section entitled *The Public Procurement System: A Business Sector Perspective* aims to empirically evaluate the public procurement system in Croatia, which is a transition country and a new EU member state. The ultimate objective of this chapter is to investigate how businesses evaluate the system, and secondly to provide experienced views on the various components of public procurement. This chapter provides unique insights into the functionality of the system from the point of view of companies, and the results could be instructive for both public procurement authorities and for policy-makers in countries that have a similar business environment in the Western Balkans region. In the final chapter of this section, *The role of higher education in a knowledge economy,* the authors aimed to determine whether higher education in Bosnia and Herzegovina can be a key contributor and driver of knowledge economy development. The results presented in this chapter are obtained through empirical research, which has been conducted in B&H in 2012 on a sample of 120 medium and large enterprises and all of the state-funded higher education institutions in B&H. Based on the survey, authors conclude that the country needs to invest in the development of higher education in a way that it ensures education for adequate human capacity building.

In the chapter called *Economic Reform and Entrepreneurship in Vietnam: A Policy Perspective,* the authors aim to portray entrepreneurship development in Vietnam by embarking on a policy perspective. First, they examine the impact of *doi moi*, or economic reform process that was triggered in 1986, and then the transition process of the Vietnamese economy, which has changed the overall entrepreneurial setting in Vietnam. Next, the authors present a closer look at the characteristics of the Vietnamese entrepreneurs, and the chapter concludes with a view on the future of entrepreneurship in Vietnam. Secondly, in the chapter *Researching the entrepreneurial sector in Serbia*, author's aim is to identify and analyze the key requirements for the growth of innovative and entrepreneurial businesses in Serbia. They use annual surveys on entrepreneurs and SME owners, conducted by the National Agency for Regional Development. Based on the collected data, the authors analyze the impact of the selected factors on the gross value added (GVA), as an indicator of the growth of SME sector in Serbia, for the period 2004–2012. Their research suggests that state incentives and the cost of doing business have the greatest impact on entrepreneurship and business development/growth in Serbia. Thirdly, the chapter *Innovation and firm-performance correlations: The case of Central and South Eastern Europe countries* is an empirical investigation of the innovation-performance correlation. A dataset derived from the Business Environment and Enterprise Performance Survey (BEEPS) of 2002, 2005 and 2009 is employed, and they apply instrumental variable technique. First, the authors review the literature related with the innovation-performance correlation. After, they elaborate the sample and the data and explain the methods of research. In the concluding section the authors present very interesting results and present valuable recommendations for policy makers. In the fourth chapter of this section entitled *The Psychological climate in the organization—a determinant of entrepreneurial behaviour,* the authors present an empirical study framed by the theory that task-oriented and relations-oriented leadership behaviours are positively related to the employees' perceptions of its organizational climate. The study introduces this theoretical perspective and examines the relevant literature that supports the significance of leadership behaviour and the organizational climate. The results and analysis of their empirical research are presented at the end of the chapter. The next chapter named *Financing preferences of European SMEs* deals with the question of whether firms in certain European countries exhibit the same external financing preferences. It also questions for differences in external financing preferences between privately held and publicly listed SMEs. All empirical analyses in the chapter are based on the European Central Bank's Survey on the access to finance of SMEs in the euro area (SAFE) conducted from April to September 2013. The final chapter of this section *The Role of Human Resource Management in small and medium sized companies in central-eastern Europe*, explores the existence of organizations' business strategy and HR strategy in SMEs, as well as HR departments, and analyses the role of HRM in the business of the SMEs. The special task in this research is the exploration of HRM activities and trends (recruitment, selection, compensation, performance management, training and development, human resource information systems, etc.) that are present in the SMEs in the CEE region. Based on descriptive statistical methods, t-tests of independent samples and ANOVAs tests, the authors conclude that generally, SMEs that possess HR departments, HR strategies and HR managers that are present on the board—rated their performance at a higher level.

In the chapter *Venture Capital Funds in Transition Countries: An Empirical Study of Bosnia and Herzegovina,* authors analyze the possibilities and limitations of funding available to promising start-up SMEs in B&H, through venture capital, as well as the interest of SMEs in using VC as a source of finance. Their departure point was the research assumption that the encouragement of the formation of VC funds will contribute to the economic growth and development of B&H through the comprehensive support for the development of innovative SMEs, measured by the increase of the level of employment and the commercialization of innovations. The authors found very interesting results, while in concluding section authors present valuable recommendations for policy makers. In the next chapter *The boundaries of coopetition: a case study of polish companies operating in the high-tech sector* the authors aim to identify the boundaries of the streams of cooperation within 'coopetition'. 'Co-opetition' is a relatively new but rapidly growing phenomenon in the global economy, and is becoming increasingly important throughout the world as evidenced by the growing number of identified relationships and research activity of numerous academic centres across the world. The importance of the coopetition phenomenon has increased with the development of globalization processes, especially at the level of sectors and particularly corporations. The concept was introduced in the late 1980s as a combination of two concepts: cooperation and competition. The data in the chapter was gathered on the basis of questionnaire research. The authors present the areas dominated by cooperation, taking into account the type of activities in the value chain (primary and secondary) and the multiplicity thereof. The originality of the chapter is also the result of the presentation of unique quantitative research related to the characteristics of the areas of cooperation in coopetitive relationships. Another advantage is the fact that such research is rare not only in transition economies, but also on an international scale. In the following chapter *Entrepreneurial learning and communities of practice—the case of the cross-border cultural tourism development Bulgaria—Romania* the author analyzes the cross-border cultural tourism development of Bulgaria and Romania as a thriving possibility for entrepreneurial learning and communities of practice. The chapter unfolds the existing potential of these countries and looks into the specifics of how the complex nature of contemporary society is affecting the transformational essence of exchange versus value co-creation. The further objectives of this chapter are to analyze the value and elaborate on a model of entrepreneurial learning and community of practice establishment in the cross-border region of these two economies in transition. Bulgaria and Romania are analyzed through the lens of cultural tourism by looking at the complexity and the value creation interaction possibilities that are enhanced by entrepreneurial and community development. This section ends with a chapter entitled *Present state and perspectives of entrepreneurial financing in Bosnia and Herzegovina*. Authors first present theoretical background on financing entrepreneurial activity, and by using a growth cycle theory, different types and sources of financing available in different stages of entrepreneurial firm life cycle are discussed. Afterwards, the authors present the current state and future perspectives of entrepreneurial financing in BiH. The main focus of the empirical research is on the banking and microcredit sector, government grants and subventions, and venture capital financing perspectives. This research showed that the majority of entrepreneurs are not educated about the available financial products offered by the microcredit sector and therefore do not use this type of financial support.

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Part I
Business Environment in Transition Economies

Is Culture an Underpinning or Undermining Factor in the Business Environment of the Transitional Countries?

Ružica Šimić Banović

Abstract The interplay of formal (laws, regulations) and informal institutions (culture, tradition, norms of behaviour) has showed to be initially underestimated in the recent economic, political, and social transformation of Central and Eastern European countries. This predominantly led to a uniform approach that undervalued intangible legacy and consequently could neither predict nor address the divergence of countries' development and evolution of their business systems.

Dominant national culture has been recognized as a very influential factor of the institutional change. Considering that favourable business environment is vital for economic progress, "institutional stickiness" of business-related laws and regulations and culture is thoroughly researched. It is further linked with overall quality of the business environment and level of economic development. This article suggests that favourable business environment is expected to be found in societies characterised by weak power distance, high individualism, low uncertainty avoidance and indulgence instead of restraint. Yet, opposite characteristics are found in numerous transition countries. The findings also suggest lesser likelihood of successful institutional import from Western to Eastern European societies.

1 Introduction

In Central and Eastern Europe, institutional design seems to be highly influenced by the complex legacy of their societies (Elster et al. 1998). It has now been widely accepted that "no size fits all" when implementing institutional reform (Murrell 1991; Roland 2004; Nye 2008; Kornai 2008; Rodrik 2009). Transition experience confirms several factors as essential for the institutional change: the existing belief

The initial research on the topic was conducted for the Doctoral Dissertation "Institutional Change in Transition Economies: Analysis of the Croatian Business Environment" defended at the Faculty of Economics, University of Ljubljana in December 2012. The extended version of this chapter was published as a Journal paper "Institutional Interaction in the Business Environment: Eastern European Versus Western European Countries"

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_2

system and its evolution (North 2005; Alston et al. 2010), trust (La Porta et al. 1997; Dixit 2004) and culture (Roland 2004; Guiso et al. 2006; Tabellini 2008; Skokic 2010; Arias 2011). In post-socialist societies, the prevailing culture is considered to be the main cause of increased transaction costs of institutional restructuring (Pejovich 2003a).

The discussion on the interaction between formal and informal institutions increasingly emphasises the importance of the harmony between formal and informal institutions in order to reach intended economic results (Greif 1994; Ensminger 1997; Williamson 2000; Teubner 2001; Nee 2003; Aligicia 2006; Easterly 2008; La Porta et al. 2008; North 2008; Nye 2008; Roland 2012). When new formal institutions fit well with existing informal institutions, it is most likely that their implementation will run smoothly and they will yield benefits resulting in improved economic performance. Along those lines, Institutional stickiness framework is developed aimed at explaining “the ability or inability of new institutional arrangements to take hold where they are transplanted” (Boettke et al. 2008, p. 332). That framework was further developed by quantifying both formal and informal institutions and acknowledging that informal institutions largely influence economic development (Williamson 2009). The findings confirmed the institutional stickiness paradigm emphasising that “the success of formal institutions depends on the ability to map onto informal rules” (Williamson 2009, p. 383) and at the same time implying that the most appropriate institutional mix is difficult to identify and transplant from one country to another (Williamson 2009). The framework in this research is based on the Institutional stickiness and it is focused on the business environment (Fig. 1).

Aims of this analysis can be summarised as follows. First, institutional stickiness in the business environment is tested in a comparative perspective: European transition[1] versus developed countries. Second, informal institutions’ role is explored seeking to answer if they are undermining or underpinning formal institutions, i.e. were the formal institutions well selected. Overall importance of the dimensions of culture for the business environment quality is investigated. Finally, “interaction thesis”, i.e. culture as key transaction costs in transition, is examined and quantified.

By examining and expanding several theoretical concepts, this chapter strives to contribute to “institutions matter (in transition, too)” stream, more precisely to “culture matters (a lot)” stream. While providing a quantitative contribution to Pejovich’s interaction thesis, the findings suggest lesser likelihood of successful institutional import from Western to Eastern European societies.

[1] Some authors have recently started using the term ‘post transition countries’ for the group of countries that started their post-socialist transformation at the end of 1980s/beginning of 1990s. Hereinafter ‘transition countries’ will be used for that group of countries. This choice of wording was additionally encouraged by the same term used by established scholars in numerous works, most recently in the volume “Economies in Transition: The Long-Run View” edited by Roland (2012).

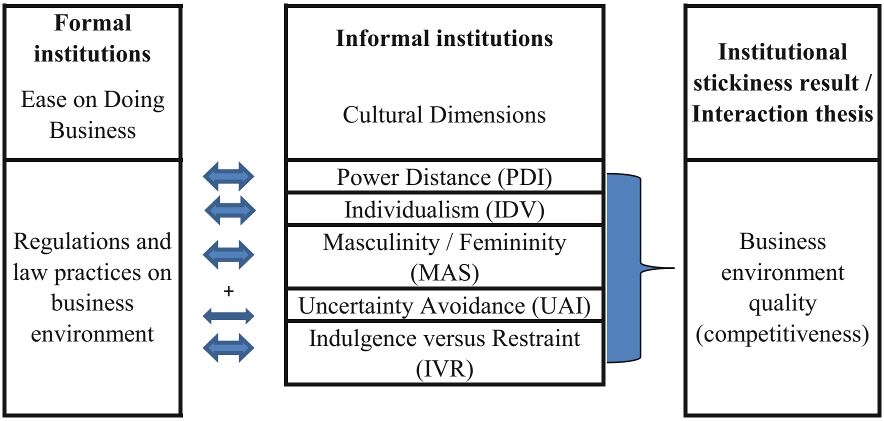

Fig. 1 Framework for analysis: institutional stickiness in the business environment

2 Culture: Key Concepts and Problems

The origins of the works using cultural explanations for economic outcomes can be traced all the way back to Adam Smith and John Stuart Mill (Guiso et al. 2006, p. 26) and a long time ago business community recognised cross-national cultural, religious and social differences and adapted accordingly (Jaklič and Zagoršek 2003, p. 2). Yet, only recently the influence of culture on economic development has been increasingly discussed among theoretical economists. In that regard it is defined as "customary beliefs and values that ethnic, religious and social groups transmit fairly unchanged from generation to generation" and by that definition it is focused on inherited, slow-moving components of culture and avoids possible causality issues (Guiso et al. 2006, pp. 23–25). Besides observing culture through cultural traditions inherited from ancestors, current social interactions are also considered as an influential factor (Tabellini 2008, 2010). It is now claimed that recently improved techniques and data enabled researchers to recognize and analyse differences in people's preferences and beliefs and link them with various aspects of cultural legacy. Consequently, this leads to an approach "introducing culturally-based explanations into economics that can be tested and may substantially enrich our understanding of economic phenomena" (Guiso et al. 2006, p. 23). There are already critiques pointing to the unnecessary ubiquity (King 2010) and controversy (Mueller 2010) of this issue. Nevertheless, same as "institutions matter" mantra has had a strong effect in the economic theory; "culture matters" seems to be the new research-provoking stream with high potential of significant findings. Those studies are dispersed in numerous directions and mostly include the insights from other social disciplines. This interdisciplinarity and multidisciplinarity can be vastly explained by other social scientists analysing the influence of cultural variables on economic performance throughout the decades by 1990s when economists, mostly the ones analysing institutions, started giving their contributions to the topic (Guiso et al. 2006). Lal (1999) emphasises the close linkages of institutions and culture while identifying both cosmological and material beliefs as determinants of economic performance. Gorodnichenko and Roland (2011a) confirm individualism versus collectivism as the only dimension of culture that matters for long-run growth. Thomas and Mueller (2000) analyse cultural influences on entrepreneurship development and consider culture both as an important contextual factor for the emergence of entrepreneurs and a key for entrepreneurship theory internationalisation. Arias (2011) perceives cultural features as the real obstacles to Latin American development, such as culture of keeping the status quo instead of culture of improvement that is connected with insufficient confidence and inclination to authoritarian leaders. Mueller (2010) notes that institutional approaches examining post-communist transformations have started including cultural dimensions because by doing so institutions gain legitimacy, authority and symbols of collective identity; this alteration in the approach was largely pushed by the differences in the development of those countries.

Under the provocative title "Understanding the Transaction Costs of Transition: It's the Culture, Stupid" Pejovich (2003a) claims that the interaction between the Western formal institutions and informal institutions in the former socialist states was a key reason for the unsatisfying results of the institutional restructuring. The rationale behind that argument is that the harmony between the formal and informal rules will reduce the transaction costs and hence enable some resources for the production of wealth. In the opposite situation when there is no harmony in the changes between formal and informal rules, the transaction costs will rise and that will diminish the creation of wealth in the society. Claiming that the process of CEE transition from socialism to capitalism is a cultural rather than technical issue (as already mentioned) and emphasising the role of the informal institutions, Pejovich (2003a, p. 10) named it interaction thesis:

> When changes in formal rules are in harmony with the prevailing informal rules, the incentives they create will tend to reduce transaction costs and free some resources for the production of wealth. When new formal rules conflict with the prevailing informal rules, the incentive they create will raise transaction costs and reduce the production of wealth in the community.

Roland (2004) confirms that argument explaining that any endeavours to impose Western fast-moving institutions like political ones that are appropriate for the Western culture in countries with a very different historical and cultural background will not result in same economic success. Roland (2004) distinguishes between fast moving and slow moving institutions whereby fast moving ones are political and legal institutions and slow moving institution is culture. As indicated by their name, slow moving institutions change a little at a time while fast moving institutions may change in a moment. Yet, slow moving institutions have to change all the time in order to create inconsistencies with fast moving institutions and catalyse changes (Roland 2004, p. 117). North (2008, p. 51) stresses that despite the fact that formal economic and political rules are created to improve exchange, democracy in the political arena should not be treated as equivalent to competitive markets in the economy and concludes that this "distinction is important with respect to the efficiency of property rights".

Culture is increasingly seen as "the missing link between distant history and current institutional performance" (Tabellini 2008, p. 909). By finding exogenous sources of cultural variations, Tabellini (2010) explores the differences among European regions within countries based on the linkages between historical institutions, culture and finally, economic development. The culture is considered to be influenced by ongoing social interactions and tradition inherited from the ancestors. The findings show that distant history is an important determinant of current economic performance both across countries and across regions within countries. This may imply the questionable primacy of formal institutions as economic development drivers since the regions investigated had same formal institutions for several centuries, but the influential traces of early political institutions are still identified and cannot be attributed only to institutional inertia. Moreover, two sets of cultural features seem to have a positive impact on economic development: social capital and confidence in the individual. Social capital includes trust and respect, whereas confidence encompasses control in one's life and obedience in a negative sense. These institutional features may influence economic development directly or through existing institutions. The latter influence is likely to be more efficient.

Pejovich (2003b) analyses the prevailing culture in a society that encompasses moral values, customs, beliefs and other norms of behaviour that connects the generations in a particular society. The prevailing culture is analysed because a culturally homogeneous community does not exist. Transition is considered equal with institutional restructuring and it is claimed that the interaction of formal and informal rules may be the key reason for the difference in performance in CEE. Following that statement, transition means the enforcement of formal rules, and "the results of transition depend on the interaction of new formal and prevailing informal rules. Of course, the rules do not interact. *Individuals do*." (Pejovich 2003, p. 8; the italics are by the author). Pejovich (2003a, b) emphasises the following issues: the main formal institutions of capitalism, the kind of culture that is in tune with capitalism rules, and consequently the differences between that culture and the informal institutions in the CEE. He considers the free market economy not only as an economic system, but as a way of life based on the culture of liberalism. Moreover, he stresses that in order for capitalism to work "a culture that encourages behaviour based on self-interest, self-responsibility and self-determination" is essential (Pejovich 2008, p. 43). On the opposite side, the common features of the culture in CEE are biased towards collectivism, egalitarianism, extended family and shared values. Consequently, the inherited culture in the CEE prefers equal results and social welfare programmes over individual results, risk taking and the freedom to choose. Transaction costs in the process of transition emerge from the collision between formal capitalist institutions and predominant culture in those countries. Furthermore, the intercultural differences produce various levels of transaction costs of transition. The size of the conflict of formal rules and culture increases the transaction costs of transition. The final results depend to a large extent on the ways leaders cope with factors affecting the transaction costs of transition (Pejovich 2003a, b). In North's (2008, p. 42) perspective on the role of informal institutions: "… strong religious beliefs or commitment to communism, for example, provide us with historical accounts of the sacrifices individuals have made for beliefs."

3 Mapping the Key Factors of the Framework: Introducing Evidence and Themes in Practice

Numerous authors agree with Estrin's (2002, p. 101) statement that "[i]mproved company performance must be at the heart of any successful transformation from a command to a market-oriented economy." In line with that, Berglof et al. (2012, p. 254) stress that "one way in which the state can enable markets to function properly is by creating a favourable business environment". Yet, it has been shown that the claim on the linear trajectory from socialist towards capitalist system was misleading (Murrell 1991; Neuber 1993; Roland 2000; King 2002; Zupanov 2002; Mueller 2010) and that (pure) import of formal institutions did not result in expected outcomes. Reflecting on institutional stickiness in the business environment of transitional versus developed societies may highlight some of the key issues of the deficits noticed (Fig. 1).

3.1 Informal Institutions: Culture

Culture with ts slow-changing nature is recognised as a very influential factor in institutional change (Roland 2004; North 2005, 2008; Guiso et al. 2006; Tabellini 2010; Aoki 2011; Jellema and Roland 2011). Cultural factors that determine the acceptance of the formal rules are extremely important for the success of reforms (Aligicia 2006). Further research showed that out of all dimensions of culture only individualism has a strong effect on long-run economic growth (Gorodnichenko and Roland 2010, 2011a). Historical evidence shows the likelihood of individualist societies to be more efficient than the collectivist ones, particularly when widening their economic activities outside their core group (Greif 1994). No other cultural variable based on Hofstede dimensions[2] shows robust effects on growth, and in the

[2] The researchers usually use four dimensions (IDV, PDI, MAS, UAI) that were initially created by Hofstede. In this research IVR is included as well. This is an additional dimension created by M. Minkov and included in Hofstede's main work. The sixth dimension (LTO) is not used because it still needs to be scientifically confirmed (Schachner, personal communication, 2012) and the data are in the fine tuning stage due to large (methodological and consequently numerical) differences.

same analysis only power distance dimension negatively influences some specifications (Gorodnichenko and Roland 2011a).

As for business environment, Whitley's (1997) business system approach shows markets, companies and economic outcomes to be socially constructed and embedded. Both economic structures and outcomes are strongly influenced by background and proximate social institutions and their interplay. Background (informal) institutions are mostly cultural ones which roots may date all the time back to pre-industrialisation period and related values are transferred through private communities and education system. Proximate (formal) institutions on the other hand are result of industrialisation and include political, financial and labour systems. Regarding transition countries, Pejovich (2003a) strongly argues that culture accounts for main transaction costs in the transformation from planned to market economy. He justifies it by his interaction thesis.

In order to measure informal institutions in her institutional stickiness model, Williamson (2009) relied on culture variable and used the World Values Survey data. This research will use Hofstede's (et al. 2010, also published as Hofstede 2012) data.

3.2 Formal Institutions: Business Regulations and Law Practices

The importance of a legal setting is a widely recognised factor for the execution of economic activities (La Porta et al. 1998, 2008; Djankov et al. 2006; Aldashev 2009; Dixit 2009). More business-friendly can also be qualified as less burdensome (Djankov et al. 2006). Because of the business environment focus, WB Doing Business data will be used as a measure of the formal institutions in this research. It will be correlated with every single cultural dimension (Table 1).

The overall score named Ease of Doing Business is used because it captures the main regulatory milestones of doing business: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency (Doing Business 2012). These indicators are not separately analysed nor ranked in correlation with informal institutions due to two reasons: first, it would not correspond to the overall scope of the analysis and second, the notion that "…setting up 'horseraces' between institutions is

Table 1 Business environment: institutional matrix

Informal institutions: cultural dimension X	Formal institutions: ease of doing business regulations and law practices	
	Less business-friendly	More business-friendly
High score	Group of countries	Group of countries
Low score	Group of countries	Group of countries

potentially misleading because these institutional variables may be correlated" (Jellema and Roland 2011, p. 109). The components that could be at the first glance considered as missing in the framework will be used as control variables: GDP growth and GDP per capita PPP.

Data sources for all analysed countries (EU countries, Serbia and Russian Federation) are listed here:

- Formal institutions: IFC/WB Doing Business Reports 2006–2011—rankings
- Informal institutions: Hofstede's Cultural Dimensions (data for 2010, valid for last three decades at least, based on initial and verified by replicated studies)—scores
- Result of the institutional stickiness in the business environment: WEF Global Competitiveness Reports 2006–2011 (World Economic Forum 2005, 2006, 2007, 2008, 2010, 2011)
- Control variables: GDP growth and GDP per capita PPP—IMF World Economic Outlook 2012

4 Empirical Analysis: Doing Business and Cultural Dimensions—More Evidence, Themes in Practice and Outcomes

For the Doing Business degree rankings the min-max data normalization is executed for the years 2006–2011, i.e., Doing Business Reports from 2007 to 2012. In order to group the countries according to their overall Doing Business features, hierarchical clustering was the next step and the Ward method was used. Dendrogram shows that the optimal number of clusters is two. First cluster covers 15 countries being more business friendly (from Austria to UK in the Table 2), whereas the second cluster consists of 13 countries (from Bulgaria to Spain in the Table 2) being less business friendly. Difference between two clusters obtained was tested with ANOVA. It was clearly shown that they differ significantly, $F\ (1, 26) = 43.978$, $p < .001$ (Appendix).

In the Table 2, transition countries are put in bold. It is evident at the first glance that they prevail in the cluster 2 consisting of less business friendly countries. Further research is expected to show the dominant features of informal institutions that might be associated with (missing) business friendliness in both transition and non-transition countries. Same as with easiness of doing business level, hierarchical clustering was used in order to group countries according to five cultural dimensions. The relation of Doing Business degree and every single cultural dimension was then further investigated.

Table 2 Countries according to business friendliness level

	Cluster 1 (more business friendly)	Cluster 2 (less business friendly)
Ward method	Austria Belgium Denmark Estonia Finland France Germany Ireland **Latvia** **Lithuania** Netherlands Portugal **Slovak Republic** Sweden United Kingdom	**Bulgaria** **Croatia** **Czech Republic** Greece **Hungary** Italy Luxembourg **Poland** **Romania** **Russian Federation** **Serbia** **Slovenia** Spain
Doing business normalization—mean	88.57	60.60

4.1 Power Distance and Doing Business

Power distance as a cultural dimension is explained as "the extent to which the less powerful members of institutions [family, school, community] and organizations [work places] within a country expect and accept that power is distributed unequally" (Hofstede et al. 2010, p. 61). Through that dimensions, the relations of leaders and subordinates are primarily explored. Bosses in countries with high PDI are usually characterised by autocratic or paternalistic behaviour and they emotionally manage employees that are either dependent or counter dependent on them. Centralisation is desired and there exists a significant number of supervisory personnel. Managers are focused on formal rules and on their bosses. Superiors are most likely to enjoy privileges and status symbols that are considered to be normal. On the contrary, countries with low PDI may be portrayed by consultative style of leadership and decision-making that enables the subordinates to freely express their opinions, even if it is fully opposed to their manager's. Decentralisation is desired and a large number of supervisory personnel is not needed. Managers rely on themselves and their subordinates and subordinates expect continuous and pragmatic interaction. Privileges and status symbols are most commonly disapproved (Hofstede et al. 2010, Chap. 3).

The afore-described relations in the workplace are likely to be seen as the reflection of the power relations in society in general. When observing those relations in a wider context, it becomes evident that people in the countries with small power distance tend to minimise inequalities and expect the interdependence of less and more powerful people. Therefore, following groups are usually treated as equals: parents and older family members versus children, teachers versus students, patients versus doctors, etc. Hence, two-way communication and proactivity are strongly encouraged. On the opposite, people in countries with large power distance are most likely to expect inequalities and do not question hierarchy, they feel comfortable with it instead. The desired values of expectedly inferior groups are obedience, respect and passivity to a large extent, i.e., the behaviour of the followers towards the gurus. Moreover, in large power distance countries people use only few sources of information and are convinced that the ones they are used to provide them with reliable information. They are unlikely to discuss politics and disagreements on it usually lead to violence. One party usually dominates in the political system. Alternatively, there are strong left and right wings (Hofstede et al. 2010, Chap. 3).

Group centroids enable grouping the countries according to both business friendliness and power distance in the society (Fig. 2). It is useful seeing not only the exact countries being part of a certain group, but also the distances from other groups and countries according to given variables. Previous clustering data showed the dominance of transition countries in high PDI cluster (Appendix). Figure 2 pinpoints Russia, Central and South East European countries scoring the highest among transition countries while Baltic countries tend to be closer to most of the Western European low PDI countries. This finding as one of the crucial ingredients of informal institutions may also contribute to their affiliation with liberal market economies as seen in varieties of capitalism approach (Feldmann 2006). Neverthe-less, most of post-socialist countries still seem to be highly influenced by the legacy

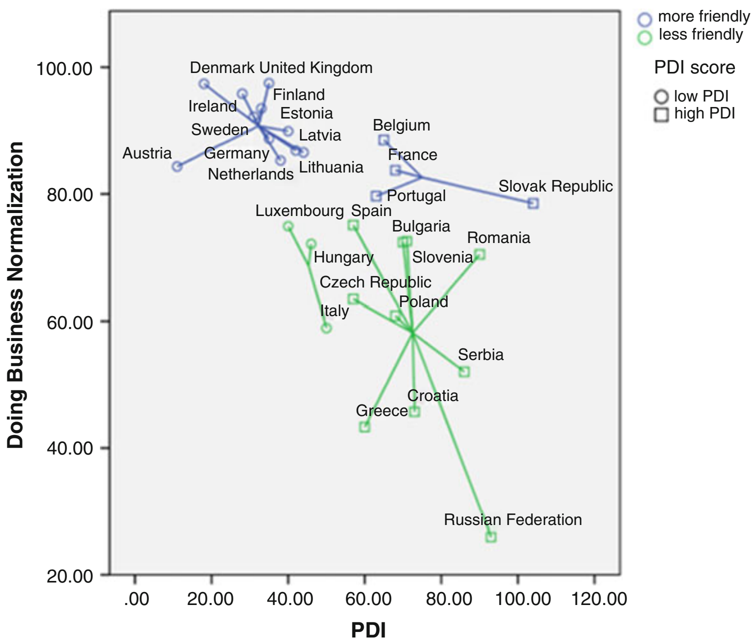

Fig. 2 Power distance and business friendliness

of rather distant relations of leaders versus subordinates despite previously (nominally) existing egalitarianism. The strong traces of nomenclature system still appear to exist in most of the transition countries, with Russia being the "over-achiever" in keeping that inheritance. It is therefore plausible to consider this finding as being in tune with its affiliation to a patrimonial capitalism type of a country (King 2002). The values underlying large power distance in a society appear to underpin clientelistic relations and parasitic behaviour both of elites and to a smaller extent their close subordinates. The contemporary position of the subordinates might be seen as an extension of a past role of the state as a "nanny" of the employees (Zupanov 2002) who are actually willing to trade their rights and opportunities to express their opinion for a lifelong job protection. On the other side, the background of numerous members of the political and economic elites is questionable in many aspects. Still, they use and increase their privileges and status-symbols, and also behave in symbolically powerful manner. Paradoxically, the non-elites usually consider all those signs of power to be normal. Latin proverb *Quod licet Iovi, non licet bovi* seems to be fully misunderstood in transition societies. Furthermore, voters tend to choose same parties over years and at the same time passively accept the businesspeople obviously connected with them. A reflection of a large power distance in a society may be found in some aspects of the rise of nationalism at the beginning of transition. At that time, it was deemed as an act against the country to question obvious corrupt behaviour with the nationalism veil, particularly when concerning the most powerful society members. Those circumstances enabled fraud during privatisation, unskilled people to obtain and keep top positions, and numerous smaller gains for the ordinary people who, under the protection of the most powerful ones, strongly emphasised their love for the country and their victims in that regard.

4.1.1 Power Distance, Legal Setting and Competitiveness

In the next step, these groups of countries (low/high PDI and more/less business friendly) are further associated with their competitiveness scores. As seen (Appendix), the group averages of competitiveness scores are in tune with previous "rankings" of the groups according to business friendliness, i.e., the most competitive countries have low PDI and more business friendly laws and regulations and a group of the least competitive countries is the one with high PDI and low business friendliness. Correlations Doing Business—PDI prove a negative correlation of business friendliness and power distance in a society at a high statistical significance, $r = -0.641$, $p < .001$, i.e., more business friendliness is associated with lower power distance.

Previously presented and elaborated linkages of power distance and doing business with competitiveness, combined with doing business and power distance correlations have at least two implications. One is that formal institutions imported from the Western countries (found mostly in the first quadrant[3] of the Fig. 2) are unlikely to be efficient in the transition countries (found mostly in the fourth quadrant of the Fig. 2 showing completely the opposite values from the first quadrant). Second, it can also be expected that underlying informal institutions are unlikely to support even the “home-grown” formal ones being intrinsically business-oriented. When trying to predict the future linkages between power distance and success of business environment reforms, it is interesting to note Hofstede et al.’s (2010, pp. 86–88) assessment on the persistence of power distance relations over centuries despite the expected convergence due to globalisation. Nevertheless, due to their partial interconnectedness, it is valuable to test those implications on other cultural dimensions.

4.2 Individualism and Doing Business

Individualist societies are primarily characterised by loose ties between people, i.e., “everyone is expected to look after him- or herself or her immediate family” (Hofstede et al. 2010, p. 92). On the contrary, in collectivist societies “people from birth onward are integrated into strong, cohesive in-groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty” (Hofstede et al. 2010, p. 92). It is valuable to note that, with rare exceptions, large power distance societies are usually collectivist whereas small power distance societies are overwhelmingly individualist (Hofstede et al. 2010, pp. 102–105). Most of the countries in the world are collectivist, and wealthy countries are predominantly individualist (Hofstede et al. 2010, pp. 91–97). In the individualist societies the interest of an individual prevails over the interest of the group and it is expected that all the members of the group have their own opinions. In collectivist societies instead, the opinion of an individual needs to be in line with group opinion and it is a consequence of the way people are raised in the extended family since an early age. Individualist societies emphasise independence, self-supporting lifestyles and mostly extravert values. Those values are expectedly found in the working environment as well. In collectivist societies future employees are preferred if being related to a specific in-group and family-like link is being built with the employer, while in individualist societies it is a contract in the labour market that is in line with employer’s goals.

Professional mobility, self-actualisation and individual freedom are much higher in individualist societies. The role of the state in economy is limited. On the other hand, in collectivist societies state’s influence in the economy is crucial, patriotism

[3] The lines of the quadrants are not drawn in the graph. Hereinafter the positions of the quadrants are considered according to the common practice and following wording is used: first quadrant—upper left, second quadrant—upper right, third quadrant—lower left, fourth quadrant—lower right.

is an ideal, and harmony and consensus in society are highly desired (Hofstede et al. 2010, Chap. 4). The low IDV cluster consists of Southeast European transition countries, Russia, and two Mediterranean countries. However, six out of eight are transition countries. The high IDV cluster consists of Western European countries and Central European and Baltic transition countries. Despite small difference in absolute numbers, the relative numbers show dominance of transition countries in the low IDV cluster (Appendix).

When exploring the relation of Doing Business and individualism versus collectivism, the results in the 2×2 table suggest that countries with dominant individualist culture are usually more business friendly than the countries with prevailing collectivist culture (Appendix). These results are further verified by both Chi-Square and Fisher's tests (Appendix). Furthermore, groups' average scores also show that the most competitive countries have the most business friendly regulations and prevailing individualism, while the least competitive ones are collectivist and have least friendly legal setting for doing business (Appendix).

4.2.1 Individualism, Legal Setting and Competitiveness

Individualism and Doing Business show a positive correlation at a high statistical significance, $r = .587$, $p = .001$. This result, same as the linkages with competitiveness, was quite expected when taking into account Hofstede et al.'s (2010) correlation on wealth of the countries and individualism and Gorodnichenko and Roland's (2010, 2011a) finding on IDV dimension being the only one with strong effect on economic growth. For further analysis it is important to consider (again) that "[i]mported economic theories are unable to deal with collective and particularist societies" (Hofstede et al. 2010, p. 130).

As seen from Fig. 3, Croatia, Serbia, Greece, and Russian Federation are the farthest from the individualistic societies with the most favourable regulatory business environment. Those countries joined by Slovenia, Romania, and Bulgaria are also affiliated with high PDI cluster. That makes their collectivism more stable and long lasting, hence less likely to move towards individualist values that appear to be a prerequisite for long-run economic growth and wealth. It is also worth considering as a missing link or key informal institution of South European/ Mediterranean model of capitalism (as portrayed by Amable 2009, and Cvijanovic and Redzepagic 2011), particularly when applied to transition countries in that region. The combination of high PDI and low IDV also explains the movements on a political scene; high PDI mostly implies the dominance of one party, and in the initial transition years this was a very nationalist one, and low IDV puts a patriotism stamp on it. Due to national consensus building, at least the nominal one, it is expected that this is everybody's choice and unanimous opinion. Further legacy-relevant features of low IDV are practically inseparable connection of individuals with the group, avoidance of disagreements with a majority and a vast influence of the state on the economy. Those factors reinforce egalitarianism and enable superiority of politics over numerous spheres of economic and social life. Strong

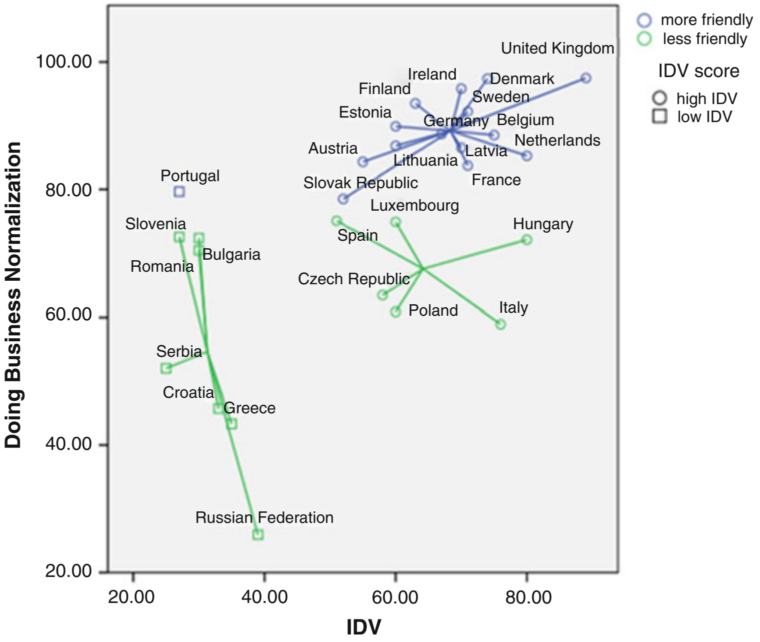

Fig. 3 Individualism and business friendliness

presence and persistence of these informal factors were most likely to underpin the transformation of post-socialist countries towards political capitalism instead of entrepreneurial capitalism (as defined by Zupanov 2002). Those underlying factors help in keeping that model as *a status quo* that by now has shown series of downsides, yet wealthy elites and mostly poor, but inert ordinary people do not show enough or any initiative to change it. Furthermore, these two poles in South-eastern Europe: rich, powerful elites massively using clientelistic relations on one side and majority of citizens living in modest conditions, but with lifelong expectation of job and social protection by the state, on the other, are likely to converge towards patrimonial capitalism in Russia (as pictured by King 2002, 2007). Both cultural dimensions and economic and political movements in those societies appear to indicate that inclination. Bearing in mind Hofstede et al.'s (2010, pp. 134–135) point on resistance of collectivism, especially when combined with large power distance, and its relation with economic wealth, it is highly probable that in Southeast European (SEE) countries fast changes resulting in entrepreneurial capitalism or some other capitalist form based and developed on individualist values are not feasible. In retrospective, this combination of informal institutions being fully opposite to the Western set of IDV and PDI values also explains the impossibility of import of Western formal institutions and the switch from relation-based to rule-based governance. Furthermore, it can easily be argued that non-responsiveness and lacking accountability of governments in transition countries is supported by high power distance and collectivist values of population, i.e., citizens easily accept that kind of government behaviour, they rarely react to it or question the execution of pre-election promises.

4.3 Masculine Versus Feminine Values and Doing Business

Selected countries were clustered into the groups with higher and lower MAS scores. This process lead to a group of 12 countries possessing high MAS score and a group of 16 countries with low MAS score (Appendix). A one-way ANOVA was used to test for a difference between two clusters. There is a significant statistical difference, $F\ (1, 26) = 52.032$, $p < .001$ (Appendix). Clusters show prevalence of transition countries in low MAS cluster with only Czech Republic, Hungary, Poland and Slovak Republic being part of high MAS cluster.

While noting the increasing change in gender roles around the world, Hofstede et al. (2010, pp. 136–139) stresses that in his initial survey masculinity versus femininity was the only dimension in which women and men consistently gave different answers. In short, regarding work men are focused on high earnings, recognition, advancement to higher-level jobs, and challenge as an essential part of the job. On the contrary, women's priorities are good relationships at work, job security, and living area that suits their family needs. Consequently, societies are considered to be masculine "when emotional gender roles are clearly distinct: men are supposed to be assertive, tough and focused on material success, whereas women are supposed to be more modest, tender, and concerned with the quality of life" (Hofstede et al. 2010, p. 140). On the other side, in feminine societies emotional gender roles overlap, hence "both men and women are supposed to be modest, tender, and concerned with the quality of life" (Hofstede et al. 2010, p. 140). Even though it might seem that individualism versus collectivism is to a great extent connected with masculinity versus femininity, it is not the case. The former reflects the positioning of an individual not concerning his group ties versus the positioning of an individual based on in-group connections and interactions. The latter emphasises ego compared to relations with others, regardless of their group affiliations. Nevertheless, the relation was found between high IDV and low MAS, like the case of Denmark, and it is linked with an emphasis on well-being. On the other side, societies being preoccupied with survival are usually collectivist and masculine societies (Hofstede et al. 2010, p. 146).

4.3.1 Masculine Versus Feminine Values, Legal Setting and Competitiveness

The 2×2 table shows equal distribution of high MAS countries into more and less business friendly, whereas nine low MAS countries are more business friendly and seven are less business friendly (Appendix). That table linked with competitiveness averages appears to straightforwardly indicate only that the least competitive countries are less business friendly and have low MAS score (Appendix). The initial impression that the most competitive countries are more business friendly and score high on masculinity is eliminated when considering a tiny score difference between more business friendly countries with low MAS score. Finally, there is no statistically significant correlation between masculinity and doing business (Appendix).

Due to the non-existing correlation between doing business and MAS dimension, the dimension itself will not be further elaborated. It only remains to draw a parallel between its key values (Hofstede et al. 2010, Chap. 5) and the proclaimed values of the socialist system. The overlaps of feminine values and values from the previous system primarily include emphasis on relationships and quality of life rather than career goals, equality based instead of equity based rewards, preference of leisure time over money, working in order to live and not vice versa. Furthermore, listed characteristics contribute in portraying the most common post-socialist type of business environment.

4.4 Uncertainty Avoidance and Doing Business

Uncertainty avoidance is "the extent to which the members of a culture feel threatened by ambiguous or unknown situations" (Hofstede et al. 2010, p. 191). People in countries with low uncertainty avoidance consider uncertainty to be a normal part of everyday life, feel comfortable with unfamiliar situations and new products and technologies, have flexible rules in their private sphere, and are curious about different things and situations. On the opposite, people in countries with high uncertainty avoidance perceive uncertainty as a threat, are able to accept only the known risks, products and technologies, have strict private rules and consider unknown phenomena to be dangerous. In their professional life, people in low UAI countries more often change their jobs than in high UAI countries and are inclined towards the necessary rules only rather than having numerous nominal rules like in high UAI countries. Low UAI countries produce more innovations, while high UAI countries are better at implementation. Employees in low UAI countries are most likely to be motivated by achievement and esteem whereas in high UAI countries they will be motivated by security and esteem. In a wider social context, it is valuable to note that high UAI countries show to be more fertile environment for extreme political parties, homophobic and xenophobic movements. Moreover, countries with strong uncertainty avoidance and strong collectivism, i.e., non accepting differences and primarily identifying with in-groups, usually deny or tend to eliminate ethnic, linguistic, or religious minorities (Hofstede et al. 2010, Chap. 3).

4.4.1 Uncertainty Avoidance, Legal Setting and Competitiveness

The outcome of linking the clusters of less/more business friendly and low/high uncertainty avoidance countries into 2×2 table suggests that more business friendly countries are the ones with lower levels of uncertainty avoidance (Appendix). Same finding is verified when linking those clustered data with average competitiveness scores, yet with somewhat smaller difference compared to high UAI/more business friendly countries (Appendix). Still, that statement is further confirmed by Chi-Square tests (Appendix). Doing Business and UAI show quite strong negative correlation at a high statistical significance, $r = -0.679$, $p < .001$.

All the data linking uncertainty avoidance with doing business and further associating it with competitiveness indicate that lower uncertainty avoidance is connected with more business friendliness. Those findings suggest that most of the transition countries, have informal institutions that are not supportive to business environment development. Furthermore, it shows that institutional stickiness of the formal institutions imported from the Western low UAI countries is unlikely to emerge. In addition to that, it does not seem surprising that former Yugoslav countries are to be found in high UAI cluster characterised by low tolerance for ethnic and religious minorities and consequently fertile ground for the continuous conflict. It is outside the scope of this work to analyse 1990s war and previous consideration should be taken in a wider time context. In that regard it is also interesting to note that high UAI countries were mostly hostile to foreign investors and preferred domestic ownership even when non-respectable businesspeople were taken into account. High UAI combined with high PDI is also reflected in quasi existing civil society that is unlikely to have a qualitative leap in its development as long as such strict and conservative notion of right and wrong is desirable tending to keep the existing state of affairs. This whole picture could also be explained as "the devil one knows" phenomenon complementary with "what is different is dangerous" as a key feature of strong uncertainty avoidance. In this context it is valuable to observe the case of Slovenia as the economically most advanced among former Yugoslav republics and at the same time at the top among new EU member states. Still, its collectivism, somewhat high power distance and strong uncertainty avoidance seem to influence its development and probably keep it at slower pace than it would be if having those cultural dimensions inclined towards Western values. This finding is confirmed by Jaklič and Zagoršek's (2002, 2003) analysis portraying background social institutions of Slovenian business system that have been developing since nineteenth century and are still to be found in (post)transition Slovenia. They assert several key characteristics as contextual factors: strong affiliation with local community, persistence and distinctiveness of informal networks and grey economy, unquestionable autonomy of managers with insufficient reference to owners' interests, and underdeveloped collaboration between companies from different communities and areas. Listed factors are fully in line with previously identified cultural dimensions' scores.

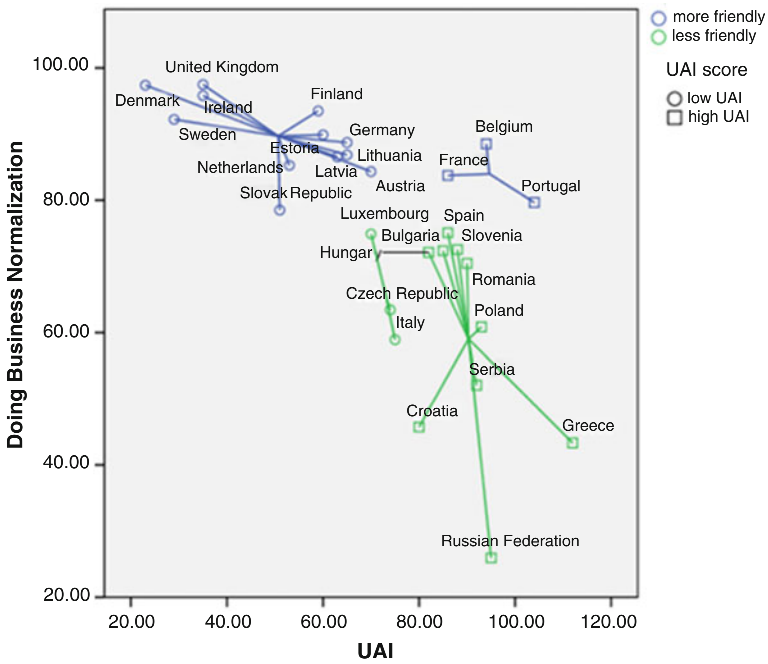

Fig. 4 Uncertainty avoidance and business friendliness

It is interesting to note that strong uncertainty avoidance is predominantly spread among SEE and Mediterranean countries (Fig. 4) that according to Amable (2009) show very similar type of capitalism. In that capitalism type, uncertainty avoidance as a building block of national mindsets may explain the inclination towards high job protection despite fall in productivity and strong involvement of the state regarding social protection. Both afore mentioned characteristics, job market restrictions in particular, put employers in an unfavourable position.

4.5 Indulgence Versus Restraint and Doing Business

This cultural dimension is characterised by two poles: indulgence is defined as "a tendency to allow relatively free gratification of basic and natural human desires related to enjoying life and having fun" whereas restraint stands for "a conviction that such gratification needs to be curbed and regulated by strict moral norms" (Hofstede et al. 2010, p. 281). Indulgent societies have bigger ratio of citizens feeling happy and healthy than restrained societies. People in indulgent societies mainly have positive attitude, put leisure, friends and freedom of speech among their priorities. On the opposite, people in restrained societies perceive themselves as helpless and not being able to manage their lives, they are also more pessimistic and cynical and overwhelmingly do not consider themselves healthy. Keeping order in a society is considered highly important in restrained nations. Despite the impression that economic development should influence those perceptions, it is valuable to note that citizens of former Soviet Union, same as Bulgaria and Romania, experienced significant growth rates in their transition period but did not change their attitudes (associated with IVR) yet (Hofstede et al. 2010, Chap. 8). In line with that, it is remarkable that all the transition countries except Slovenia fall into low IVR cluster, i.e., are considered to be restrained societies (Appendix).

4.5.1 Indulgence Versus Restraint, Legal Setting and Competitiveness

Both count of countries connecting doing business and IVR and connections of those clusters with competitiveness scores (Appendix) suggest that more indulgent societies are more business friendly. That finding is further confirmed by Chi-Square tests (Appendix). Doing business and IVR show statistically significant, moderate positive correlation, $r = .460$, $p < .01$. Following findings on previous cultural dimensions, the results of IVR linkages with doing business and competitiveness are expected. It becomes apparent that values underpinning loose societies contribute to better business environment. In case of IVR, these include freedom, open-mindedness and assertiveness.

In the Fig. 5 showing group centroids according to IVR scores and business friendliness it is evident that among low IVR countries Croatia is the one with the highest IVR score. Croatian and Slovenian highest scores among transition countries may be explained by their development level as Yugoslav republics, relative openness at that time and therewith connected sooner adoption of Western values. Despite being relatively closer to Western countries according to some other cultural dimensions, former Soviet republics, Romania and Bulgaria score the lowest on IVR dimension. This can most probably be attributed to the reflection of the closeness in the socialist era. That closeness was reassured by the order and discipline in a society that, despite substantial reason absent, is still considered highly important in low IVR countries.

When applying institutional stickiness perspective, it is highly unlikely to expect that formal institutions from high IVR countries will work in low IVR countries having fully opposite informal institutions. In case of this cultural dimension, transition countries are almost fully distinguished from Western European countries.

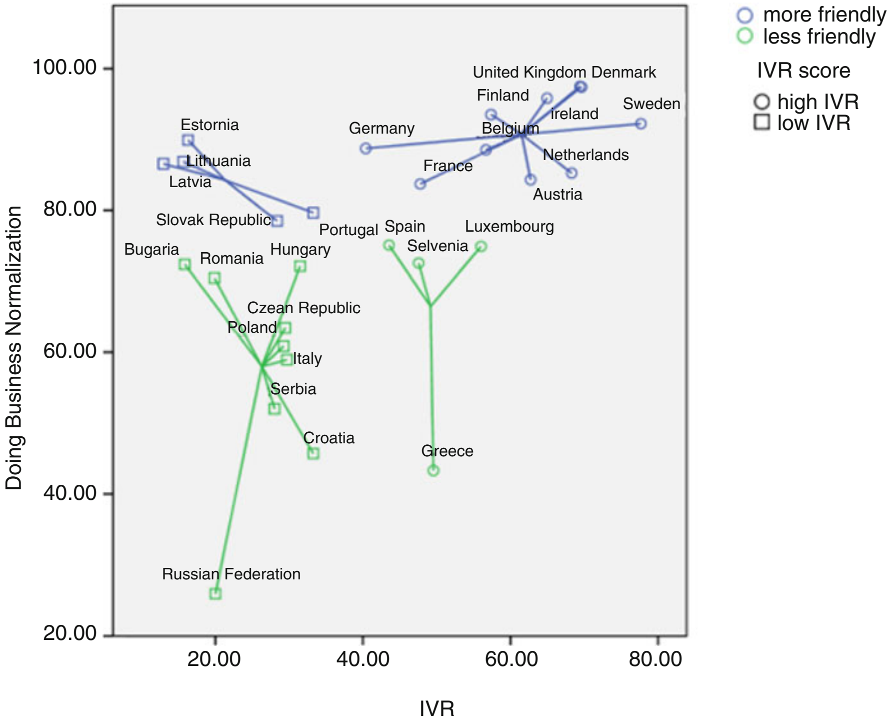

Fig. 5 Indulgence versus restraint and business friendliness

4.6 Clustering According to All Cultural Dimensions: Trying to Create a Cultural "Ideal Type" for Doing Business?

The result of capturing all the cultural dimensions simultaneously was the clustering of countries into two groups (Table 3). First cluster is characterised by low PDI, high IDV, low MAS, low UAI, and high IVR, and consists of eight countries (Austria, Denmark, Finland, Ireland, Luxembourg, Netherlands, Sweden and United Kingdom). The second one can be described by opposite characteristics and consists of remaining 20 countries. ANOVA was used to test for difference between the groups according to cultural dimensions. It showed a statistically significant difference among two clusters according to all dimensions except for MAS (Appendix). This dimension was already indicated as the only one that does not correlate with doing business.

As indicated by previous analysis according to every single cultural dimension, favourable business environment is expected to be found in societies characterised by weak power distance, high individualism, low uncertainty avoidance and indulgence instead of restraint. It is valuable to note that all the transition countries are in the second cluster owing non-business friendly society characteristics. That finding reconfirms unlikeliness of institutional stickiness that used to be denied by the

Table 3 Countries according to all cultural dimensions

	Cluster 1: low PDI, high IDV, low MAS, low UAI, high IVR	Cluster 2: high PDI, low IDV, high MAS, high UAI, low IVR	
Joint	Austria Denmark Finland Ireland Luxembourg Netherlands Sweden United Kingdom	Belgium **Bulgaria** **Croatia** **Czech** **Republic** **Estonia** France Germany Greece **Hungary** Italy	**Latvia** **Lithuania** Poland Portugal **Romania** **Russian** **Fed.** **Serbia** **Slovak** **Rep.** **Slovenia** Spain
PDI mean	29.25	64.10	
IDV mean	70.25	51.30	
MAS mean	40.50	48.00	
UAI mean	46.75	82.00	
IVR mean	65.76	31.44	

proponents of shock therapy approach. From the other point of view, it is highly probable that informal institutions in transition societies undermine the development of favourable business environment.

Additionally, the average normalised doing business and competitiveness rankings are calculated for both clusters covering all the cultural dimensions. It shows that cluster one is both more business friendly in terms of laws and regulations in those countries and more competitive which indicates the overall quality of business environment. ANOVA confirms that there is a statistically significant difference in the clusters formed that way, both regarding doing business, $F\ (1, 26) = 9.764$, $p = .004$, and competitiveness, $F\ (1, 26) = 20.880$, $p < .001$ (Appendix).

4.6.1 Doing Business and Competitiveness

In order to test the relation between doing business and competitiveness, the existing more and less business friendly clusters were associated with their competitiveness results. The results show that countries with more business friendly legal setting score in average higher on competitiveness than countries with business disabling legal environment. ANOVA confirms a statistically significant difference between these two groups, $F\ (1, 26) = 21.428$, $p < .001$ (Appendix).

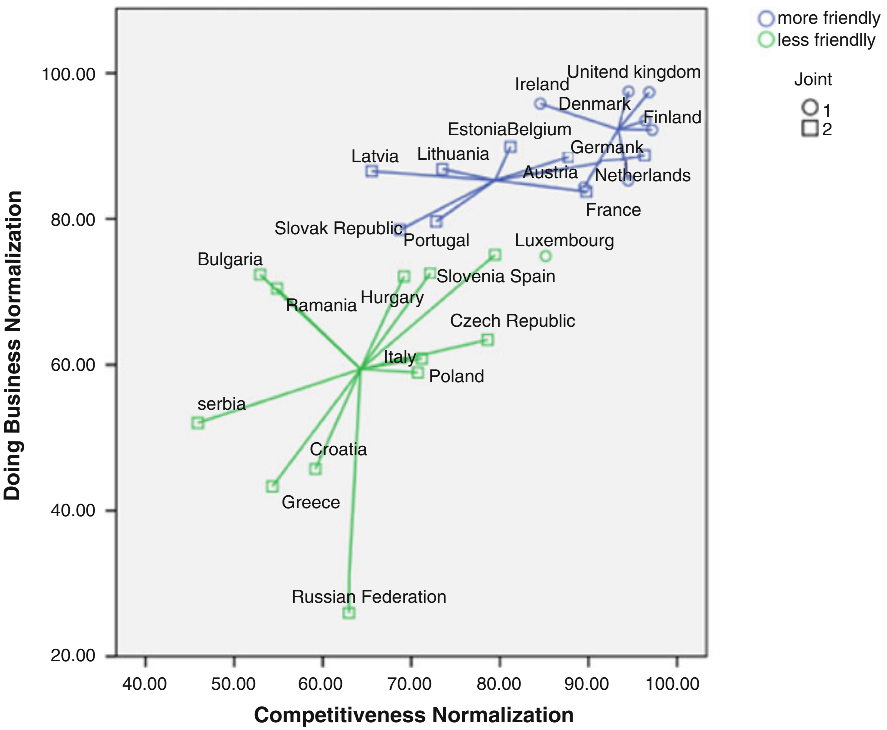

Fig. 6 Doing business and competitiveness

As assumed, doing business and competitiveness are positively correlated. The results indicate a strong correlation at a high statistical significance, $r = .734$, $p < .001$. Yet, when cultural dimensions are introduced as control variable, a statistically significant correlation still exists, but it becomes rather moderate, $r = .431$, $p = .02$. Therefore, it indicates that a part of variance is explained by cultural dimensions. When linking this finding with analysis on every single cultural dimension, it appears to be a quantitative contribution to Pejovich's (2008) interaction thesis.

Figure 6 shows exact normalized rankings of the countries according to doing business and competitiveness and their division into groups based on more/less business friendliness and affiliation to previously defined clusters covering all cultural dimensions simultaneously. Besides Luxembourg, all other countries from cluster 1 overlap with more business friendly cluster. Expectedly, those countries being affiliated with cluster 1 and more business friendly cluster are best positioned according to both indicators given. Based on this and previous clustering covering each cultural dimension separately, it is plausible to consider Luxembourg an outlier in less business friendly cluster.[4] This can be additionally confirmed by its economic development data. Same as in several previous benchmarks, Russia, Croatia, Greece and Serbia show the most unfavourable results.

5 Chapter Summary

The interplay of formal (laws, regulations) and informal institutions (culture, tradition, norms of behaviour) has showed to be initially underestimated in the recent economic, political, and social transformation of Central and Eastern European countries. This predominantly led to a uniform approach that undervalued intangible legacy and consequently could neither predict nor address the divergence of countries' development and evolution of their business systems.

Dominant national culture has been recognized as a very influential factor of the institutional change. Considering that favourable business environment is vital for economic progress, "institutional stickiness" of business-related laws and regulations and culture is thoroughly researched. It is further linked with overall quality of the business environment and level of economic development. Analysis of interplay between cultural dimensions (informal institutions) and doing business regulations (formal institutions) in EU countries, Serbia and Russian Federation proved that favourable business environment is expected to be found in societies characterised by weak power distance, high individualism, low uncertainty avoidance and indulgence instead of restraint. Yet, opposite characteristics are found in numerous transition countries. This implies the unlikelihood of institutional stickiness (as defined by Boettke et al. 2008), i.e., the impossibility of Western formal institutions to be successfully implemented in the Eastern transitional societies. Moreover, some of the combinations of cultural dimensions like low individualism and high power distance show to be extremely resistant so that no short- or medium-term change can be expected. And long run change in this case is defined by centuries rather than decades. Besides unlikeliness of institutional import, success of "home-grown" reforms is questionable due to recognised passivity and missing openness for changes in most of the transitional societies.

Ease of doing business and competitiveness show strong positive correlation, yet part of their relation is explained by cultural dimensions. When linking this finding with analysis on every single cultural dimension, it appears to be a quantitative contribution to Pejovich's (2008) interaction thesis pinpointing culture as major, yet often denied and misunderstood, transaction costs in transition societies. Moreover, the level of economic development partly explains the connection between business friendliness and cultural dimensions. That statement is in line with Rodrik's (2009) point on high quality institutions being possibly explained as both the cause and the

[4] In C. Williamson's (2009, p. 377) work Singapore as an obvious outlier was a very similar case.

result of economic prosperity. Overall, those findings also contribute to the account on (path-dependent) deep roots of economic development of both transitional and developed countries.

Appendix

The extended version of this paper including Appendix (covering research data analysis) is published as a Journal article: Šimić Banović, R. (2015). Institutional Interaction in the Business Environment: Eastern European Versus Western European Countries. *Zbornik Pravnog fakulteta u Zagrebu*. 65(3–4).

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Restrictive External Factors and Their Influence to the Business Environment in the Republic of Srpska

Zoran Lukić, Predrag Đurić, and Boris Novarlić

Abstract The greatest problem today, in the period of crisis and insecure times for new investments, is the insecurity of those who want to gain profit and regain invested properties in a short period of time. The period from 2008 until today is characterized by fallen production, unemployment, but also by the lack of foreign investments. It is also important to mention the high public debt of Bosnia and Herzegovina (B&H), and the Republic of Srpska (RS) as her constitutional part, combined with a low rate of economy growth, insufficient competitiveness, political inconsistency at the state level, which all results in an insecure business environment.

So, the macroeconomic environment represents an essential base for development and empowerment of national competence. However, if there is a negative trend characterized by an insecure business environment, it could endanger the economic stability of a certain country.

According to Morisset and Lumenga (Administrative barriers to foreign investment in developing countries. The World Bank Group, 2002), the main challenges that companies in the RS are confronting in terms of globalisation, lie in the bureaucratic structures such as the inconsistency and slow implementing of legal acts and the anticipated procedures. The latest international experience has showed that excessively complex administrative procedures discourages foreign investment, which leads to decreased national economic competence [Walkenhorst and Yasui (Quantitative assessment of the benefits of trade facilitation, overcoming border bottlenecks-the costs and benefits of trade facilitation. OECD, 2009,

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_3

pp. 19–49)]. Furthermore, it can be noted that there are no sufficiently constructed and trained institutions for business sector support in the RS [Petković and Novarlić (Acta Economica 10(17):53–82, 2012)]. The above-mentioned obstacles influence the level of activity in companies, and thus aggravate business and increase business risk.

The complex empirical research displayed in this chapter aims to point at key external elements, which could promote a stronger-business environment in RS. The research was conducted in the form of a structured questionnaire at a random sample of 150 companies in RS (for more detail read the research results).

The main problem of this research can be presented in the form of the following question: Do administrative and regulatory barriers reduce the business success and competitiveness of companies in RS?

1 Introduction

To this end, the chapter seeks to conduct a theoretical and empirical analysis of the influence of administrative and regulatory barriers onto the business success of companies in RS. Therefore, the subject of this research is in the field of theoretical economy, while the narrow area of research is actually business management; all the other scientific disciplines will be taken as constant factors.

The basic hypothesis (X_0), that is the beginning point of this research, is: *Administrative and regulatory barriers reduce business success and competitiveness of companies in Republic of Srpska.*

In this chapter, there is also a sub-hypothesis (X_1): Adapting a special mechanism for removing administrative and regulatory burdens out of economy, will contribute to the successful management of it.

The first part of this chapter explains the role and importance of companies in the economic structure of RS, and its role in relation to the European Union and globally.

The second part of this chapter is related to external factors, which influence the companies' business, especially those factors in the domain of regulatory and administrative barriers.

The third part presents an analysis of research results and tests the hypotheses concerning the relation between the participants in certain assignments within the business environment and the success companies achieve in that process.

In the fourth part, there is a representation of a contemporary model of business registration in the RS, which is actually the author's idea of a concrete application of that model.

The final part discusses and compares the research results with other similar research in our milieu, but also in Europe and internationally.

It is necessary to mention that the empirical research of this chapter represents only a part of more complex and wider research conducted in the first half of 2013 and that it follows the basic hypothesis of that research that needs to be proven. So, it is important to find the best solutions, which would eliminate the negative influence of administrative and regulatory barriers from successful business management, with the final goal of economy recovery in later stages of economy growth.

2 The Term and the Importance of a Business Enterprises

An enterprise is an economic business system which, through its managing as well as growth and development, does all economic business activities that foster national and international trade (Nikolić et al. 2002). As a business system, an enterprise should be registered at the official institutions, so that it can perform its business within the proper legal framework. In order to register an enterprise, one must choose a legal organizing form for the enterprise, which has to concord with positive legal regulations. In the countries of our region, various legal forms of institutional organization of enterprises can be found such as a lone enterprise, an association of citizens, associations of capital, and collective enterprises (Babić and Lukić 2009).

According to the recommendations of the European Commission an enterprise implies:

Any subject engaged in economic activities regardless of the legal form, including subjects engaged in crafts and other individually or family based activities, as well as partnerships or associations that regularly engage in economic activities (Official Journal of the European Union, L 124/03, Commission Recommendation 2003/361/EC).

An enterprise implies each subject involved in an economic activity regardless of the legal form. This includes, especially, the people who are self-employed, family businesses engaged in trade or other activities, partnerships, associations which are regularly involved in economic activities (Petković 2010: 251).

An enterprise is defined as a complex system due to its structure, which contains a large amount of diverse sub-systems, while those sub-systems are made of deeper structured sub-systems. An enterprise is also an open system because it works in such a way as it is reciprocally connected to its environment and its management depends on external factors. The dynamism of an enterprise is expressed through constant changes of its organizational structure, the qualification structure of its employees, the specialisation of technical process and etc (Ibid 2009a).

An enterprise is an organisational manifestation of economy, which as an economic business system, through its business and development implements a wide spectre of diverse economic, but also non-economic, interests-from individual ones to the widely covered general social, i.e. public interests (Nikolić et al. 1996: 5).

When defining the size of an enterprise, besides the number of employees as one of the quantitative indicators, the total sum of balance of enterprise assets and total annual income are taken into consideration. For example, small enterprises in the RS are less than 50 employees, which have a total annual income lower than 2,000,000 BAM or whose average value of business property is less than 1,000,000 BAM. On the other hand, medium enterprises are economy subjects with 50–250 employees whose total annual income is between 2,000,000 BAM and 8,000,000 BAM and whose average value of business property is worth less than 4,000,000 BAM. Amongst small enterprises we can distinguish micro-enterprises, which employ less than ten workers (Official Herald RS 2013).

As an additional classification, some countries also use certain qualitative indicators such as; the form of property, organisational structure, qualification structure of the employees, and the flexibility of the production programme (Babić and Lukić 2009). In the empirical study of this chapter, an enterprise will be seen as a business system within the management and theoretical economy field, while the financial factors will be disregarded in this analysis.

Small and medium enterprises meet the requirements of a certain part of the market, which large enterprises can hardly satisfy as they have a more flexible production programme than larger business systems that are flexible in the face of turbulent and unpredictable business conditions. Small enterprises have an ability to react relatively quickly and change their technology, and introduce more modern and up-to-date equipment. Small enterprises are more flexible in comparison to larger enterprises as they swiftly enter new business projects but also leave those projects much faster. This is because they ask for lower financial investments in ongoing and future needs, which makes them significant creators of new job placements. According to Berberović and Jelić (2005), from the organisational aspect, the enterprises mentioned are characterised by a online system of management where there is usually no job division into sectors, information channels are short and direct, assigning authorities is defined only in special situations. There are also almost no problems with activity coordination, the level of formalization is extremely low, and the level of management flexibility is high, while personal contacts of the employees are also supported.

The basic differences between small, medium and large enterprises can be analysed according to the functions within it which are: marketing, management, internal communication, qualified technical working power, financials, scale economics, development and growth, patents and so on. One of the weaknesses of small enterprises, especially those recently founded, is the fact that they usually have only one owner, who does not have enough knowledge to be a rival for large enterprise managers. However, the problem appears also in large enterprises when managers strive to make the employees satisfied which often proves difficult (Deželjin et al. 2002).

3 Main Problems of the Business Environment in Enterprises' Successful Business Modeling

In the contemporary business environment, characterized by instability and great competitiveness, there is a great influence of external factors on the company's business. Business systems base their business on purposeful product, support and information exchange with the environment, which ensures survival, development and further growth of the company. The environment represents everything that is outside of the company, i.e. it is made of numerous institutions which directly influence business and its results, but which the company cannot control (Babić and Lukić 2009).

The key problems burdening the business environment in the RS can be divided into three main categories:

- Inadequate information flow between the official institutions and the business sector,
- Little attention given to the influence of regulations (laws, regulations) onto the business sector and the economy in general when they are being introduced into the system, and
- The need for change in the regulation system is not developed enough.

The fact is that the business environment substantially influences the company's business; thus we can conclude that it is important to adjust the business so that the influence of the environment can be reduced to a minimum. Depending on the type of activities of the company, the influence of the environment in some companies is static and in others dynamic.

3.1 Administrative Barriers

According to administrative barriers are treated as a problem that appears even before the companies are founded (especially in developing countries like B&H, Serbia, etc.) but also later during business making and managing. There are barriers in the process of the opening, but also in the complex managing process, which is related to local administration institutions and the insolvency and inefficiency of the legal system. On the other hand, foreign investors are not attracted as long as there are administrative obstacles, and thus there is little chance to create a favourable macroeconomic atmosphere that guarantees success in the RS. A stable macroeconomic environment and clear legal regulations and rules are an important condition for existing and new foreign investors, and guarantee economic prosperity and stability of developing countries.

Kunaka (2010) emphasizes special difficulties for faster progress and development of companies in Bulgaria, seen at the regional and global level too, which are increased by unclear and constantly changing laws and regulations imposed by the state. Thus, those difficulties are identical both in Bulgaria and the RS.

In the RS, the active involvement of local communities in coordination with the government is necessary in order to reduce the procedures and costs for opening a business. So, it is important to free the economic agents from numerous obligations, and most importantly from local administrative taxes. One of the possible solutions to help our companies at the local, regional and international level is the so called "one-counter system" or the registration process of business. This system has been launched recently and is supposed to reduce the time needed for the registration of new economic subjects from 23 down to 3 days. It gives all companies, especially small ones, an excellent possibility to affirm their business ideas in practice (read more on this topic in the fifth part of this chapter).

Qualitative, coordinated, logical, understandable and applicable regulations in all areas, work in the interest of economic development and the efficient realization of the rights of citizens' and business communities. Institutional conditions are determined by the social-economic system, as well as politics and the measures it undertakes. Institutional conditions are legally regulated and are obligatory for all companies regardless of their form. Numerous legal regulations regulate a wide range of issues like founding, extending, integration, recovery and liquidation of companies. Based on numerous international reports dealing with this problem, it can be concluded that in our country there is an excessive number of regulations for business and organizational forms of companies, and there is a tendency for them to constantly change (Regulatory reform strategy and introducing the process of evaluation of the regulations' influence in the RS in the period between 2012 and 2015, 2012).

The process of the identification of administrative barriers is a process that should be conducted by the responsible republic institutions (Official Herald of RS 2009). The goal of this process is to analyse the administrative burdens that are supposed to determine the formalities (taxes, fees, licences, necessary documentation) issued by the RS institutions, burden the economy [read more on this topic in Stojanović and Raičević (2013: 305–317)]. The analysis of business barriers represents a calculation of costs for the application submitter, including every individual formality represented through direct costs (taxes and fees, necessary documentation, time needed to collect the documentation) and indirect costs (time needed to collect the documentation necessary to submit before submitting the application, and time needed to get a response from the responsible institutions). This analysis provides an opportunity to calculate potential savings. The purpose of this analysis is to find information about each direct and indirect cost, identify expensive ones and estimate possible savings which could be achieved by implementing recommended changes in terms of abolishing or simplifying some formalities.

Some problems that slow down businesses in Belgium are related to difficulties of VAT (Value Added Tax) returns and reduced transparency in businesses in certain economy branches, which are not coordinated with EU regulations (Stephenson et al. 2011). If we look at various barriers and difficulties in the businesses of our neighbours like Serbia, Montenegro and Croatia—a recent member of the EU—we can conclude that in these countries there is no application of standards and transparent procedures, which are clearly defined in EU countries. This therefore decreases their competitive potential in the region as well as internationally (Ibid 2008).

3.2 Regulatory Barriers

Regulatory barriers are obstacles that emerge from existing rules and regulations, and which *stop free functioning of the internal market of a certain country* (Stephenson et al. 2008). According to that, in some cases there are close relations between administrative and regulatory obstacles, so it is hard to classify and categorize them. However, according to Donato De Rosa et al. (2013), in the case when companies oppose administrative rules, they actually oppose legal regulations. On the other hand, we can easily say that regulatory barriers are those that conduct regulations and legal regulations.

Regulatory reform means realizing changes that improve the quality of regulations, and effects, profitability and legal quality of regulations (Lalović and Skopljak 2008).

Within the field of regulations, which define the terms of the business environment, it is important for responsible institutions to create and adopt legal solutions that respect the needs of the business sector. In the RS, the ministry of economic relations and coordination make sure that the existing regulatory system is in accordance with EU regulations. The ministry of finance estimates the financial influence of the suggested regulations onto the budget but it does not include a detailed analysis. The regulatory department checks the suggested laws and the government amendments to ensure that they are in concord with the state constitution. These evaluations are not coordinated from the inside, and underestimate key aspects—evaluating influence on the business sector, economy activities, and other key components as the environment and society.

In the RS, there is a process of special strategic options going on, which includes regulatory reform in terms of simplifying procedures of business registration, property registration, getting construction licences and other administrative barriers recognized in The White Book, Foreign Investors Council, and other relevant world reports (Chamber of Commerce of RS 2012). On the other hand, in Montenegro a strategy of regulatory reform and business environment promotion has been adopted, and that means that business barriers and unnecessary regulations and procedures are being removed in order to save time and money for the employers (MNE Official Herald 2013). This way the state could influence registration time, thus shortening and lowering business costs.

Regulatory reform as a continuing process has a few basic goals which should be realized in practice and those are: achieving better political results with lower costs, reduce barriers for entering the local market, reducing the cost of business and the regulatory risk, increasing the level of transparency, productivity and competitiveness, and ensuring more working places, and legal security with a stable and recognisable legal framework.

In our country, a strategy of regulatory reform and the introduction of an evaluation process of the influence of regulations in the RS for the period between 2012 and 2015 was adopted in 2012 (Registry of approval in economy, 2013). It was planned that the strategy will improve the business environment, increase competitiveness of the local economy on the European and global market, and improve the international importance of the RS in terms of improving the quality of its business environment. Besides that, the strategy planned to introduce a methodology for evaluating the influence of regulations in the process of introducing amendments (Government of Republic of Srpska 2013).

4 Evidence and Empirical Results of the Research

The research was conducted in the first half of 2013 on the territory of five cities and four towns in the RS. The size of the sample was limited to 150 companies, mostly from the territory of the city of Doboj, which is approximately 52 % of the total sample. So, the city of Doboj is a good starting point for the evaluation of the problem of this chapter. Even though the number of questionnaires is relatively small (0.83 % of the total number of companies in the RS according to the Annual report for small and medium enterprises and associations in the RS for 2011, 2012), so we cannot speak of a representative sample, it is important to mention that all the material is collected randomly and this increases the credibility of the results.

The sample is defined according to the regional principle, and in the following figure one can see the layout of companies surveyed in this research, divided by cities and towns (Table 1):

While conducting quantitative research, we used the random choice method. We gathered data using a questionnaire, in the form of a closed question with multiple choice answers, and open questions asking personal opinions, which is both quantitative and qualitative because it had many questions measuring attitudes by scales.

Table 1 The structure of sample companies according to the regional principle

Name of the city/municipality	Number	%
Doboj	78	52
Bijeljina	8	5
Prijedor	10	7
Banja Luka	8	5
Istočno Sarajevo	9	6
Modriča	10	7
Derventa	9	6
Teslić	9	6
Petrovo	9	6
Total	150	100

Source: Author's calculations

The questionnaires were processed by applying methods of descriptive and quantitative statistics in the *IBM SPSS Statistics* software packet.

The research was conducted on a relatively small sample of companies including small and medium enterprises but also large businesses. A general limitation of this research was the lack of finances, which would mean wider research on more companies in the RS. We also have to mention that the companies, and representatives of various economic associations, we had sent the questionnaires to showed a low level of moral responsibility towards this research. It is important to say that highly positioned owners or directors, managers and bosses filled in these questionnaires, thus we could not avoid subjectivity and personal attitudes, so we recommend taking the answers with reserve.

Within the research results we will show the most important ones, which are related to the following peculiarities and important for testing the hypotheses:

- General information about companies with special analysis of legal form of companies, year of foundation, number of employees and the type of activities the companies undertake;
- Analysis of administrative procedures which influence the success of business managing;
- The influence of administrative limitations on the financial stability of the companies;
- Determining certain regulatory regulations which are relatively applicable in practice and which reduce the business success.

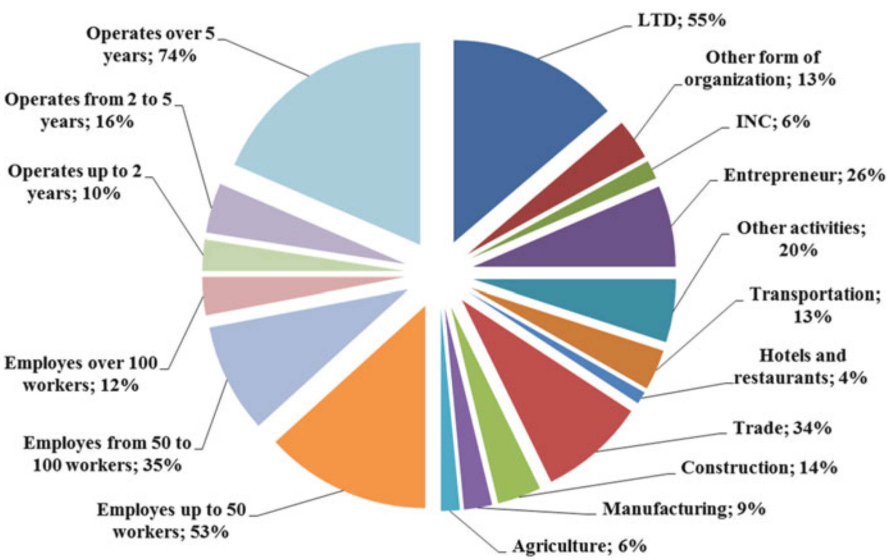


Fig. 1 The structure of companies according to the year of foundation, number of employees, activities and form of organization. *Source*: Author's calculations

Based on the comparative analysis given in the Fig. 1 we can conclude the following:

- Distribution of the surveyed companies observed according to the founding year shows the following: 10 % of companies are founded in the last 2 years; 16 % in the last 2–5 years; 74 % in the last 5 years and earlier;
- On the other hand, by the number of employees we can see: 53 % of the companies have up to 50 workers; 35 % have between 50 and 100 workers; 12 % have over 100 workers;
- If we look at the structure according to the companies' activities we can see: 34 % are within the field of commerce, motor vehicle repair (which is close to the republic average of 43 %, according to the Annual report of small and medium enterprises and associations in the RS for 2011, 2012); 20 % are in the domain of "other" activities; 14 % are construction businesses, 13 % traffic, 9 % manufacturing industry, 6 % agriculture and 4 % catering;
- According to the legal form of companies, after the research we can see that: 55 % are organized as associations with limited accountability (Ltd), 26 % are independent entrepreneurs, 13 % are corporations, and 6 % are "others".

So, according to the previous statements we can conclude that the RS still has a dominant trading field, with a large share of companies organized as associations with limited accountability, and that most companies are founded 5 years ago and earlier. This is estimated to be very negative for the total economy structure of this country.

In the rest of this research we tried to determine whether companies are faced with complicated and long-lasting administrative procedures and we received the following answers:

- 48 % of companies confirmed that they face complicated administrative issues;
- 35 % responded that they occasionally face long and complicated administrative procedures;
- 17 % responded they do not see this as a problem that burdens their business.

In the following figure we can see the confirmation of the research results in the field of administrative burdens companies constantly face (Fig. 2).

The results of this part of the research have confirmed that companies are faced with this problem quite often, or in 48 % of the time.

Fig. 2 The influence of administrative procedures onto the business. *Source*: Author's calculations

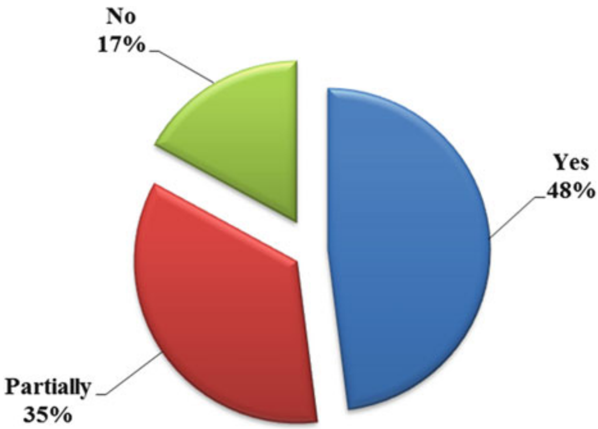
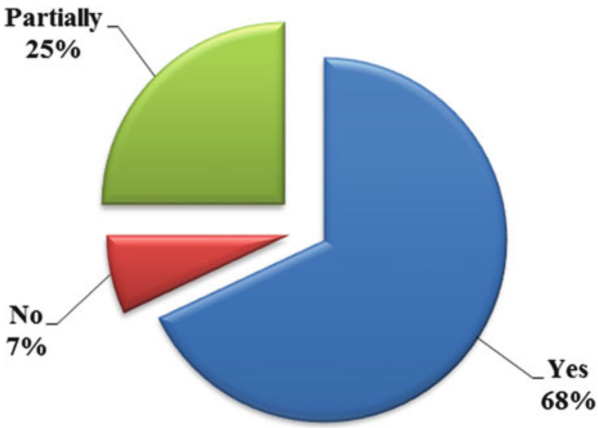


Fig. 3 The level of influence of administrative barriers on companies business. *Source*: Author's calculations



In the continuation of this research, and based on the answer to the question: "Do administrative barriers companies face with produce extra financial burdens?" we received the following results: 68 % answered positively, 25 % said it affects them partially, and 7 % said that they have no negative influence (Fig. 3).

Therefore, the results of this part of research confirm that administrative barriers produce extra financial burdens for the companies (68 %).

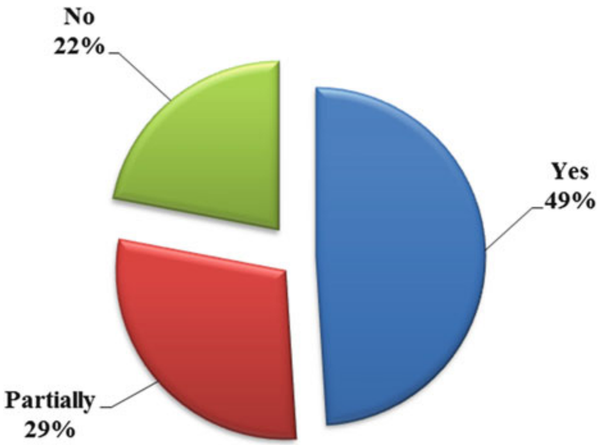


Fig. 4 Showing if there are regulations used in practice which burden the companies' Business. *Source*: Author's calculations

To get a realistic image of the business environment in the RS, it was necessary to get an answer to the following question too: "Are there specific regulatory regulations (laws, amendments, regulations) used in practice which burden your business?"

These are the results we received; 49 % confirmed there are such regulations; 29 % they partially agree that such regulations exist; 22 % said there are no such regulations (Fig. 4).

The results of this part of the research confirmed that the majority of companies (49 %) consider that there are burdening regulations that are often used in practice.

So, based on the results of this part of this chapter we can conclude that there are still no clearly regulated policies in the RS that ensure all necessary conditions for survival, development and management of companies, especially for a longer period of time. This decreases the inflow of foreign capital and new investments, but at the same time it questions the competence of this country in comparison to international companies.

According to this, we can conclude the burdens on the RS economy have yet to be removed, and thus the success of our economy is reduced. So, the main hypothesis of this chapter is confirmed as true, meaning that administrative and regulatory obstacles decrease the business success and competitiveness of companies in the RS.

5 Theme in Practice

After we had presented and analysed the research results and hypotheses testing, we came to the conclusion that the RS is yet to create the necessary conditions for progress and development of companies in order to make them recognisable and competitive. In this chapter, we will present the empirical research in Europe and our closer region in order to confirm or refute our results in comparison to EU standards.

In research conducted by Morisset and Lumenga (2002), covering a sample of 32 developing countries, it was proven that administrative costs vary from country to country. Those costs are related to corruption, business quality, and the openness of the public sector. In that way, it is necessary for those costs to be a priority for change in the sample countries in order to reduce the barriers and enable better business progress and development of all companies.

Research conducted in Switzerland, related to administrative and regulatory limitations companies in this country have shown that state regulations are clear and precise for each and every business activity and legal form. Therefore, small enterprises do not face the same administrative costs as middle or large enterprises in this country.

A Polish study conducted at the beginning of 2000, concluded that the main external factor for slowing down businesses was caused by the lack of qualified administration.

The situation in Romania concerning business obstacles is also very interesting and different in comparison to other countries in our region. In this country there is a lack of financial and business support for opening new companies and working posts, which is caused by strong bureaucracy, often-political changes, and a lack of trust towards the local administrative institutions. On top of all these problems Romania has still not adapted its laws according to the directive of the European Union (Donato De Rosa et al. 2013). Further, an analysis of the business environment in Montenegro conducted in 2007, explicitly confirms that enterprises in this country are burdened by numerous barriers despite the fact they already adopted numerous laws and institutional regulations and reforms (Ratković 2009).

As for Croatia, Škabić and Banković (2008) emphasize that removing administrative barriers is the first condition for development of a successful and internationally recognized Croatian economy. The same authors add that creating an appealing business and investment environment depends on simplifying administrative processes, i.e. forming an institutional organizational framework to conduct necessary regulatory reforms. According to Rosa et al. (2009), a restrictive administrative and regulatory policy matching EU standards has been in place for a long time in Croatia. So, the regulations promoting for example competition in certain sectors and giving the same rights as the local companies, is just a part of the rules that aim to empower international competitiveness and prosperity in general.

In B&H, in comparison to other countries, the procedures for founding a company are the longest and mostly bureaucratic. Having in mind that the steps and procedures of registration are designed to follow a certain sequence, if there is a delay of only one step, the whole system is in danger of falling apart (FIAS 2001). A project "EU support to institutional capacity building for regional and local economic, and small and medium enterprises development" (Needs Analysis-Report on Survey Findings, EU Support to Institutional Capacity Building for Regional and Local Economic and SME Development, BiH, WYG International Ltd 2010: 6) aimed to support the construction of institutional capacities in BiH. The period of implementation of this project would be between 2009 and 2012, and it would include the ministry of local administration of the RS, the association of municipalities and cities, the republic agency for small and medium enterprises development, as well as local agencies for development.

The project would consist of two components:

- Support for regional and local economic development;
- Providing training and consultations for small and medium enterprises.

Within this project in the first half of 2010 a "Needs research for small and medium enterprises in BiH" was conducted on a sample of 140 companies (39 large, 66 small and 35 medium) that belong to different business forms. The general conclusion of this research is that all challenges that small and medium enterprises face have a high result (above 3), meaning that managers of the surveyed companies see all these challenges as a problem for their company. A big problem concerning the external factors, according to research results, is "the lack of state programmes of support for companies" (4.06), and "the lack of access to adequate sources of financing" (3.85) and other "administrative and regulatory barriers" (3.30). When it comes to issues related to internal questions it is important to mention "the lack of qualified and educated workers" (3,10) and "the lack of qualified and competent managers" (3.04).

Conclusively, we can see that the responsible ministries in the government and local communities in the RS should create restrictive policies in order to empower the business environment that is in concord with the rules and policies of the EU in the context of local politics.

6 A Contemporary Model of Business Registration in the Republic of Srpska as a Key Outcome of the Research

In 2013, the RS adopted a set of laws, which represent a meaningful step forward in the field of business environment improvement, mostly in the field of registration reform. The laws which were changed were: Registration of business subjects law, Foreign investments law, Catering law, Tourism law, Electronic signature law, Classifying agency law, Agency for intermediary, Information and financial services law, Administration taxes law, Vocational and entrepreneur laws, Court taxes law, Economy societies law, and Tax procedures law (Government of Republic of Srpska 2014).

Adapting changes and amendments of these laws means that the costs of starting a business in the RS have been significantly reduced. Some of the changes are:

- Minimal founding fee was reduced from 2000 BAM to 1 BAM;
- For one-member Ltd companies, notary processing of documents was reduced to verification of documents only;

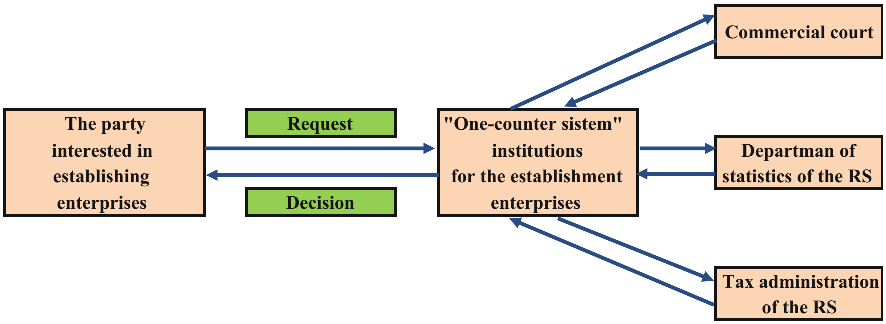


Fig. 5 One-counter registration system of business subjects in the RS. *Source*: Author's modeling

- The process of registration is significantly simplified so it is much faster and less expensive because the administrative taxes have been reduced (a maximum administrative tax is now 30 BAM). Furthermore, the first time registration is free from court taxes as well as of costs of publication in the Official herald. Also, taxes on excerpts from court or other public registries are issued for free on the customer's request. The legal regulations have also been changed in order to reduce the time, procedures and costs of the registration process. This reform will reduce procedures because the customer goes to the so called One-counter institution, i.e. the Agency for intermediary, information and financial services (APIF), instead of going to numerous institutions (Court, Statistics department, Tax directory) in order to submit and resume the necessary documentation. The process of registration begins and ends in this agency, and the only other thing the customer needs to do is to verify his/her documents at a public notary (Fig. 5).

The One-counter system will be introduced at 11 locations: Banja Luka, Prijedor, Gradiška, Doboj, Modriča, Bijeljina, Zvornik, Istočno Sarajevo, Sokolac, Trebinje and Foča.

The first phase of this project implies adopting law changes in terms of business registration and cost reduction. The second phase implies introducing the one-counter system, and the third phase involves the On-line registration of business subjects.

The main goal of this reform is to consolidate the registers of economy subjects in the RS instead of having three different ones (court, taxes and statistics). With other registers that introduce APIF, a new analytical approach to the process of economy support will be created and will thus ensure new measures for the revitalisation of the RS economy. This reform will create conditions for quality presentation and data exchange in order to form a unique register of business subjects in the RS within the system of economy registers of the EU.

7 Chapter Summary

By analysing the research results and testing the hypothesis it was proved that the RS still lacks a strong enough mechanism to create a favourable environment for the affirmation of new and existing companies.

Having in mind that efficient discovery and removal of administrative and regulatory obstacles help economic growth and economic efficiency, the empirical research presented in this chapter showed that the aspects mentioned are worth our attention and further investigation.

If we look at the research of local and foreign authors it has been proven that external factors significantly influence or interfere with business management. It was concluded that insufficiently clear laws and regulations, non-transparent managing and bureaucracy, as well as business barriers and unnecessary regulations and procedures, altogether reduce the success of companies and their possibilities to connect to the European and global economy.

In the empirical research, it was found that within the total sample, 34 % of companies deal with trading which is rated as extremely bad. So, there are no clearly defined strategies to improve the growth of other economy branches, and use the advantage and geostrategic position of the RS.

On the other hand, it was concluded that the greatest problems in business companies of the RS are complex regulations and barriers, as well as the need for their elimination and simplification. Besides that, it is necessary to start business environment improvement by implementing the plans suggested by the government, which are related to dynamism and coordination of activities within regulatory and structural reforms.

The RS government should adopt a special action plan to exert changes and amendments, operation plans for promotion and regulatory policies as well as structural reform. So, the Government should establish special bilateral contacts with governments and institutions in our region that have successful examples of regulatory business environments, removing business barriers, and transparency of procedures for business environment improvement.

One of the steps forward in this field was recently taken in the RS, and it is related to facilitating business creation and new business founding and registration; it is the introduction of the so called "one-counter system" of registration of business subjects, which is supposed to facilitate registration of new businesses and encourage growth in the number of potential business people who want to start their own business.

The key question is: *do companies in the RS have enough strength to fight the non-favourable environment, which reduces its competitiveness on the local and international market*? Is there a strong enough mechanism that can improve the business environment in the RS, so it can create a favourable macro-economic environment to last for a long period of time? Is it possible to reduce the enormous influence of administrative and regulatory burdens onto the companies in our country? These, but also numerous other questions require a new and much wider discussion, which can be a starting point for further research and suggestions.

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Assessing the Impact of Public Financial Support to Small and Medium Enterprises: An Empirical Study from the Republic of Srpska, BiH

Jadranka Petrović

Abstract The aim of the chapter is to theoretically and empirically analyze the impact of public sector financial support policies on the development of small and medium sized enterprises (SMEs) and entrepreneurship in transitional countries. Through empirical research, on the case study of the Republic of Srpska Investment-Development Bank (Investiciono-razvojna banka Republike Srpske—IRBRS), one of the two public development banks in Bosnia and Herzegovina, we explored the impact of IRBRS loans on selected business performance indicators: operating revenue, export and employment of SME borrowers. The study was based on the comparison of indicators in the year prior to the use of IRBRS loans with the data from the 4-year period after using IRBRS loans. Also, the selected indicators of IRBRS loan users have been compared with those of the control group which were the companies that have not used IRBRS loans. Our empirical results, based on quantitative data research for 120 SMEs in the Republic of Srpska in the period 2007–2012, showed that the Republic of Srpska Investment-Development Bank had a positive impact on operating revenue, exports and, especially, on the employment of SME borrowers.

1 Key Concepts of a Subject Theme

Numerous studies have highlighted the importance of small and medium-sized enterprises (SMEs) and entrepreneurship in fostering sustainable economic growth, job creation and poverty reduction, such as Birch (1979), Acs and Audretsch (1988), Wennekers and Thurik (1999), Carree and Thurik (2010), Ayyagari et al. (2011). Along with the growth of the SME sector, the role of public support to SME sector has also been increasing. With the development of policies and instruments of public support to entrepreneurship and SMEs, a need for research of

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_4

the effects of these policies has emerged. Also, the methodologies of impact assessment have been developed.

The subject of this chapter is a theoretical and empirical analysis of the impact of public financial support policies on the development of SMEs and entrepreneurship. Attention will be focused on the historical and theoretical research of the role and importance of entrepreneurship and SMEs in the development processes on the one hand, and the role of the public sector in supporting SMEs and entrepreneurship on the other hand. There will be particular focus on the policies of financial support and the issue of the impact and effectiveness of these policies. Also, through empirical research on the case study of the Republic of Srpska Investment-Development Bank (IRBRS), one of the two public development banks in Bosnia and Herzegovina, we will explore the impact of IRBRS loans on business performance of SME borrowers by looking at operating revenue, export and employment.

Structurally, part one provides an overview of key concepts of a subject theme, while part two gives an overview of the problems and evidence. Part three describes the theme in practice—research design, methodology and sample used in the empirical study. The research results are presented in part four, while the chapter summary is presented in the final part.

2 Problems and Evidence

The academic interest in entrepreneurship and small and medium enterprises (SMEs) increased in the early 1970s with the growth of the number and importance of SMEs. Part one specifies some of the authors who have addressed the question of the importance of SMEs and entrepreneurship in fostering sustainable economic growth and job creation. While SMEs are a major source of employment and income for all countries, they are particularly important for developing countries, where SMEs have the largest share of employment and GDP. According to IFC research, SMEs typically represent more than 90 % of all firms and account for more than 60 % of the total number of employees, and more than 60 % of GDP in developing economies (IFC 2010).

The growth in the SME sector can potentially reduce the exposure of an economy to international economic cycles by strengthening the domestic economy in sectors that are less exposed to international factors including commodity and foreign currency markets, as well as to the cycles of international private capital flows (Griffith-Jones et al. 2010).

2.1 Public Sector Support to SMEs and Entrepreneurship

In response to the growing importance of SMEs, there has been public sector support for SMEs. So, why should the public sector support the development of SMEs and entrepreneurship?

Storey (2008) justifies public support to the SME sector due to the existence of the so-called "market failure". If markets were perfect, and buyers fully informed, then there would be no justification for public policy. However, this is not the case with respect to SMEs, and it is the presence of the mentioned "market failure" that justifies government intervention. Secondly, Storey argues that a wide range of government policies (for example: taxation, social policy, education and macro-economic policy) have either positive or negative impacts on SMEs and entrepreneurs. As key political constituents, small business owners take into account the impact of government policies on their businesses in choosing whom to vote for. Therefore, the government must take into account this electorally important political "constituency".

Hallberg (1999) explores the economic rationale for supporting SMEs, on both theoretical and empirical grounds and finds justification of SME support in the market and institutional failures that have a negative impact on the size distribution of firms, rather than on economic benefits provided by small businesses. The role of government is mainly to provide a favorable business environment that opens up access to markets and reduces policy biases against small businesses.

The research of Organization for Economic Cooperation and Development (OECD) shows that most OECD countries have programs to support SMEs. One quarter of all public support programs reported to OECD is primarily aimed at SMEs. Germany, Iceland, Japan and New Zealand devote more than 50 % of their total government support programs to SMEs. This OECD research shows the best practice policies for SMEs lie in the following five areas: finance, business environment, technology, management and market access (OECD 1998).

Some of the leading authors who explore the issue of public sector support to entrepreneurship and SMEs in transition countries are the Nobel Prize winner Joseph Stiglitz, David Smallbone, and Friederike Welter. When analyzing problems related to economic development in transition economies, Stiglitz considers that there is a need to put much more emphasis on the importance of institutional infrastructure (Stiglitz 2001). As one of the four "bridges" to a market economy in Russia and countries in transition, Stiglitz sees the recognition of the importance of the economy reconstruction "from the bottom up", with SMEs as start-ups as well as the satellites of large enterprises (Stiglitz and Ellerman 2000). Regarding the contemporary role of the state in the economy, Stiglitz believes that although the market is at the heart of the economy, the government must play an important role. What is important is the balance between the state and the market (Stiglitz 2013).

Smallbone and Welter (2010) explore the relationship between institutional change and the development of entrepreneurship, as well as the role of government in post-socialist countries. The authors conclude that the process of market reform requires a fundamental change in the role of the state in the economy, as the government changes its role from the planner of resource allocation and pricing, owner and financier of companies through subsidies and transfers, to the role of regulator and facilitator of activities of private companies. Xheneti and Smallbone (2008) point to the need for post-socialist governments to strengthen their capacities at various levels, which will allow them to better meet the needs of enterprises. The work also has important implications for the theory of entrepreneurship, strengthening the need to recognize the important role of the state in the development of entrepreneurship.

2.2 Public Sector Financial Support to SMEs and Entrepreneurship

Numerous studies show that access to finance is one of the main obstacles to the growth and development of SMEs, such as Ferranti and Ody (2007), Storey (2008), Beck et al. (2008) and IFC (2010). It follows that the policy of financial support to the SME sector and entrepreneurship is one of the major government policies aimed at supporting the sector.

Ferranti and Ody (2007) find that in the majority of developing countries the capital is the critical missing element to SMEs. Governments can help by removing artificial policies and regulatory barriers for lending to SMEs. Policies that promote greater competition in the financial sector as a whole are important for smaller borrowers, such as SMEs.

According to Storey (2008), improving access to finance is a key area of public policy support for small businesses. This is because small businesses are suffering the negative consequences of the existence of "market failure", as a result of higher risk levels and imperfect information about their business. Therefore, governments consider legitimate "intervention" in the provision of public funding in the form of loans and equity. Beck et al. (2008) analyzed bank financing of SMEs around the world using data from a survey that included 91 banks in 45 countries. The results show that banks consider the SME segment to be profitable, but they see macroeconomic instability in developing countries and competition in developed countries as the main barriers to financing this segment. Compared with large firms, banks are less exposed to small businesses, they charge them higher interest rates and fees, and have more non-performing loans. These characteristics of the banking system create unfavorable lending conditions for SMEs.

Griffith-Jones et al. (2011) investigated the role of the European Investment Bank (EIB) in financing SMEs. They conclude that the major role that the EIB group play in financing SMEs in Europe shows the importance of the role that the public sector needs and can play in providing direct financial support to SMEs, as well as to help catalyze private financing for them due to the large market imperfections and gaps in private financial markets (especially credit markets) for SMEs.

This became particularly evident during the crisis in the period 2008–2010, where the EIB group has played an important countercyclical role in providing credit, in the face of rapid decline in private lending to SMEs.

The valuable role that public financial institutions have is also applicable to the role of national development banks. State-owned banks have played an important role in financing SMEs in many countries, as shown in two World Bank surveys, one conducted globally (Beck et al. 2008) and the other focused on the Middle East and North Africa region (Rocha et al. 2011). Also, Rudolph (2009) concludes that state-owned banks can play a useful complementary role in providing loans to SMEs. However, the prerequisites for the success of such financing are: legislation specifying clear mandates, healthy management structures with independent boards, clear performance criteria, the commitment to determining loan interest rates according to risk, the obligation to generate a positive return, and finally the ability to recruit and retain qualified staff.

2.3 Assessing the Impact of Public Sector Support to SMEs and Entrepreneurship

With the development of policies and instruments of public support to SMEs and entrepreneurship, various research on the effectiveness of the different types of support to SMEs and different organizations have been carried out, such as Bennett et al. (1994), Storey and Westhead (1996). It was thought that if public money was spent on supporting SMEs, it was important to conduct impact assessments of these initiatives. Different studies tried to find the appropriate assessment methodologies that accurately identify the real effects of certain support policies for SMEs.

Storey (1998) gives a comprehensive overview of the issues related to the assessment studies of public sector support to SMEs. He suggests a two stage assessment process of public sector support to SMEs. These are monitoring and evaluation and, within them, Storey suggests steps that are needed to assess the effects of policy support for SMEs. Monitoring entails collecting information about companies that participate in the program of support, along with financial information about the money that is spent on support. At the stage of monitoring one should only look for the opinions of the recipients that receive support. On the other hand, the evaluation aims to compare the effects of the recipients of support with other groups of individuals or businesses. Storey argued that most of government support impact assessments in OECD countries fall under the category of monitoring and not the true evaluation.

In their study, Bennett and Robson (2001) analyzed companies in the UK between 1991 and 1997 to compare the level of use of external business advices by SMEs. The study showed that there was an increased use of government support to SMEs through agencies and regional development bodies. Further comparison in

1999 suggests a decline in the use of Business Link services and a stronger focus on the use of government services to support SMEs.

Business Link in the United Kingdom is one of the major initiatives to support SMEs. It was established in 1992 and designed as a one-stop-shop or complete support to SMEs in one place. Many authors explored the impact of Business Link in the UK, such as Bennett and Robson (2000), Hart and Roper (2003) and Mole et al. (2008). Bennett and Robson (2000), using a sample of companies that have used Business Link services during 1997, analyze how the companies characteristics, local geographical context, intensity of services and other variables affect the use of Business Link services, the effect of the service and satisfaction with Business Link services. In their study, Hart and Roper (2003) analyzed the impact of Business Link support on the productivity of companies that used its consulting services in the course of 1996, and compared the results with a control group which did not use these services. Mole et al. (2008) further explore the impact of support services to SMEs within Business Link. In an empirical study involving more than 3000 small businesses in England, they studied the effects of using the services of Business Link during 2003 on employment and sales of the companies within the next 2 years. The study results showed a positive and significant employment growth as a result of "intensive" Business Link support, while they did not find a significant effect of non-intensive or "other" assistance.

3 Theme in Practice: Empirical Study "Assessing the Impact of the Republic of Srpska Investment—Development Bank Loans"

3.1 Research Design

The Republic of Srpska Investment-Development Bank (IRBRS) was founded in December 2006. The Bank is registered as a joint-stock company which is 100 % owned by the Republic of Srpska. In January 2012 the IRBRS became a member of the European Association of Public Banks (EAPB). The strategic objectives of IRBRS are encouraging investment and stimulation of the RS development. Support to SMEs, support to employment increase and support to production to reduce the trade deficit are among the several identified priority objectives.

The IRBRS approved its first loans in April 2008 through the following six credit lines: (1) loans for start-up activities, (2) loans for micro business in agriculture, (3) loans for agriculture, (4) loans for entrepreneurs and businesses, (5) housing loans and (6) loans to local governments. In the period between April, 2008 and March 31, 2014 the IRBRS approved a total of 7399 loans amounting to 1.134 billion KM (equivalent to 579.8 million euros), out of which 2895 loans for entrepreneurs and enterprises in the value of 838.36 million KM (equivalent to

428.65 million euros). On the other hand, total banking sector loans to public and private enterprises in the RS as of September 30, 2013 amounted to 2.3 billion KM.

Therefore, it is evident that the IRBRS is the main instrument of public financial support for entrepreneurship and SMEs in the RS. For that reason it is important to evaluate the effects of this important instrument of public funding.

3.2 Methodology

The aim of this chapter is to examine the impact of IRBRS loans on selected performance indicators of SMEs, IRBRS loan users: operating revenue, exports and employment.

We set the following hypotheses which will be tested in the chapter:

H1. IRBRS loans had a positive impact on the operating revenue growth of SME borrowers.
H2. IRBRS loans had a positive impact on the export growth of SME borrowers.
H3. IRBRS loans had a positive impact on the employment growth of SME borrowers.

In order to test the hypotheses we will gather and analyze empirical data on three selected performance indicators of enterprises that used IRBRS loans during years 2008 and 2009. The study was based on a comparison of data on operating revenue, exports and employment in the year prior to use of IRBRS loans (reference/base year) with data from the 4-year period after using IRBRS loans. Also, we will compare the trends of indicators of IRBRS loan users with those of the control group, that is, companies that did not use IRBRS loans in the reference year. With sample defined in such a way it will be able to assess the impact of the IRBRS financial support to enterprises that have used IRBRS loans, but also to compare this impact with companies in the control group.

3.3 Sample

The sample is represented by 120 SMEs from the Republic of Srpska, BiH, out of which 30 SMEs which used IRBRS loan during years 2008 and 2009 (IRBRS loan users) and a control group of 90 SMEs which did not use IRBRS loan during years 2008 and 2009 (IRBRS loan non-users), that correspond to a group of users by type of business activity. In order to have a valid sample there have been provided three control companies versus one company loan user (Hart and Roper 2003).

The sample of 30 enterprises IRBRS loan users includes all SMEs listed on the Banja Luka Stock Exchange, which used IRBRS loan during years 2008 and 2009, while the sample of 90 enterprises of IRBRS loan non-users was selected by random sample method stratified by type of business activity, from the database of all listed companies of the Banja Luka Stock Exchange.

The sample consists of companies listed on the stock exchange because of the availability of data on the financial performance and other characteristics of companies, published on the website of the Banja Luka Stock Exchange, www.blberza.com.

The sources of data were IRBRS database of loans, available on the IRBRS website www.irbrs.org, as well as information on operating revenue, export, employment and type of business activity of sample enterprises available from the income statements of enterprises, published on the Banja Luka Stock Exchange website.

The sample consists of two sub-samples: one sub-sample is a group of 17 companies that used IRBRS loan in year 2008 and corresponded control group of 51 companies IRBRS loan non-users. The second sub-sample consists of 13 companies that used IRBRS loan in year 2009 and corresponded control group of 39 companies of IRBRS loan non-users.

For companies that used loan in 2008, the reference/base year is 2007, which was compared with the 4-year period 2008–2011, while for the companies that used loans in 2009, the reference/base year is 2008, which was compared with the 4-year period 2009–2012.

Reference/base year for both sub-samples is marked as zero year, the year of loan use as year 1, while the following years as year 2, year 3 and year 4. The total value of the operating revenue, exports and employment of IRBRS loan users is obtained by summing the values of indicators in the years 0, 1, 2, 3 and 4 of loan users from year 2008 with loan users from year 2009. In the same way the total values of the indicators for the control group were obtained.

The IRBRS loan users used loans from two IRBRS credit lines: (1) loans for entrepreneurs and enterprises, and (2) loans for agriculture. During years 2008 and 2009 a total of 397 loans have been approved from these two credit lines. It means that the sample of 30 enterprises loan users represent 7.56 % of the base set (Table 1).

Since the sample of the control group (IRBRS loan non-users) is selected by random sample method stratified by type of business activity, the share in business activities of non-users is almost identical to the share of IRBRS loan users.

As we can see from Table 2, the sample of IRBRS loan users is dominated by medium-sized enterprises with 60 % share, small businesses account for 33.33 %, while the share of micro enterprises is 6.67 %. On the other side, the sample of IRBRS loan non-users is dominated by small enterprises with 41.11 %, while the share of micro and medium-sized enterprises is almost equal (28.89 % of micro and 30 % of medium-sized enterprises).

Table 1 Sample of enterprises by type of business activity

No.	Type of business activity	IRBRS loan users		IRBRS loan non-users	
		Number of enterprises	%	Number of enterprises	%
1	Agriculture	5	16.67	15	16.67
2	Food processing	4	13.33	12	13.33
3	Paper production and printing	2	6.67	6	6.67
4	Traffic	1	3.33	3	3.33
5	Construction	5	16.67	15	16.67
6	Machine industry	2	6.67	6	6.67
7	Metal industry	3	10.00	9	10.00
8	Wood processing industry	1	3.33	4	4.44
9	Designing and research	1	3.33	3	3.33
10	Hotel management	1	3.33	3	3.33
11	Utilities	4	13.33	11	12.22
12	Veterinary services	1	3.33	3	3.33
	Total	30	100.00	90	100.00

Table 2 Sample of enterprises by size

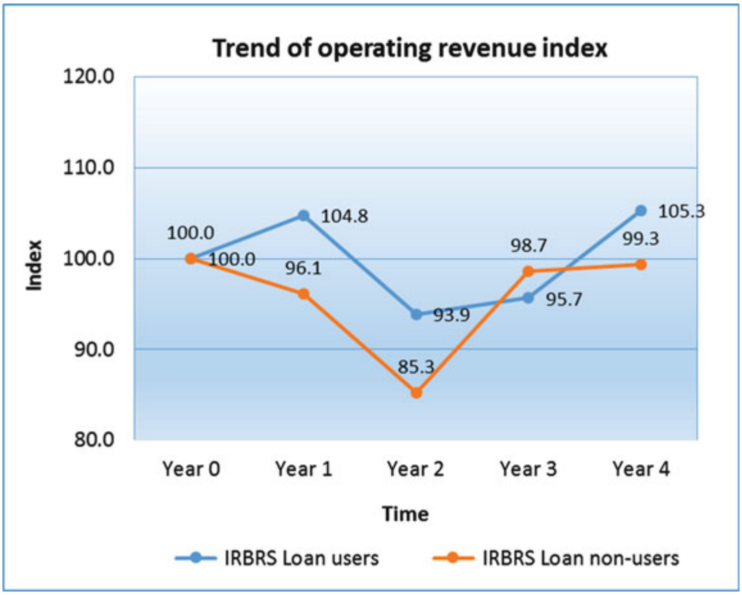
No.	Size of enterprises	IRBRS loan users		IRBRS loan non-users	
		Number of enterprises	%	Number of enterprises	%
1	Micro (1–9 employees)	2	6.67	26	28.89
2	Small (10–49 employees)	10	33.33	37	41.11
3	Medium (50–249 employees)	18	60.00	27	30.00
	Total	30	100.00	90	100.00

4 Outcomes

In this part the following research results are presented: the impact of IRBRS loans on operating revenue, export and employment of IRBRS loan users compared with performance of the control group or IRBRS loan non-users.

4.1 Impact of IRBRS Loans on Operating Revenue

Figure 1 shows a comparison of the operating revenue index trend of the IRBRS loan users and non-users in the 4-year period after the use of the loan in relation to the referent/base year (the year prior to loan disbursement). The operating revenue category from the income statement (AOP 201) has been chosen instead of the total



Source: author's processing of data from the income statements of sample enterprises, available on the website of the Banja Luka Stock Exchange, www.blberza.com

Fig. 1 Comparison of operating revenue index trend of IRBRS loan users and non-users

revenue category, because it better reflects primary business operations of a company.

Figure 1 shows that the IRBRS loan users had an increase in operating revenue of 4.8 % in the first year (the year of loan disbursement), compared to the reference/base year (the year prior to loan disbursement). In the second year there was a decline of 6.1 % compared to the base year, while in the third year there was a slight increase of operating revenue but still below the level of the base year of 4.3 %. In the fourth there was a significant increase in operating revenue, reaching the level of 5.3 % above the base year.

In contrast, in the control group or IRBRS loan non-users, there was a decrease in operating income of 3.9 % in the first year. There was a further decline in the second year, which amounted to 14.7 % compared to the base year. In the third year, there was a significant growth in operating revenue, but still below the level of the base year of 1.3 %. In the fourth year there was a further slight increase in operating revenue that achieved a level of 0.7 % below the base year.

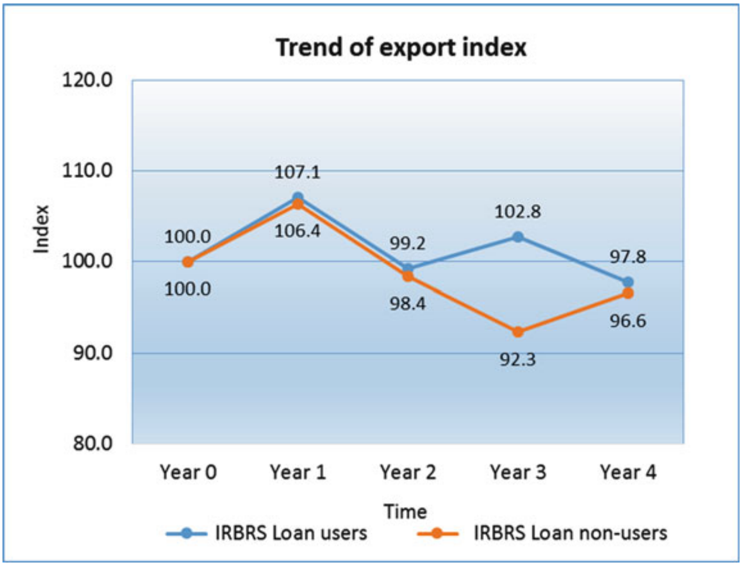
Thus, while in the first and the fourth year the IRBRS loan users achieved the increase of operating revenue to the levels above the base year, the IRBRS loan non-users realized the operating revenue below the level of the base year in all

4 observed years. The average operating revenue index of IRBRS loan users in the observed 4-year period was 99.9 compared to 94.86 of a control group.

4.2 Impact of IRBRS Loans on Export

Figure 2 shows a comparison of the export index trend between the IRBRS loan users and non-users in the 4-year period after the use of the loan in relation to the referent/base year (the year prior to loan disbursement).

Figure 2 shows that in the first year (the year of loan disbursement), the export of IRBRS loan users increased for 7.1 % compared to the year before loan disbursement. In the second year the export declined to the level of 0.8 % below the base year, in the third year export increased to the level of 2.8 % above the base year, while in the fourth year the export declined to the level of 2.2 % below the base year. As for the control group, the export increased by 6.4 % in the first year. In the second year the export significantly decreased to the level of 1.6 % below the base year. In the third year, the export further declined to the level of 7.7 % below the



Source: author's processing of export values obtained from the income statements of sample enterprises, available on the website of the Banja Luka Stock Exchange, www.blberza.com

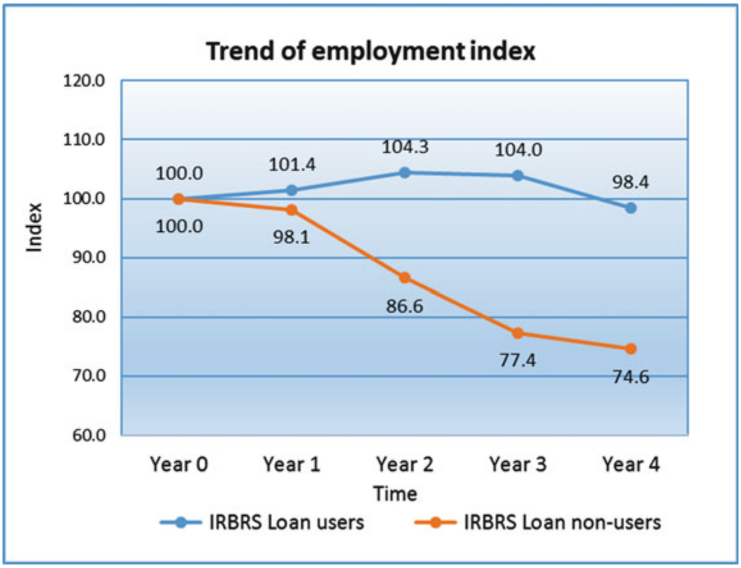
Fig. 2 Comparison of export index trend of IRBRS loan users and non-users base year, while in the fourth year the export slightly increased to the level of 3.4 % below the base year.

Thus, while the IRBRS loan users achieved export increase above the level of the base year in the first and the fourth year, the IRBRS loan non-users recorded export increase above the level of the base year only in the first year of the observed period. The average export index of IRBRS loan users in the observed 4-year period was 101.72 compared to 98.41 of the control group.

4.3 Impact of IRBRS Loans on Employment

Figure 3 shows a comparison of the employment index trend of the IRBRS loan users and non-users in the 4-year period after the use of the loan in relation to the base year (the year prior to loan disbursement).

Figure 3 shows that in the first year the employment of IRBRS loan users increased by 1.4 % compared to the base year (the year prior of loan disbursement). In the second year employment further increased to the level of 4.3 % above the base year. In the third year there was a slight decrease in employment to the level of



Source: author's processing of employment data for the sample of enterprises, available in the website of the Banja Luka Stock Exchange, www.blberza.com

Fig. 3 Comparison of employment index trend of the IRBRS loan users and non-users

4.0 % above the base year, while in the fourth year the biggest decline in employment occurred, to the level of 1.6 % below the base year. On the other hand, in the control group, or IRBRS loan non-users, there was continuous decline in employment from year to year. In the first year, the decline was 1.9 % compared to the base year. In the second year there was a further decline to the level of 13.4 % below the base year. In the third year the decline continued to the level of 22.6 % below the base year, while in the fourth year employment further declined to the level of 25.4 % below the base year.

Thus, while the IRBRS loan users in the first 3 years recorded employment level above the one of the base year, the control group recorded continuous and significant decline in employment in all 4-year period and did not succeed to reach the level of the base year. The average employment index of IRBRS loan users in the observed 4-year period was 102.2 compared to 84.17 of the control group.

The analysis of the average indexes of operating revenue, exports and employment in the observed 4-year period showed that:

- The average index of the operating revenue of IRBRS loan-users was 99.9 while the average index of the IRBRS loan non-users was 94.86. It means that on average, in the 4-year period, operating revenue for the IRBRS loan-users remained at almost the same level as in the year prior to loan disbursement, while the control group recorded 5.14 % lower annual average operating revenue compared to the base year. Thus, in the observed period the IRBRS loan-users have made average annual operating revenue 5.04 % higher compared to the IRBRS loan non-users.
- The average export index of the IRBRS loan users was 101.72 while the average export index of the IRBRS loan non-users was 98.41. This means that the IRBRS loan users achieved average annual exports of 1.72 % above the base year, while the control group recorded 1.59 % lower annual average export compared to the base year. This means that the IRBRS loan users achieved average annual export 3.31 % higher than loan non-users.
- The average employment index of the IRBRS loan-users amounted to 102.02 while the average employment index of the IRBRS loan non-users was 84.17. It means that in the observed 4-year period the IRBRS loan users employed on average 2.02 % more employees than in the base year, while loan non-users employed on average 15.83 % less workers then in the base year. Thus, IRBRS loan users achieved average annual employment 17.85 % higher compared to loan non-users.

5 Chapter Summary

Our empirical results, based on quantitative data research for 120 SMEs in the Republic of Srpska in the period 2007–2012, showed that the Republic of Srpska Investment—Development Bank had a positive impact on operating revenue, exports and employment of SMEs borrowers.

The IRBRS loan users achieved average annual operating revenue 5.04 % higher than the IRBRS loan non-users, the average annual export 3.31 % higher than non-users, and average annual employment 17.85 % higher compared to non-users in the observed 4-year period. Analyzing the average indexes of selected performance indicators during the 4 year period, we can conclude that the IRBRS loan users retained the level of operating revenue and slightly increased exports and employment, while the IRBRS loan non-users recorded a decrease of all three indicators below the level of the base year.

The most prominent positive impact of IRBRS loans is reflected in maintaining the level of employment of IRBRS loan users, while the non-users had a constant decline in employment, so that at the end of the 4-year period, the employment of IRBRS loan non-users was reduced by more than one-fourth, precisely by 25.4 % compared to the base year.

The main conclusions of the research can be summarized as follows:

– The study partially confirmed hypothesis H1. Observing the average index of the 4 year period, the average operating revenue of the IRBRS loan users remained at the level of the base year, while the average operating revenue of the IRBRS non-users decreased for more than 5 % compared to the base period.
– The study confirmed hypothesis H2. The IRBRS loans had positive impact on export growth of the IRBRS loan users.
– The study confirmed hypothesis H3. The IRBRS loans had positive impact on employment growth of the IRBRS loan users.

The analyzed period 2007–2012 coincides with the period of the global financial and economic crisis. Further analysis could shed light on the participation of certain internal and external factors in the movement of observed indicators, i.e., to what extent the IRBRS loans and to what extent other factors (like market conditions, the characteristics of the owner/manager, enterprise features, etc.) contributed to the changes in operating revenue, exports and employment of the IRBRS loan users.

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The Public Procurement System: A Business Sector Perspective

Jelena Budak and Edo Rajh

Abstract This chapter empirically evaluates the public procurement system in Croatia, a transition country and a new EU member state. The research is based on empirical evidence collected by surveying a large sample of companies. It investigates how businesses as actors in the public procurement tenders evaluate the system and what their perceived and experienced views are on the various components of public procurement. The baseline model borrows from the literature by including companies' characteristics in terms of company size and sector of business operations. Furthermore, it assumes that there are significant differences in attitudes and ratings among companies that have participated in public procurement as direct suppliers compared to companies that have been indirectly involved as subcontractors. The business opinion on the public procurement system procedures and regulations has been assessed as well, providing insights into the business perceptions on main public procurement principles: accountability, effectiveness, value for money, integrity and achieving the EU standards. Special attention has been dedicated to the assessment of corruption risks in public procurement. The evidence for Croatia reveals that in spite of the EU standards introduced there are still, at least from the point of view of companies, irregularities and lack of trust in the national public procurement system.

1 Introduction

Public spending makes up a significant portion of national economies, and in most countries government procurement of goods and services accounts for 15–20 % of gross domestic product (GDP). While in OECD countries this figure is 12 % on average, developing and emerging economies often spend about 25–30 % of GDP on public purchasing. In 2008, on average public procurement in the EU was about 15 % of GDP, with large variations among national procurement expenditures

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_5

observed (OECD 2011). The size of the public procurement market is hard to measure precisely because of different legislative definitions of what is considered public procurement and registered in national records, thus making worldwide comparisons impossible. However, due to the considerable impact of public spending on the economy, policy-makers use public procurement for economic policy purposes, striving to channel as much public spending as possible through public procurement bidding procedures, and setting the principles governing the public procurement market.

Governments in many countries responded to the latest economic crisis with increased public investment that should have generated a new business cycle. Croatia is a South-East European transition country with a small and open economy highly dependent on EU trade and political relationships and struggling with serious structural problems (World Bank, Croatia Overview). There is an ongoing expert debate on the role of public procurement in the times of economic downturn which have hit Croatia severely. Some arguments are in favor of public procurement that would serve as a driving force for economic activity and increased competitiveness, whilst others argue that doing business predominantly with the state has already created imbalances and had actually led to the unfavorable situation of the Croatian economy even before the crisis. Apart from the economic policy debate, public procurement participants in Croatia seem often to get around the declared principles of public procurement. Big corruption scandals in Croatia are associated with awarding public contracts to loyal companies managed by persons closely connected with the politicians in power and in conflict of interest (Ateljević and Budak 2010). Public procurement is sensitive to corruption, as supported by the evidence in Western Balkans countries and post-communist transition countries (Grødeland and Aasland 2011). Anecdotal evidence[1] on subcontractors complaining that they have difficulties getting paid for the work done in huge public contracts, that bidding documentation is designed to suit large companies and/or preferential ones, that suppliers were asked to pay an entry fee, and other irregularities deserve to be further explored. It might be the case that other countries in the region with a similar past institutional environment share the same concerns, which are not present in the developed Western economies and old EU countries.

On the other hand, in the process of Croatia's accession to the EU and upon implementation of strict public procurement legislation since 2008, the new institutional set-up was expected to increase the efficiency of the public procurement system. How do businesses as actors in the public procurement tenders evaluate the system? What are their perceived and experienced views on the various components of public procurement? One of the hypotheses is that there are differences in attitudes between direct suppliers and their subcontractors. Which principles of public procurement are fulfilled and where are the weak points? Another hypothesis is that the national system actually performs worst if compared to the "ideal" EU

[1] Lider, 13 December 2013, pp. 26–28

standards. This chapter aims to empirically evaluate the public procurement system in Croatia, a transition country and a new EU member state. The objectives of this chapter are to investigate how businesses evaluate the system, and secondly, what are their experienced views on the various components of public procurement. This chapter provides unique insights into the functionality of the system from the point of view of companies, and the results could be instructive for both public procurement authorities and for policy-makers in the countries with a similar business environment in the Western Balkans region.

2 Public Procurement Principles and the EU Policy Context

Literature on public procurement tackles a wide range of issues, and as Preuss (2011) duly noted, there is no single literature body that covers the entrepreneurship and public procurement nexus. Studies dealing with public procurement market, regulations and business participation in public tendering are often interdisciplinary and cross-dimensional, exploring a variety of issues in the domain of public policy, entrepreneurship, law and regulation, competitiveness and other, depending on the particular research question and objectives.

Therefore, only a brief literature introduction into the context of this research will be offered. Having in view that the chapter examines entry barriers to the involvement of companies in public procurement, the selected empirical studies dealing with the role and participation of firms in public procurement will be used to conceptualize the research model. We provide first an overview of the principles of public procurement because they reflect the policy objectives and derived regulations and procedures of the public sector.

The EU principles of public procurement date from the early 1970s and are in line with the fundamental principles of the EU common market and its four freedoms: free movement of goods, capital, services and persons. The EU principles of public procurement are equal and non-discriminatory treatment, transparency of terms and procedures, and proportionality of requirements (for a review of EU public procurement regulation, see Bovis 2012). Public procurement policy guidelines developed for practitioners in European countries describe these principles in more detail. For example, the Central Procurement Directorate of Northern Ireland (2011) elaborates 12 principles governing public procurement: accountability, competitive supply, consistency of procurement policy across the public sector, effectiveness, cost-efficiency, fair-dealing and commercial confidentiality, integration with other economic and social policies, integrity, informed decision-making, legality, responsiveness, and transparency. In the process of accession to the EU, Croatia had developed a new public procurement system in line with the EU standards, so the principles of competitiveness, transparency, fairness and equal treatment, integrity and corruption-free procedures are implemented in the national legislation (Box 1).

Box 1. Principles of public procurement in Croatia
Article 3

(1) In the implementation of public procurement procedures under this Act, in relation to all economic operators, contracting authorities/entities shall respect the principle of freedom of movement of goods, the principle of freedom of establishment and the principle of freedom to provide services and the principles deriving there from, such as the principle of competition, the principle of equal treatment, the principle of non-discrimination, the principle of mutual recognition, the principle of proportionality and the principle of transparency.

Source: Public Procurement Act (Official Gazette, 90/2011, 83/2013, 143/2013)

Erridge and McIlroy (2002) found that contemporary public procurement practices lay on three competing strands of public procurement: commercial, regulatory and social strand. Policy-makers and procurers are urged to prioritize and find the optimal combination of the selection criteria applied. Previous literature examined barriers for small and medium enterprises (SMEs) to participate in the public procurement tenders. The participation of SMEs in public procurement markets is far below their share in national economies. In the EU27, in 2008 SMEs on average secured 38 % of the value of public contracts and 61 % of the number of successful bidders (European Commission DG Enterprise and Industry 2010), and middle-sized companies were performing better than micro-firms. The European Commission study offers the systematization of entry barriers that should be overcome by EU policy measures (Box 2). Accordingly, the European policy-makers have recognized the need to make the public procurement market easily accessible to SMEs[2] by reducing the administrative burden and costs related to tendering, by improving transparency and simplicity of procurement systems (for example, in terms of encouraging the usage of e-procurement).

Box 2. Obstacles for SMEs to access public procurement markets in the EU

- Difficulties in obtaining information
- Lack of knowledge about tender procedures
- The large size of the contracts

(continued)

[2] For the effects of SME-friendly policies in the public procurement domain, see Loader (2013).

- Too short time span to prepare the proposal
- Cost of preparing the proposal (since many costs are fixed, SMEs face disproportionately high costs in comparison with larger enterprises)
- Too high administrative burdens
- Unclear jargon used
- High qualification levels and required certification
- Financial guarantees required
- Discrimination against foreign tenderers, in other words, favoring local and national enterprises
- Finding collaboration partners abroad

Source: European Commission DG Enterprise and Industry (2010)

From the business sector perspective, three broad categories of obstacles for SMEs could be identified: the bidding process and regulation, the size of the contract and lack of information. The empirical research arguments are in line with above-mentioned barriers identified by policy-makers. However, academic literature on public procurement market barriers is twofold. The major body of the research deals with the obstacles from the business sector perspective, however, it is worth mentioning the empirical investigation from the point of view of public tenderers. Preuss (2011) conducted empirical research to identify barriers for sourcing from SMEs as perceived by UK local government procurement managers. His study listed barriers in terms of restrictions arising from EU procurement directives, skill levels of devolved buyers, lack of information and resources among public tenderers, excessive bureaucracy and suppliers' perceptions that public contracts are difficult to win (Preuss 2011).

Studies that have examined the relationship between the size of firms and public sector tendering showed that "size, measured by employee number, significantly influences small and medium-sized enterprises' (SMEs) tendering resources, behaviour and success" (Flynn et al. 2013). Karjalainen and Kemppainen (2008) examined how availability of resources as perceived by companies influence SME involvement in the bidding process. Based on the survey results of 203 Finnish SMEs, they demonstrated that companies facing a lack of IT, legal, administrative and supply capacities are less likely to become public sector suppliers. As expected, the perceived lack of legal and administrative resources prevented SMEs from participating in public procurement tenders, and micro-firms were shown to be more vulnerable to the lack of resources. SME involvement in public procurement was higher for Finnish SMEs using electronic processing of orders and invoices. On the other hand, there is empirical evidence that SMEs perceive the public procurement market to be attractive for their business for a range of benefits including long-term growth opportunities or raising reputation.[3] Based on a survey of SMEs in the

[3] Flynn et al. (2013) offer a literature review.

UK, Loader (2005) listed perceived benefits in terms of certainty of payment, speedier payment and security over the long term. However, SMEs perceived serious obstacles to their engagement in public procurement, where major barriers included lack of awareness of opportunities, difficulty in getting on the approved supplier list, lack of knowledge of the procurement process, and lengthy and complex tendering process (Loader 2005).

3 Assessing Public Procurement: Model and Survey Applied

The existing literature is focused on the role, barriers to and benefits of SMEs' involvement in public procurement. The interest in SMEs stems from the fact that about 98 % of companies in the EU are SMEs (corresponding to the share of SMEs in the total number of Croatian companies as well[4]), and because of the policy goal to increase SMEs' involvement as public suppliers. In assessing business attitudes towards the public procurement system, this chapter builds on the empirical literature regarding the company size, and adds the supplier business sector as an underexplored but possibly significant characteristic of respondents (Flynn et al. 2013). The model also differentiates between principal contractor and subcontractors as shown in Fig. 1.

The developed model therefore fills the gap in the research body on "how SME characteristics influence ability and willingness to tender", as suggested by Flynn et al. (2013). They proposed to extend future empirical investigation to variables other than company size, such as business sector, and to include large companies into the analysis. Here the experience and attitudes of firms towards public procurement practices in the new EU member state of Croatia are explored so this chapter may serve to test the previous findings in jurisdictions other than the old EU and Western-type developed countries.

Based on Morand's observation on the disproportional participation rate of prime contractors versus subcontractors in the public procurement market (Morand 2003), the model distinguishes between direct supplier and subcontractor. It is posited that incentives and problems associated with public procurement differ significantly between companies that negotiate in the bidding process on their own and companies that are engaged as subcontractors after the public contract has been awarded.

We use data on Croatian companies collected in a specially designed cross-sectional survey conducted in April 2013.[5] In developing the core questionnaire, we

[4] In 2012, out of 97,254 companies in Croatia, 99.6 % were SMEs: 98.3 % were small and 1.3 % were medium-sized companies (CEPOR 2013).

[5] The authors would like to thank Transparency International Croatia for supporting the survey fieldwork conducted by the Promocija Plus agency which supplied us with the original database for this research. The survey tool development and interpretation of the results remain the authors' responsibility only.

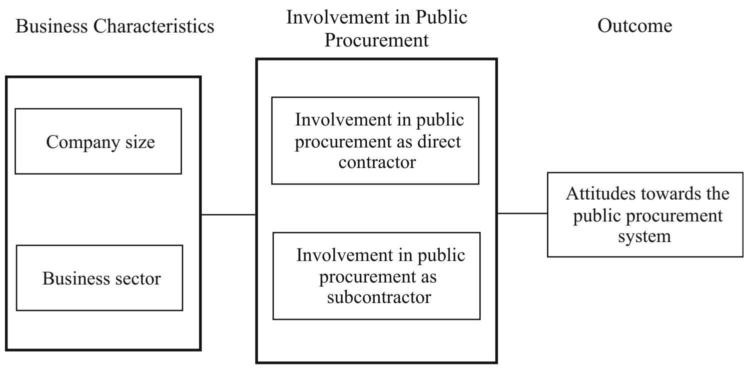

Fig. 1 Conceptual model

borrowed from available similar surveys (OECD 2007; PPDA 2010; EC 2007; Tátrai 2010) and customized the survey to capture the public procurement issues we consider specific for Croatia.

The target population includes active businesses of all sizes. The stratified sampling procedure is applied with company size, region and business sector as control variables. There were 3 categories for company size (small, medium, large), 6 categories for region (Zagreb region, Northwest Croatia, Central and Mountainous Croatia, Slavonia, Dalmatia, Istria and Croatian Littoral) and 15 categories for business sector according to the NACE Rev. 2 classification, where sectors omitted from the sample were sectors considered not participating in public tenders (Table 2). The total net sample size is 300 Croatian companies, where the share of SMEs is 90 % (Table 1). The sampling procedure combined stratified sampling and quota sampling, where the stratification variable is participation/non-participation in public procurement tenders. Namely, the sampling was conducted by first randomly selecting 200 companies and then filling the rest of the sample with 100 companies that had participated in public procurement tenders. The sample includes medium and large companies above their share in the national economy because it is assumed that larger companies are more eligible to participate in the public procurement market (Table 1). The survey was administrated through telephone interviews.

The business profile of the companies shows the prevalent orientation towards the domestic market: for almost 80 % of the respondents, the principal sales market is the national (Croatian) market, a further 10 % mainly operate on the regional market of neighboring countries, and the remaining 10 % export to the EU or the global market. Most of the companies surveyed (63 %) are from construction, services, and wholesale and retail trade sectors (Table 2).

Regional representativeness of the sample (Table 3) shows that 39 % of the respondents are from the Zagreb (capital city) region.

Table 1 Respondents by number of employees

Number of employees[a]	Number of respondents/ companies	Structure, as % of total	Structure of companies in Croatia, in % of total number of companies[b]
1–10	11	3.7	
11–20	14	4.7	
21–50	139	46.3	
Small	164	54.7	98.3
51–100	64	21.3	
101–250	41	13.7	
Medium	105	35.0	1.3
251–500	18	6.0	
Over 500	13	4.3	
Large	31	10.3	0.4
Total sample	300	100.0	

[a]As on December 31, 2012; [b]*Source*: CEPOR (2013)

Table 2 Respondents by sector of business activity

Business sector[a]	Number of respondents/companies	Structure, as % of total
C—Manufacturing	15	5.0
D—Electricity, gas, steam and air conditioning supply	13	4.3
E—Water supply; sewerage; waste management and remediation activities	13	4.3
F—Construction	68	22.7
G—Wholesale and retail trade; repair of motor vehicles and motorcycles	49	16.3
H—Transporting and storage	12	4.0
I—Accommodation and food service activities	5	1.7
J—Information and communication	12	4.0
K—Financial and insurance activities	5	1.7
M—Professional, scientific and technical activities	10	3.3
N—Administrative and support service activities	9	3.0
P—Education	2	0.7
Q—Human health and social work activities	12	4.0
R—Arts, entertainment and recreation	2	0.7
S—Other services activities	73	24.3
Total sample	300	100.0

[a]According to the NACE Rev.2 classification

Table 3 Respondents by region

Region	Number of respondents/ companies	Structure, as % of total
Zagreb region	116	38.7
Northwest Croatia	27	9.0
Central and Mountainous Croatia	24	8.0
Slavonia	36	12.0
Dalmatia	53	17.7
Istria and Croatian Littoral	44	14.7
Total sample	300	100.0

The questionnaire consists of 37 questions.[6] The structure of the survey enabled us to differentiate experiences of Croatian companies that have participated in the public procurement tenders directly as principal contractor and those that have participated as subcontractors. For both groups of participants the study identified main reasons for not participating and not being awarded a contract. The business opinion on the public procurement system procedures and regulations has been assessed as well, providing insights into the business perceptions on main public procurement principles: accountability, effectiveness, value for money, integrity and achieving the EU standards. Special attention has been dedicated to the assessment of corruption risks in public procurement.

The survey data were analyzed by means of descriptive statistics techniques and Chi-square test, and the results are presented in the following section.

4 Empirical Evidence: A View from Within

Out of the total 300 companies surveyed, over the last 5-year period 75 % have competed in public procurement tenders as a direct supplier, with a significant success rate (93 % of participants were awarded a public contract), and above one-third of the surveyed companies have participated as subcontractors.

The structure of the competitors in public tenders shows a prevalence of small companies. Almost half of the participants in public procurement tenders were companies with less than 50 employees (Table 4). The participation rate is evenly distributed among small, medium and large companies regardless of their role as direct suppliers or subcontractors. There is a statistically significant difference in structure by size between those companies that participated in public procurement as direct contractors and those that did not. There is a considerably larger share of small companies among non-participants than among participants in public procurement as direct contractors (71.6 % vs. 49.1 %). Both medium and large companies are more prevalent among participants in public procurement as direct

[6] The questionnaire is available from the authors upon request.

Table 4 Public tender participants by size of company

Business size	Participated as a direct supplier/contractor (%)[a]		Participated as a subcontractor (%)[b]	
	Yes (n = 226)	No (n = 74)	Yes (n = 108)	No (n = 192)
Small	49.1	71.6	48.2	58.3
Medium	38.5	24.3	38.0	33.3
Large	12.4	4.1	13.9	8.3

[a]Chi-square: 12.1124, df = 2, p = 0.002344
[b]Chi-square: 3.79945, df = 2, p = 0.149615

Table 5 Public tender participants by sector of business activity

Business sector	Participated as a direct supplier/contractor (%)[a]		Participated as a subcontractor (%)[b]	
	Yes (n = 226)	No (n = 74)	Yes (n = 108)	No (n = 192)
C—Manufacturing	4.0	8.1	3.7	5.7
D—Electricity, gas, steam and air conditioning supply	5.3	1.4	6.5	3.1
E—Water supply; sewerage; waste management and remediation activities	4.9	2.7	1.9	5.7
F—Construction	27.9	6.8	37.0	14.6
G—Wholesale and retail trade; repair of motor vehicles and motorcycles	16.4	16.2	9.3	20.3
H—Transporting and storage	4.4	2.7	5.6	3.1
I—Accommodation and food service activities	0.4	5.4	0.9	2.1
J—Information and communication	4.4	2.7	4.6	3.7
K—Financial and insurance activities	0.9	4.1	0.0	2.6
M—Professional, scientific and technical activities	2.2	6.8	4.6	2.6
N—Administrative and support service activities	3.5	1.4	1.9	3.7
P—Education	0.0	2.7	0.0	1.0
Q—Human health and social work activities	2.7	8.1	0.9	5.7
R—Arts, entertainment and recreation	0.9	0.0	0.0	1.0
S—Other services activities	22.1	31.1	23.1	25.0

[a]Chi-square: 45.0003, df = 14, p = 0.000041
[b]Chi-square: 37.7889, df = 14, p = 0.000561

contractors when compared to non-participants (38.5 % vs. 24.3 % for medium-sized companies; 12.4 % vs. 4.1 % for large companies).

The large share of SMEs in public tenders in Croatia and especially the important participation of small enterprises indicate that small companies (up to 50 employees) play an important role in the Croatian economy and that they could be considered relatively "big" for Croatian standards.

With regard to the business sector of the competing companies, the largest share of participants comes from the construction sector, followed by services and trade (Table 5). Companies originating from the service sector equally participated as direct suppliers and subcontractors (about 22 %). Differences have been observed in the case of construction companies, with a prevalent share of subcontracting suppliers, while trade companies prefer to compete directly. This result is expected since construction bids are more complex and require a range of specific work that might be more effectively contracted and performed by specialized suppliers engaged as subcontractors. In the case of wholesale trade, one supplier can more easily offer the entire quantity of goods.

There are statistically significant differences both for direct contractors and for subcontractors in structure by business sector between participants and non-participants. The most striking difference is evident for companies from the construction sector. They have a much larger share in the participant group, both for direct contractors and for subcontractors.

Reluctance to Participate The main reason for not participating in public tenders as a potential direct supplier and/or subcontractor is not offering goods or services purchased by the public sector (Table 6). The remaining reasons could be grouped in three categories: no capacity, no interest and no trust, and each group of reasons calls for a different policy response.

Besides companies that are actually not eligible for public tenders, over 5 % of potential subcontractors declared they compete exclusively as a direct supplier. Companies indeed prefer to get the principal contract and this fact contributed to the total of 18 % of "no interest" reasons reported by potential subcontractors. As expected, lack of resources in terms of human and other capacities is the second major reason for not participating in tenders as a direct supplier. As for subcontractors, a perceived lack of capacities is not so important a reason for not participating in public tenders.

Companies having no interest or lacking capacity to participate in public procurement are worth considering by public procurement policy-makers; however, having no trust in the regularity or fairness of procedures is worrying. One out of ten reasons for not participating in public tenders is bad past experience or belief that public contracts are not transparently awarded. Additionally, informal payment or counter-favor asked to get the subcontract was reported by potential subcontractors.

Table 6 Reasons for not participating in public procurement as a direct supplier and/or subcontractor

Main reasons for not participating in public procurement tenders	Direct supplier (n = 74), % of all reasons listed	Subcontractor (n = 192), % of all reasons listed
Not eligible	48.3	36.0
No interest	11.4	18.2
No trust	10.1	10.8
No capacity	13.8	5.9
Corruption	0	1.0
Other/don't know/don't remember/ no answer	16.4	28.1

Table 7 Satisfaction with particular aspects of public procurement

	Dissatisfied (%)	Satisfied (%)
Price level achieved	36.4	34.4
Tender deadlines	10.5	71.3
Clear tender documentation	8.6	73.2
Transparency of procedure	7.7	72.7
Contract deadlines	5.7	78.0
Openness of the tender to competitors	5.3	76.1
Availability of the tender information	1.9	86.1

Dissatisfied = fully dissatisfied and mostly dissatisfied; Satisfied = completely satisfied and mostly satisfied
[a]Respondents that were awarded contract in at least one public procurement tender (n = 209)

This makes corruption one of the reasons why some companies are excluded from the procurement market.

Evaluation of Procurement Procedures as Experienced by Participants The level of satisfaction with selected components of procedure (Table 7) helps in identifying the potential corruption risks related to the public procurement procedures. Actually, companies that were awarded public contracts express most dissatisfaction with the price achieved and tender deadlines, which are two components not directly related to corruption risk. The majority of companies (about two-thirds) is satisfied with the transparency of procedure and considers the tender documentation clear. This business opinion stands in favor of low corruption risk in the public procurement procedure, at least for those companies that were successfully awarded a public contract.

From the point of view of companies that have not been successfully awarded, the public procurement decision was influenced by unfair and illicit behavior in terms of designing the tender for a pre-selected contractor (39 % of responses) and by “too much bribery and corruption” (7.7 %). The corruption-related reasons, however, make up less than half of all reasons (46 %) and could be attributed to the frustration of companies that lost in the bidding process. The remaining one-third of companies admitted they failed due to objective reasons such as not fulfilling formal tender requirements, undergoing bankruptcy, or submitting a less competitive offer (Table 8).

The companies that were not awarded a public contract in 70 % of cases did not submit an appeal, mainly because they did not want to further waste resources on an appealing process with an uncertain outcome (Table 9). Some respondents think there is no point in submitting an appeal because nothing would change, or they have no evidence to claim irregularities. Few respondents think that submitting an appeal would jeopardize their future business.[7]

[7] The results presented in Tables 8 and 9 should be taken as an indication of potential issues only because of the small subsample (n = 13).

Table 8 Reasons for not being awarded a public contract, in the opinion of companies participating in public tenders as a direct supplier/contractor (n = 13)

Reasons	Structure (%)
The tender was designed to suit known future contractor	38.5
We did not fulfil formal tender requirements	15.4
Don't know	15.4
Our offer was not competitive	7.7
We are awaiting the results of a current tender we are participating in as a direct supplier/contractor	7.7
We were not aware of the fact that we could not participate because our company is in bankruptcy	7.7
Too much bribery and corruption	7.7

Table 9 Appeals submitted against the decision on public tender results, companies that were not awarded a contract as a direct supplier/contractor (n = 13)

Appeals submitted	Structure (%)
No, we didn't want to waste further resources on the appeal process	30.8
Yes, and we are satisfied with the outcome of the appeal (decision cancelled, etc.)	15.4
No, an appeal would not change anything	15.4
No, we didn't have solid evidence to submit an appeal	15.4
No, submitting an appeal would jeopardize the business prospects of our company	7.7
Don't know/don't remember	7.7
Refuse to answer	7.7

Table 10 Ways of getting subcontracts in public procurement (n = 108)

How the subcontract was awarded	Structure (%)
Due to the previous successful business relationship with the contractor	49.1
We had agreed cooperation and business deals in advance if the principal contract was signed	17.6
Our company ensured the subcontracting by informal channels	14.8
Because our company is doing business in the particular region	0.9
Due to the best price we offered	0.9
Don't know/don't remember	16.7

Getting the subcontract in public procurement is attributed to a track record of successful business relations with the principal supplier (according to 49 % of respondents). In some cases it is the result of their pre-agreed cooperation with the principal supplier in the event that they are awarded the public contract. Around 15 % of subcontractors ensured the deal by informal channels and less than 2 % won due to pure competitive advantage, either because of the best price or regional presence (Table 10).

Evaluation of Procurement Procedures as Perceived by the Business Sector Evaluation of procurement procedures by companies that have participated in public procurement and have experienced the system from the inside does not necessarily match the business sector perceptions on the public procurement system. Figure 2 presents the attitudes of companies in Croatia towards a set of public procurement procedures and regulations. All statements have been evaluated on the 5-point Likert scale (from 1—fully disagree to 5—fully agree).

The empirical data do not confirm the anecdotal evidence on the high prevalence of corruption in public procurement in Croatia. Companies most strongly disagree

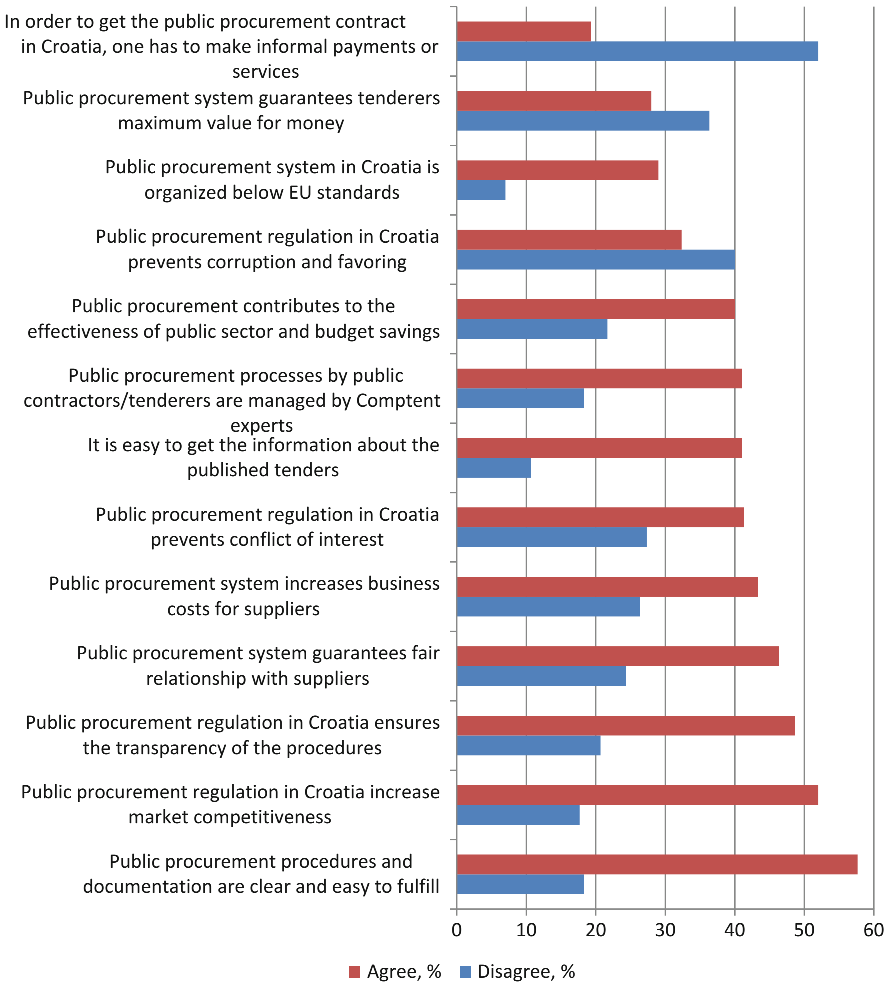

Fig. 2 Attitudes towards the system of public procurement procedures and regulations (n = 300). *Note*: Disagree = fully disagree and disagree; Agree = fully agree and agree

with the statement that one has to make informal payments or render services in order to get a public contract. However, the system itself does not prevent or stipulate corruption and favoring, but it prevents a conflict of interest. Transparency, availability of information, clear and well-prepared documentation, as well as market openness are seen as the advanced features of the public procurement system. The public procurement system promotes budget savings and it is operated by competent staff. The survey pointed out the weaknesses of the system as well. It increases business costs for suppliers that might, however, be compensated by ensuring a fair relationship with the contractor. From the business point of view, one of the most important principles of public procurement—the best value for money—is not guaranteed (Fig. 2).

In the context of the recent EU membership, companies were asked to compare the national public procurement system with the EU standards and around 40 % of respondents answered "don't know" (Table 11), while almost 30 % think that the public procurement system is organized below the EU standards. Such a large share of "don't know" answers might be explained by the rather large share of respondents operating primarily on the national market so they lack experience in EU public tenders. This might change in due course with increased participation of Croatian companies in the EU market; however, it is too early to conclude whether the recent EU integration will result in this kind of benefit for the Croatian business sector.

Taking into account the specifics of the national public procurement system, the survey investigated the perceived prevalence of irregularities among different types of public tenderers. Twelve types of contractors have been differentiated, most of them being obliged to publish public tenders (NGOs were included in the survey for their presumed transparency and fair policies). Table 12 indicates that local governments run public procurement with significant irregularities, according to the opinion of 29 % of respondents. Malpractices in procurement are widespread in public companies (15 % of respondents), followed by ministries. The case of ministries is interesting because these are the public tenderers simultaneously seen as the best performing (18 % of respondents) and as the worst performing tenderers (12 %). A possible explanation is that different companies, depending on

Table 11 Respondents unable to express their attitudes due to lack of knowledge/information about public procurement procedures and regulations (n = 300)

Selected statements with *Don't know* answers given by more than 10 % of respondents	Don't know (%)
The public procurement system in Croatia is organized below EU standards	44.0
Public procurement contributes to the effectiveness of the public sector and budget savings	14.0
The public procurement system guarantees tenderers maximum value for money	11.3
In order to get a public procurement contract in Croatia, one has to provide informal payments or services	11.3
Public procurement processes by public contractors/tenderers are managed by competent experts	11.0

Table 12 Prevalence of irregularities by type of public contractor, perceptions in % of total respondents (n = 300)

Public contractor/tenderer	Least irregularities	Most irregularities
Ministries	17.7	11.7
Pre-schools, primary and secondary schools	14.3	1.3
Non-governmental organizations and civil society organizations	7.3	0.0
Local government (counties, towns and municipalities)	6.7	29.3
Public companies	4.7	15.0
Courts and other judiciary bodies	4.3	2.0
Health sector (public hospitals, etc.)	3.7	3.7
Government of the Republic of Croatia	3.0	3.0
Cultural institutions	3.0	0.3
Public universities, research institutions	2.3	0.3
Croatian Parliament	1.7	2.0
Media	0.3	0.7
Don't know/not sure	30.7	30.0
Refuse to answer	0.3	0.7
Total	100.0	100.0

the sector in which they operate, have different experiences with particular ministries, so one ministry might be evaluated as performing well and another as performing poorly. Pre-schools, primary and secondary schools are clearly at the top of the "clean" tenderers. As 30 % of the respondents could not evaluate public tenders, the remaining tenders on the list were not the subject of evaluation (less than 5 % of positive or negative ratings).

5 Chapter Summary

The empirical assessment of Croatian companies' attitudes and experiences in public procurement has indicated some points worth discussion and further research. First, it seems that low participation of SMEs in the public procurement market is not as big an issue in Croatia as it is in the EU and larger national economies, where it represents a major policy concern. Moreover, the relative presence of small companies in public tenders shows there is an opportunity for small enterprises to grow bigger through public investments. As far as obstacles in the public procurement system are concerned, limited human and other resources prevent companies from participating in tenders as direct suppliers and this is in line with other empirical studies and EU procurement policy concerns. From the business point of view, one of the most important principles of public procurement—the best value for money—is not guaranteed in Croatia. This implies that policy-makers might want to consider placing greater emphasis on the so-called "economically best offer" criterion instead of the widely accepted (and easier to implement) criterion of the lowest price. The implementation of the "economically best offer" criterion, however, should not be an issue for the tenderer, although it implies more expert knowledge, because in the opinion of the business sector, the public procurement system is operated by competent staff, and this is seen as a differentiating advantage of the Croatian system if compared to the experience in other countries (Preuss 2011).

The results confirm two hypotheses, the first one on the existing differences in attitudes between direct suppliers and their subcontractors and the second one that, at least according to the opinion of the business sector, the Croatian public procurement system is performing below the EU standards. The empirical data, however, do not confirm the anecdotal evidence on the high prevalence of corruption in public procurement in Croatia. The lack of trust, as one of the mentioned reasons for not participating in public tenders, might be related to the perceived irregularities. This and the "no interest" reason deserve future investigation by conducting case studies. The assumption that bidding documentation is pre-designed to favor certain companies was not covered by this large-scale survey and remains to be further explored as well. In Croatia it might sooner be the case of "rigging" the tenders, where the bidding requirements are adapted to suit the personal needs of the final user, that is, the manager working with the public tenderer. This kind of empirical evidence at the micro-level would shed light on the failures of the procurement system and help to improve the system and to reinforce trust. Those public institutions that are perceived by businesses as performing irregular public procurement practices should build their reputation by promoting business ethics principles more clearly in their everyday activities.

The research presented in this chapter contributes to the limited knowledge on companies' opinions and evaluation of the public procurement system. It empirically assesses the various attributes of the public procurement in a transition country that has undergone significant changes in the process of very recent accession to the EU. Therefore, the findings and policy implications derived would be instructive for scholars and practitioners in the Western Balkans region and other transition economies.

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The Role of Higher Education in a Knowledge Economy

Sabina Đonlagić and Adil Kurtić

Abstract Governments all over the world are striving towards high-skilled and high value economies. Traditional factors of production are no longer considered to be the only contributors to economic development and growth. According to recent theories of development, knowledge has become an important factor for achieving economic development. In order to achieve these goals, a well-educated and highly skilled workforce is necessary. A knowledge economy has increased the demand for a highly educated workforce, especially a workforce with university degree. According to the Lisbon 2020 agenda—the EU development strategy—the EU is striving towards developing a knowledge economy, a sustainable economy based on employment, innovation and education. As Bosnia and Hercegovina (B&H) in the process of European integration, the country should reconsider its economic policies. However, a shift in the economic policy in this country is necessary, not only due to reasons mentioned, but also due to the fact that the current economic situation requires new policies and approaches. Endogenous growth models suggest that a country develops along its own growth path including knowledge or human capital in the model. The development of a knowledge economy in B&H might be the solution to its economic and social problems as well. In order to compare countries and knowledge economy development, the World Bank developed a framework and identified key knowledge economy pillars: education and training, research and innovation, economic incentives and institutional regime, ICT and infrastructure. Education, especially higher education, is important for knowledge economy development. Higher education institutions are import for the creation, dissemination, knowledge transfer, and spillover of knowledge to the industry.

Therefore, this chapter is aiming to determine whether higher education in B&H can be a main contributor and driver of knowledge economy development. The results presented in this chapter have been obtained through empirical research, which has been conducted in B&H in 2012 on a sample of 120 medium and large enterprises and all of the state funded higher education institutions in B&H. The results of our research as well as conclusions and recommendations for further action have been elaborated in this chapter.

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_6

1 Education and Higher Education as a Driver of the Knowledge Economy

The relevance of knowledge, innovation and technology for economic growth has significantly increased in the past few decades. The nineteenth century industrial revolution and twentieth century scientific revolution contributed greater importance of knowledge for economic development. Foundations of the knowledge economy can be found in new growth theories during the late 1950s. During this period of time, Drucker (1998a, b) introduced the term 'knowledge economy' that emphasised the relevance of knowledge and technology for economic growth and development. New growth theories are based on work by Romer (1989, 1994) or Solow (1956). For example, endogenous growth theory holds that economic growth is primarily generated by endogenous factors such as human capital, innovation and knowledge. The model developed by Romer is considered to be the foundation of the knowledge economy. A knowledge economy is an economy directly based on production, distribution and utilization of knowledge and information as fundamental enablers of growth, wealth creation and employment.

Contemporary economies have been undergoing major structural changes and adaption to rules of the knowledge economy, for example output and employment in the 'high tech' sector has been increasing in developed economies in the past decade or so. But a knowledge economy cannot be developed without an efficient and modern education system. At the 2012 Bologna Process ministerial Conference (EACEA 2012) it was stated in the Ministerial Communiqué that "higher education is an important part of the solution to current difficulties. Strong and accountable higher education systems provide the foundations for thriving knowledge societies. Higher education should be at the heart of our efforts to overcome the crisis-now more than ever."

Higher education can contribute to an economy's increased competitiveness. Higher education has become an important factor of the Lisbon Strategy and Europe 2020 strategy, which are aiming to develop Europe as the world's most competitive knowledge economy. The education system in a knowledge economy plays a key role in generating conditions for investing in creation and utilization of new knowledge and technologies which are crucial for increasing productivity and achieving economic growth. Many economists emphasise the importance of education, particularly tertiary education in a knowledge economy because of the role of higher education institutions in the creation and transfer of new knowledge. Therefore, OECD countries invest approximately 12 % of their budget into education.

A well educated work force with adequate competencies, skills and knowledge is important in a knowledge economy given that changes in work structure have contributed to increased demand for educated workers. Higher education institutions in a knowledge economy are expected to enable the acquisition of knowledge and development of skills needed in the business world. Increased demand for higher educated workers is expected to continue in the future and higher education institutions must adequately cope with this challenge. In OECD countries the average unemployment rate of individuals with lower levels of education is higher that unemployment rate of individuals with tertiary education. According to the OECD's "Education at Glance 2013" (p. 80) individuals with upper secondary education were most affected by unemployment during crisis period from 2008 (12.6 % unemployment rate). However, the unemployment rate of individuals with a tertiary education increased during this period but by a much smaller margin (4.6 % unemployment rate). The knowledge economy is characterised by increased demand for individuals with higher levels of education, which has negative effects on the labour force that has lower qualifications. The OECD 'Job study' indicated that there was a polarisation of the labour force on the labor market and a gap has been identified between labourers with lower and higher levels of education and qualifications (OECD Job study, p. 31). Individuals that enrol in education institutions today will be part of the labour force of the future and therefore they are expected to demonstrate skills and competencies which will be needed in the years to come. Scientists believe that knowledge doubles every 7 years, which means that knowledge acquired by individuals during the first year of study will be outdated by the time they finish their education. Therefore, education institutions need to provide students with knowledge and enable them to develop skills that are relevant today and which will enable them to adapt to changes in the real world.

Knowledge and skills that are acquired through education programmes must be recognised as a source of development of competitive advantages in a country. The education system is therefore important for an economy and needs to be supervised, adapted and developed by the government. Recent OECD studies indicate that an educated labour force can be important for attracting foreign direct investments. An educated labour force and application of new technologies lead to increased productivity. According to the International Labour Organisation (ILO), 1 additional year of education above the average level of education in a country can increase labour productivity from 5 to 15 %. Increased productivity can also contribute to country's attractiveness for potential foreign investors. The findings of these studies are particularly important for (small) transition countries, such as B&H, which are struggling to attract new investors.

Regardless of its development level any country can become a knowledge economy, but investing in education, the development of new knowledge, skills and competencies is the foundation of knowledge economy development (Fig. 1).

According to research, knowledge workers or an educated labour force generate approximately 60 % of production. Furthermore, empirical studies have shown that there is a positive correlation between skilled workers, an educated labour force and economic growth. The studies also showed that university graduates find jobs more easily and in a shorter period of time compared to workers with lower education levels, and these benefits reflect on economic growth in general. An effective and productive education system is fundamental for knowledge economy development. Knowledge, the accumulation of knowledge and their effects on productivity cannot be separated from an adequately developed education system. Education

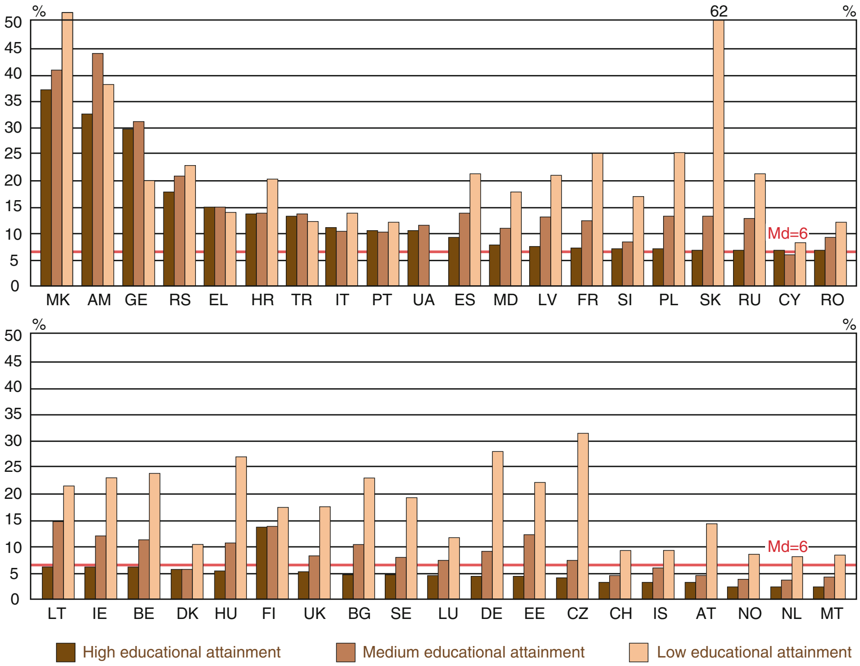

Fig. 1 Unemployment ratio of people age 20–34 by level of education in EHEA (*Source*: The European Higher Education Area in 2012: Bologna Process, Implementation report, p. 115)

institutions must enable a knowledge flow between individuals, organisations and companies through better academy-business cooperation.

B&H is currently facing socio-economic problems which are mainly high unemployment, unfavourable unemployment structure, unfavorable economic performance and uncompetitive economy. The main question remains as to how does this country achieve economic growth? For B&H, developing a knowledge economy might represent the right path toward economic growth and development, a path many developed countries have already chosen. The country has an unemployment rate of nearly 50 % (over 500,000 unemployed people) while over 350,000 are with no or with low qualifications, and over 12,000 have only secondary education. Over 90 % of all unemployed people are individuals with lower levels of education and skills and with almost no perspective of being employed in the near future. According to the Bologna Process Implementation Report 2012, unemployment ratios provide information on the value of tertiary education degrees.

Generally speaking, the higher the education levels the lower the unemployment rate. In other transition countries, unemployed individuals also mostly have lower levels of education and skills, but their governments have been allocating more funds into education. Having this in mind, it is no wonder that B&H has been dealing with the continuous fall of foreign direct investments in the past years which can partially be explained by high labor costs and a ‘low productivity labour force’ with almost no knowledge and skills needed by employers or potential (foreign) investors. The World Bank Business Environment and Enterprise performance report also confirmed that one of the main obstacles identified by business owners is the lack of adequate knowledge and skills. According to studies conducted by The European Bank for Reconstruction and Development, in the past 5 years attitudes of enterprises regarding the main obstacle for further development has changed. In 2008 it was the lack of an adequate labour force; today it is the lack of a labour force with adequate knowledge and skills.

The results of World Bank Business Environment and Enterprise performance survey (BEEPS) are presented in Graph 2 and thus it can be concluded that approximately 30 % of enterprises indicated that education and skills are the main obstacles for the further development of enterprises. This obstacle was identified as the most important by enterprises from middle-income community of independent states and South-Eastern Europe, while other obstacles have been identified as most relevant in EU countries. Due to the fact that B&H is striving towards membership in the EU and more significant economic growth, its productivity can only be increased if students are well educated and posses adequate skills, competencies and knowledge. As already mentioned, studies also show that transition countries investing in education and a skilled and well educated labor force can act as a magnet for investors which are needed to enable economic growth.

Universities play a crucial role in creating and transferring knowledge. In developed knowledge economies, universities have had a major role in supporting innovation and knowledge creation. Universities have an important role in the research and innovation process and are considered to be a center of the mentioned processes and therefore an important partner to the business sector. However, in order to be able to fulfill its role as an important factor in the knowledge economy, developing governments must create an adequate framework for higher education institutions.

2 Determining Key Factors for Knowledge Economy Development in Bosnia and Hercegovina

As explained earlier the main goal of our research was to identify the key factors for knowledge economy development in B&H and to establish a model for knowledge economy development based on these results. In this chapter we will only present a part of this research and our findings regarding the identification of key factors which are important for understanding of our research chapter. For this purpose an examination using a questionnaire was conducted on a proportionately stratified sample of 150 middle and large enterprises. The questionnaire was divided into six parts each using the four economic pillars (knowledge economy inputs, independent variables) and the knowledge economy outcomes/results (dependent variable).

Table 1 Criteria and procedures for selection and evaluation of factors

Components of factor analysis	Significant values	Justification
Value of KMO	Higher than 0.5	Acceptable in social sciences
Type of rotation	Varimax	Most commonly used type of rotation
Factor weight	0.5 and higher	The higher the factor weight the more representative is the variable
Eigenvalue	Higher than 1.00	Usual criteria for factor determination
Number of items	3	Min. number of items necessary

The data collected through the questionnaires was summarized and prepared for statistical analysis using adequate software. Factor analysis was used to identify key factors for knowledge economy development in B&H. The criteria and procedures for selection and evaluation were in accordance with the standard criteria for social science research.

Bartlett's test of Sphericity and Kaiser-Meyer-Olkin Measure of Sampling Adequacy were used to evaluate the adequacy of the data for the factor analysis and the strength of the relation between the items. Based on these results, it was concluded that the factor analysis is justified in this research since the value of KMO is higher than 0.5 KMO = 0.602. The Bartlett's test of Sphericity is also statistically significant because of its value $\chi^2 = 6298.931$, $p = 0.0001$, $df = 1485$. Based on this criteria we concluded that it was justified to use the factor analysis for this research (Table 1).

Using the factor analysis and taking into consideration the criteria presented in the table (Fig. 2).

Based on the Scree Plot it can be concluded that the solution with six factors is appropriate. These factors, ranked by their significance, are:

1. Higher education and development of educational system
2. State regulative and environment
3. Use of ICT and ICT infrastructure
4. Investment in research and development
5. Training programmes for employees
6. Importance of development and innovation activities

The results of the factor analysis refer to the fact that education is very important for development of a knowledge economy in B&H and that the respondents were extremely unsatisfied with the level of development of the educational system. This is no surprise considering that the structure of work dramatically changes in the knowledge economy and that new and upgraded skills are required. In a knowledge economy, for example, the number of factory jobs or natural resources jobs decreases while the number of office jobs or jobs in health and educational sector increases. These changes will have the most affect on lower skilled workers and factory jobs. Therefore, governments and educational institutions should emphasise the importance of long-life learning programmes. This result is also in accordance

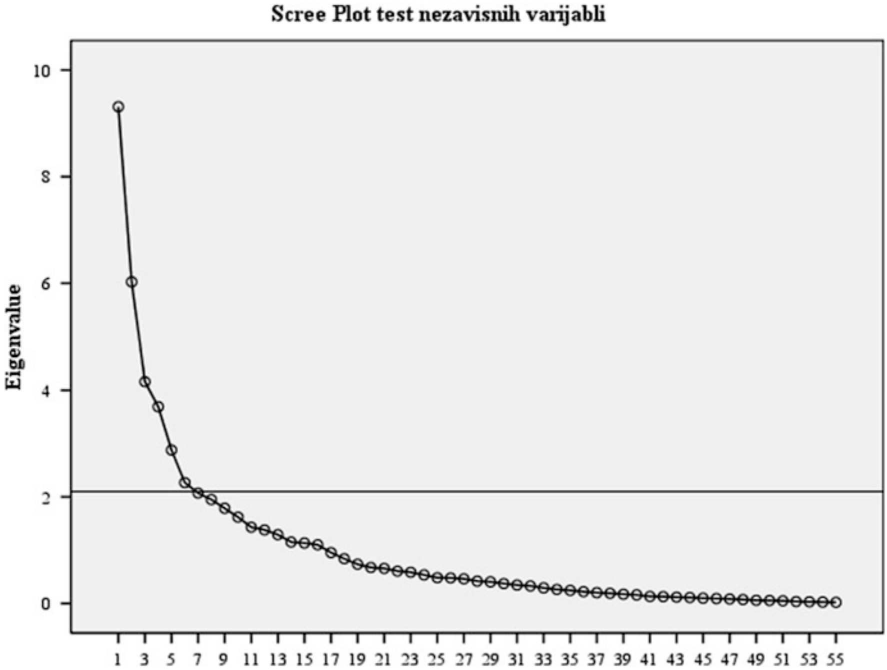

Fig. 2 Scree Plot test of independent variables (knowledge economy inputs)

to the findings of Cohen and Soto (2001) who determined the positive effect of education on economic growth of a country by comparing time series of countries to the average number of years of education.

The second most significant factor is the government and its incentives, which influence the economic activity and therefore the development of the knowledge economy. The third factor ranked by its significance is the use of ICT and ICT infrastructure. As explained earlier, the use and development of ICT can contribute to the improvement of productivity and better efficiency, but the results of the research point out the fact that the respondents were mostly indifferent towards ICT or think that the present state regarding ICT is sufficient.

The fourth factor extracted is investment in R&D where research results show that minor financial resources are invested in research and product development in the selected enterprises. The main reason for this is the economic and financial crisis, which affected the economy in B&H over the past couple of years. The fifth factor is programmes and training of employees. The results show that the selected enterprises insufficiently allocate financial funds into training programmes for employees, which is an obstacle to the adoption of new knowledge and its application. And the last factor is innovation and development activities. The low ranking of this factor indicates the decreased importance of knowledge economy development for the respondents. This result is fully in accordance with their view on research and development activities, which result in new ideas and innovated products, services or processes.

3 Readiness of Higher Education Institutions in Bosnia and Herzegovina to Enable Knowledge Economy Development

Our main goal during this research was to find out whether the tertiary education system in B&H could be a generator of knowledge economy development? In order to provide an answer to this question, we conducted research among state-financed higher education institutions in B&H as a part of wider research aiming to determine the possibilities of knowledge economy development in the country.

According to the World Bank's Knowledge Assessment Methodology (KAM) which is used to determine readiness of countries to develop a knowledge economy based on four pillars (government and incentives, education and training, ICT, infrastructure, R&D and innovation) B&H is ranked 70th out of 144 countries which are included in the KAM. Indicators for education and training have the highest values compared to indicators for other knowledge economy pillars. We compared these indicators to Denmark (the country with the most developed knowledge economy), Western Europe, Europe and central Asia. The most developed knowledge economy pillar in B&H is the education pillar with an 5.7 average score. As can be seen in Graph 4 B&H has the lowest values for selected indicators compared to others in the benchmark group. For the "Education and training" pillar, the following indicators have been selected: Adult literacy rate 6.16 (Denmark 10, Western Europe 9.2), Secondary education enrollment rate 5.0 (Denmark 9.86, Western Europe 9.2), Tertiary education enrollment rate 5.94 (Denmark 9.49, Western Europe 8.22). Even though B&H achieved the highest values for this pillar, if we compare these indicators in B&H to the benchmark group, it is obvious that its education system is far from being able to contribute to knowledge economy development (Fig. 3).

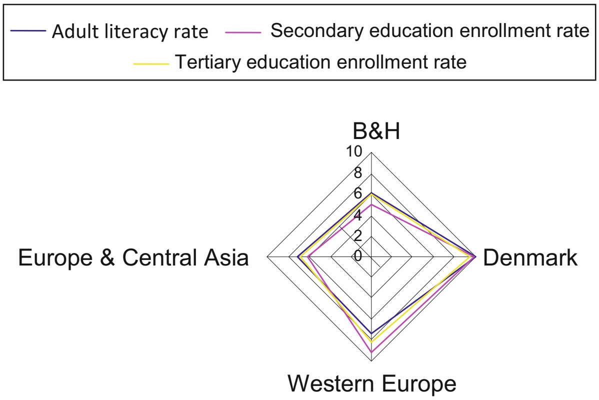

Fig. 3 KAM indicators for education and training (*Source*: World Bank, Knowledge assessment methodology, http://web.worldbank.org/WBSITE/EXTERNAL/WBI/WBIPROGRAMS/KFDLP/EXTUNIKAM/0,,menuPK:1414738~pagePK:64168427~piPK:64168435~theSitePK:1414721,00.html)

Today, the higher education system in B&H is coping with various problems and changes, such as an increased demand in higher education, the internationalization of education and research, decreased funding, the reorganization of knowledge, stakeholder relations and so on. Furthermore, higher education in B&H has been undergoing a reform process initiated by the Bologna reform even though it was not this process alone that pointed at the need for reform in higher education in B&H. The need for the academic community to act as a generator of socio-economic development also indicated the need for reforming tertiary education. Today, over 100,000 students are enrolled in university programmes in eight public and tens of private universities. A deeper analysis was conducted in order to determine the readiness of the tertiary education system for knowledge economy development. For this purpose a questionnaire was developed and structured accordingly. This research involved state-funded public universities due to the fact that over 80 % of all students are enrolled at these higher education institutions. There are eight state universities in B&H, six in the Federation B&H and two in the Republic of Srpska.

The mission and vision of a university are its foundation and encapsulate its goals and purpose. Universities must be aware of their mission and vision, which should not only relate to the educational and teaching process but also to research and its links to the community and economy as well. These statements are important communication channels to internal and external stakeholders of universities. When asked about their mission and vision statement, 87.5 % of universities stated that they have a documented mission and vision statement. However, at only 25 % of the universities were the employees sufficiently familiar with these statements. These results indicate that the relevance of institutions' mission and vision and its relation to institutions' goals, policies and plans is not recognised.

One of the main issues in B&H is the funding of higher education. During the past couple of years government(s) on all levels (state, entity, canton) have been constantly cutting funding for higher education institutions in B&H. This reduction of funds might cause serious and permanent damage to the education system in this country. The average budget of researched universities was 25 million KM (min. 10 million, max. 67 million) wherein 58 % were public funds and grants, approx. 39 % enrollment fees, 5 % revenues from collaboration with the business sector and the rest from other sources (projects, donations, etc). Evidently, universities are not significantly engaged in academy-business collaboration or R&D projects due to the fact that most of the universities' own revenues are generated from enrollment fees. Furthermore, most of the funds are spent on academic and non-academic staff. Insufficient funds are allocated on research and scientific work, which is an important aspect of university missions.

However, this problem prevails in the EU as well. According to Garben (2012) in times of economic crisis, higher education (even though it is a key factor in finding a way out of the crisis and creating a stable and competitive knowledge economy) seems to be the first area where budget cuts are made. While some EU countries such as Germany or France invested in higher education during times of crisis, most other EU countries have cut spending on higher education up to 30 %.

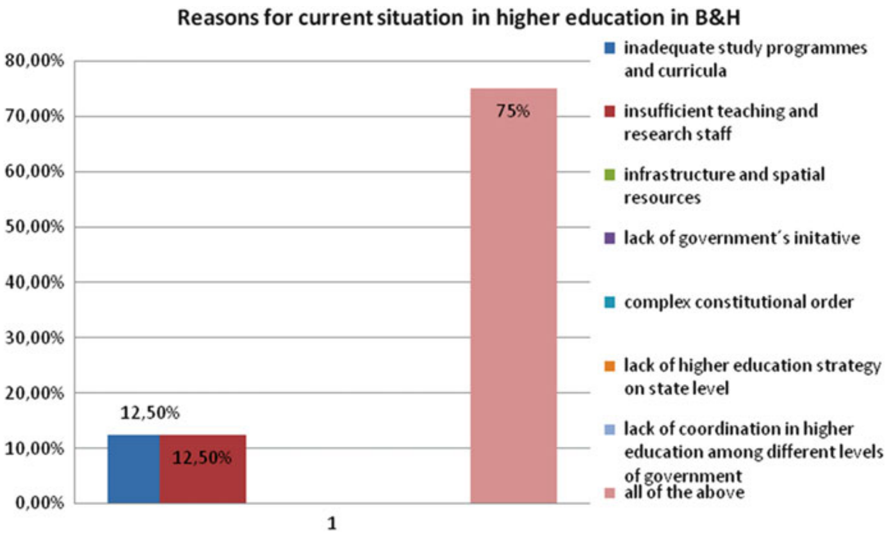

Fig. 4 Obstacles in tertiary education in Bosnia and Herzegovina

The legal framework for higher education is important in any country given that governments need to create preconditions for a functional education system, which will be able to fulfill its role in the economy and society. The legal environment must ensure academic freedom and development of science and research but also create preconditions for strengthening bonds with the economy. According to our research results, 50 % of universities assessed the legal framework and general environment for higher education institutions in B&H bad or very bad. Accordingly, 75 % of universities indicated that governments have not been undertaking the necessary steps for improvement in tertiary education. The constitutional order in B&H and jurisdiction of the higher education system at different levels influences the harmonisation of laws in higher education. The higher education framework law has created a legal framework at the national level for the modernisation of higher education in B&H in accordance with the Bologna process. Higher education laws on lower levels (federation and cantons) are not harmonised in a way in which would ensure a balanced development of higher education in the country. This legal framework is also important for establishing necessary infrastructure and institutions that are important for monitoring and developing higher education such as the national quality assurance agency (Fig. 4).

Even though the reform process in higher education started almost a decade ago, this reform cannot be considered to be successful. Two thirds of the universities have indicated that policy making in B&H in the field of higher education is bad or very bad. Accordingly, 75 % of universities stated that the education system does not meet its goals, does not contribute to the development of a modern society, and does not act as a generator of social, cultural or economic development.

In the survey, we examined the main obstacles to reform and the modernisation process in higher education in B&H. The summarised responses for this question are presented in Graph 5 and as it can be seen that 75 % of all questioned universities stated that all of the optioned answers are applicable (internal and external factors). These factors can be classified into two main groups: internal factors (organisational factors—study programmes, staff, procedures, etc) and external factors (environmental factors—government regulation, legal framework, etc).

In a knowledge economy it is very important that universities create an enabling environment for the creation and transfer of new knowledge to students and young researchers. During our empirical research we examined the key factors for knowledge economy development; we also examined the readiness of the higher education sector to act as a knowledge economy generator. In context of skills, knowledge and collaboration, we compared attitudes of universities and enterprises which were involved in the research. We ran a chi-square (χ^2) test to determine a statistically significant deviation of answers for these two groups of examinees. The reason why this research also included business enterprises is that universities must act socially responsible in the context of teaching students the skills and knowledge that is needed in the business world, they need to collaborate in R&D with the business sector etc. Furthermore, the relevance of higher education is increasingly understood in the context of economy and directed towards business aiming to strengthen the bonds with the real sector. Graph 6 presents answers of universities and enterprises in regards to the ability of universities to transfer adequate skills, competencies and knowledge to students (Fig. 5).

Students are educated in order to be able to compete on the labour market and the employability of graduates is very important for an institution. Higher education

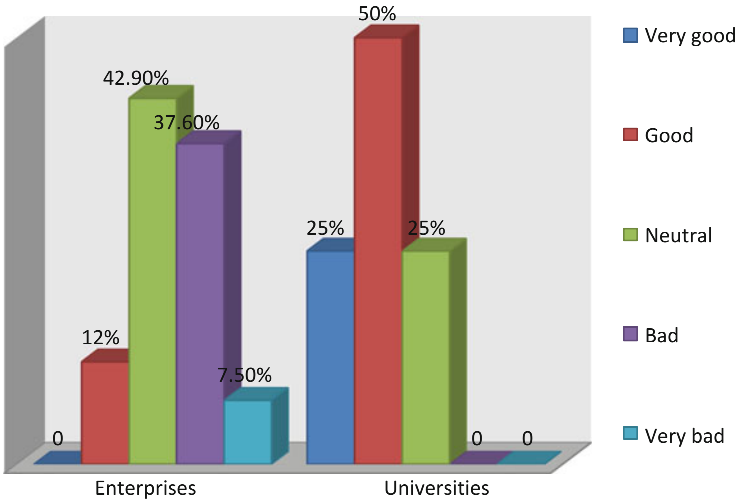

Fig. 5 Attitudes towards skills and knowledge of students at universities in B&H

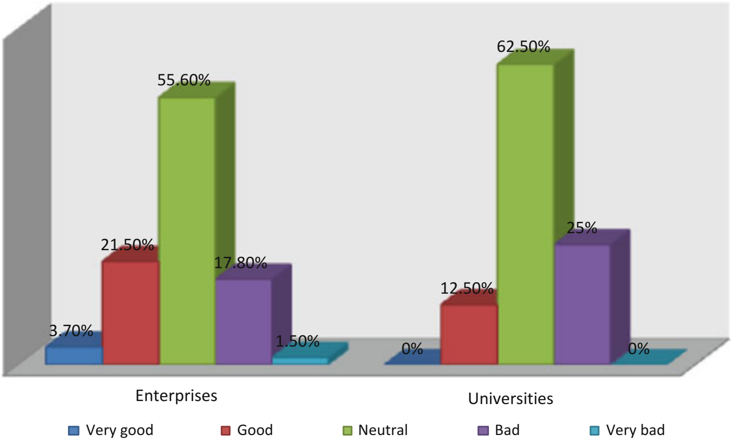

Fig. 6 Perceived quality of higher education institutions in B&H

institutions must enable students to acquire competitive knowledge and skills needed in the business world. However, as can be seen in Graph 5, answers provided by enterprises deviate significantly from those of universities. Employers indicate that the skills and knowledge of university graduates are not adequate.

However, results indicate that those universities are not able to involve all stakeholders when creating new study programmes and curricula, especially employers who are important external stakeholders. Furthermore, we investigated the perceived quality of universities and we were not surprised to get contrary answers from enterprises and universities in regards to the perceived quality of higher education institutions (see Fig. 6).

The transfer of knowledge and new technologies has also been investigated during our research. Academy-enterprise collaboration is indicated to be bad by 47.1 % of enterprises and 46.2 % of universities. Thus, cooperation and collaboration between academy and business sector must be improved in order to develop a knowledge economy. Research activities are very important in creating new knowledge. Universities play an important role in the national innovation system. But, the overall score for university R&D engagement efforts, research projects and generators of new knowledge is considered to be good by 62.5 % of universities even though only 25 % of universities indicated that they are currently satisfied with the level of scientific research at their institutions. However, in terms of results we analysed regarding research and R&D being a mid-term goal for universities, only one third of questioned universities indicated that strengthening scientific research would be a development goal in the next 5 years.

As already mentioned, during our research aiming to assess the readiness of B&H to develop a knowledge economy, various stakeholders needed to be included in this research. Some 150 middle and large companies in the real sector from all over B&H have been included in the stratified random sample for purpose of this research along with all state (government funded) universities in B&H. During our

Table 2 Chi-square test for two groups of examinees (business companies and universities)

Question	χ^2	Df	P
Fulfillment of goals of higher education system	2.884	1	0.089
Education policy is clearly and adequately implemented	0.206	1	0.650
Current development level of higher education in B&H	2.986	3	0.394
Investment in higher education and meeting of EU standards	7.315	3	0.063
Providing knowledge, skills and competencies	45.104	4	0.001
Ability to adopt to changes in environment	22.969	4	0.001
Quality of state HEIs	0.987	4	0.912
Quality of private HEIs	3.312	4	0.507
Transfer of new knowledge and technologies	1.568	3	0.667
Adequate study programmes and curricula	3.193	1	0.071
Graduates from state HEIs are competitive on the labor market	0.860	1	0.354
Graduates from private HEIs are more competitive on the labor market	0.019	1	0.892
Technology parks and incubators	0.201	1	0.654
Awareness of necessity to be involved in R&D activities	2.701	4	0.609
Efforts to innovate processes	0.870	4	0.929
Academy-business cooperation	3.480	3	0.323
Research capacities of universities	6.160	3	0.104
Importance and relevance of R&D for the organization i the next 5 years	12.246	4	0.016
Investment in R&D	18.875	5	0.002

research we assumed that *there is no deviation of answers received from business companies and higher education institutions.* We conducted a Chi-square (χ^2) Test to determine a statistically significant deviation of answers for these two groups of examinees and to confirm or reject our research hypothesis. Since the value of Chi-square depends on the level of freedom, the higher the value of degrees of freedom, the higher the value of the Chi-square.

Based on the results presented in Table 2, it can be concluded that there are statistically significant differences in proportions between business companies and universities regarding several questions. Our hypothesis that there are no statistically significant differences between answers provided by business companies and universities can be rejected in the following cases:

1. Ability of universities to provide students with knowledge, skills and competencies needed in the business world
2. Ability of universities to adequately respond to changes in their environment
3. Importance of R&D activities during the next 5 years
4. Sufficient investment in R&D by higher education institutions

Education is the essence in a knowledge economy. Based on these results we can conclude that the business sector is not satisfied with knowledge university graduates have, business companies consider research and development activities more important than universities, companies also indicated that universities are not flexible enough and do not adapt adequately to changes in their environment.

One of the main goals of higher education reform in B&H was to educate students, which will possess knowledge and skills needed by future employers. Often universities do not include any relevant stakeholders in curricula development nor do these study programmes include practical knowledge or short-term internships in the real sector. This might explain the fact that companies in B&H stated that they are not satisfied with the knowledge and skills that graduate students have.

There are significant differences between these two relevant stakeholders in a knowledge economy. Obvious differences in attitudes between the real sector and higher education institutions in all the important aspects of knowledge economy leads us to conclude that there is no systematic approach in higher education development and there is a lack of collaboration in resolving all the important issues influencing knowledge economy development.

4 Discussion

We have shown that B&H is not yet ready to develop a knowledge economy. Its knowledge economy pillars are underdeveloped as research results indicate. This empirical support now leads us to conclude that a systematic approach must be applied in developing all of the knowledge economy pillars in order to make economic progress. In this context, empirical results have shown that governments must improve regulatory legislation. Unfortunately, the laws and regulations are not adequate for enabling entrepreneurship, research or education development. Adequate laws and particularly laws on intellectual property protection are crucial in order for investments, innovation and research to happen. The results of our research provide a potential for the B&H government to make improvements in this area.

According to benchmark analysis which we conducted using World Bank's Knowledge Assessment Methodology, the indicators for B&H in the field of education were the highest compared to other knowledge economy pillars. However, these indicators were way lower compared to the benchmark group. Results from our study indicated that education (particularly tertiary education) is the most relevant factor for knowledge economy development. After a deeper analysis of the higher education sector in B&H we were able to conclude that higher education institutions do not act as knowledge creators and therefore graduate students often do not have necessary knowledge, skills or competencies. Furthermore not all stakeholders are involved in development of study programmes, there is no collaboration with enterprises, investments in research and equipment are low, funding is also an issue and so on. However, we must also emphasise that private higher education institutions have not been covered by our research. This might represent a limitation to our study and we suggest that future research include all higher education institutions in B&H regardless of their status.

The role of higher education institutions in developing a knowledge economy has been elaborated in the theoretical background of our research. Our aim was to investigate whether higher education institutions in B&H can act as crucial knowledge institutions in order to enable knowledge economy development in the country. Our study has shown that they are not ready to act as such. Results of our study have shown that the lack of a strategic approach to higher education development and strategic management of higher education institutions has a negative impact on R&D activities, innovation, industry-university collaboration and all other important aspects of a knowledge economy. Furthermore, according to endogenous growth theories, commercially oriented innovation is a major driver of technological progress and productivity growth and universities play an important role in this Triple-Helix interaction between the state-university-industry. According to our research results there is a wide gap in the application of new information-communication technologies between B&H and others in the benchmark group. However, a country's ability to absorb new technology is crucial for knowledge economy development.

5 Conclusion

Due to growing complexity of the contemporary business environment, knowledge has become a significant factor of economic development. Knowledge has become the main driver of modern economies. Building a dynamic economy that is based on the development and application of knowledge is currently an aspiration of all countries (developing countries, transition countries etc.). In such an environment where knowledge is a dominant driver of economic and social development, universities are important centers of knowledge production. Knowledge creation, research and innovation are fundamental for increasing competitiveness and productivity. The mission of universities today is to provide students with the knowledge and skills needed in the business world. Research results have indicated that tertiary education in B&H is currently not on a level that would ensure its contribution to knowledge economy development. Most importantly, the current higher education legal framework and policies are inadequate to enable development of a modern higher education system. Even though obtaining higher levels of education improves employability (in developed countries as well as in B&H), research results indicate that employers in B&H are not satisfied with knowledge and skills of university graduates. Furthermore, universities themselves indicated a lack of interest in research even though scientific research is crucial for the creation of new knowledge. Generally speaking, the number of university graduates in B&H is below European average. Simply producing more graduates is not the right option, as the country needs a higher educated work force with the right knowledge and skills. Universities must adapt to these changes more rapidly and improve institutional processes. Most importantly, universities have a public purpose and a public obligation and the opinion that individuals enrolled in university programmes is enough to benefit them cannot prevail any longer. Universities must overcome the obstacles that prevent them form responding to these new changes and expectations in a modern changing economy. So what should be done? Generally speaking, we need to enhance competitiveness and productivity. B&H has to invest in the development of higher education in a way that it ensures education for adequate human capacity building. Knowledge is in the core of a knowledge economy and therefore education, especially higher education, has an important role. Secondly, research and development activities, which can lead to innovation and commercialization of these results through a strong collaboration with the industry, is also a very important aspect of creating a sustainable knowledge economy. The development of a diverse and competitive economy is the only way that B&H can benefit economically on the long run and ensure economic development that it so desperately needs.

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Part II
Entrepreneurship and Transition Experiences

Economic Reform and Entrepreneurship in Vietnam: A Policy Perspective

Quan Anh Nguyen and Gillian Sullivan Mort

Abstract Vietnam, with a transitional economy, has been emerging as a theoretically rich context for researchers over the last few decades. Painful reforms have been undertaken in the country to transform the rigid central planning apparatus into a market economy, breaking the long standing barriers to the private sector and SME development. In this context, entrepreneurship has become an essential driving force of economic development. Shifting from a de-entrepreneurship to pro-entrepreneurship stance, a more supportive policy setting has cultivated the quest for prosperity among businesses, grounding on a more levelled playing field for all, old and new, economic sectors.

This chapter aims at portraying entrepreneurship development in Vietnam embarking on a policy perspective. First, it examines the impact of *doi moi*, or economic reform process, which was triggered in 1986, and more generally the transition process of the Vietnamese economy which has subsequently changed the overall entrepreneurial setting in Vietnam. Next, it presents a closer look at the characteristics of the Vietnamese entrepreneurs as well as entrepreneurship in the country. Following is the discussion on the impact of policy on entrepreneurship development, detailing how policy changes have underpinned entrepreneurial growth in Vietnam since the country's reunification in 1975. Finally, the chapter concludes with a view on the future of entrepreneurship in Vietnam.

1 Economic Transition in Vietnam: An Overview

Vietnam's economic reform has gained substantial achievements and attracted the attention of the media and academia, though considered not so successful as the Chinese model. Vietnam had to make choice between the 'shock therapy' applied in Russia and 'gradualist' path used in China, and is considered to have followed the gradualist model (World Bank 2011; Danna 2007; Gainsborough 2010).

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_7

The reform path was provoked by unfavourable economic conditions rather than political pressure in the context of transforming from war to peace and in political and economic isolation (Vu 1995). A learning-by-doing approach was applied with reformative ideas initiated, implemented, then ratified and officially encouraged by the Communist Party. Overcoming decades of the pain and tears of wars, the clash of ideologies and socio-economic upheavals, what Vietnam has today is a country well on its way to transitioning into a fully-functioning market economy.

1.1 The Legacy of the Past

The legacy from the past including the central planning apparatus, predominant State ownership and intensive concentration on heavy industry shaped chronic weaknesses and left a lingering impact on the Vietnamese economy. In addition, the military conflicts with neighbouring countries, the embargo from the USA and economic stagnation of the socialist block had a marked impact and subsequently Vietnam experienced severe macroeconomic imbalances in the 1980s (Turner and Nguyen 2005). *Doi moi*, or renovation, was triggered with a change in viewpoints of the governing party and led to major reform initiatives to cope with the difficulties. The wind of change has not only reversed the harsh situation but also opened a new horizon for entrepreneurship development in Vietnam (Ronnas 2001).

1.1.1 The Settings: A Backward Look

Situated in South East Asia, Vietnam has a strategic location lying in the conjunction of the major sea transportation routes, at the heart of the region, bordering with China and two members of ASEAN, Laos and Cambodia. Ironically, it is Vietnam's unique geo-political strategic location that has historically triggered the interest of the world's major players, leading to a long, uneven journey that the nation has had to take. The history of the country is closely tied with the struggles for national independence, full sovereignty and efforts to neutralise the pressures and impacts from powerful nations.

Vietnam officially claimed its independence in 1945, but the fledgling independence was unfortunately followed by three decades of wars and North-South division with devastating consequences on its people and its economy. Only since 1975 could the country start building its unified economy in peace. The journey of economic development that Vietnam has travelled over the last half a century can be divided into three main periods: period of war economy (1945–1975), period of macroeconomic crisis (1976–1985) and period of economic reforms and remarkable economic development (1986–present) (Harvie and Tran 1997). During the period of war, Vietnam set priorities in developing war-supporting industries, such as mechanical engineering, iron and steel, and electricity (Arkadie and Mallon 2004). As a result, agriculture and other industries did not have chance to properly develop. Also as the consequence of the war, Vietnam's infrastructure and necessary conditions for economic development were severely damaged, especially in the North during the US bombing in the 1965–1972 period (SarDesai 2005). The DRV (Democratic Republic of Vietnam) model was applied in the North until 1975, when a period embarking on neo-Stalinism with Soviet-style central planning aimed at 'rapid industrialisation with collectivisation of agriculture and strong central control of the economy' was pursued (Fforde and de Vylder 1996). Post the war, from 1975, efforts were then made to integrate South Vietnam's capitalist-led economy into the Northern one when the country was reunified. The "Northernisation" (Vo 1990), however, did not bring the expected results. Together with other external factors, the war-led thinking style and orthodox central planning apparatus caused many difficulties constraining the economy (Vo 1990) and unfortunately keeping it from catching the boat that other newly industrialised economies took during this time.

1.1.2 The Fall of Foreign Aids from the Former Socialist Block and Its Impact

External assistance, mostly from the former socialist countries, played a vital role in sustaining Vietnam's economy during the war time. The period of reducing foreign aid in Vietnam led to what was later named the 'weaning crisis' that Vietnam had to experience (Dang 2004). The foreign assistance had been generously offered to Vietnam as a member of the socialist block to 'feed' the 'infant', war-torn economy of Vietnam. Over a long period of time, Vietnam was able to buy good and commodities from other Council of Mutual Economic Assistance (CMEA) members with 'friendship prices' (Dang 2004).

The preferential treatment, however, was not able to be maintained forever. After officially joining the CMEA in 1978, Vietnam had to buy goods and commodities from other members using the block's pricing system, which were priced two or three times higher than the preferred prices given to Vietnam previously. Subsequently, the reduction of essential imported goods later led to a serious shortage of production materials, necessities, commodities and soon after, funds (Dang 2004). By the late 1970s, the foreign aid to Vietnam from the former Soviet Union and other European socialist countries reduced substantially (SarDesai 2005). The 'weaning' prescription appeared as a brutal stab to the newly reunified nation. The economy started to experience signs of macroeconomic imbalances foreshadowing the crisis. The virtual termination of the Soviet Union's assistance in 1988–1990 served as the final blow and led to the decline of the central planning apparatus, by which the government dropped its role of central resource-subsidy distributor (Fforde and de Vylder 1996).

1.1.3 To Reform or Not to Reform?

Critical food grain shortage started to present in Vietnam late 1970s. More severely, Vietnam suffered from a grave agrarian crisis in 1980 which signalled some deeply rooted and systematic problems of the system (Ardeshir and Akram-Lodhi 2002). The second 5 year plan (1976–1980) failed to achieve its targets "to build a material and technological base for the new socialist state and to raise the standard of living of the population" (SarDesai 2005, pp. 128–129). The plan was unfortunately a failure which was mostly attributed to Vietnam's burden from military conflicts with Cambodia and China, scarcity of funds, chronic corruption, harsh weather condition and the decline of foreign economic assistance (SarDesai 2005). Bad news came consecutively that exceeded the torn and weary economy's tolerance. By 1986, the country faced with severe economic crisis of hyperinflation (Table 1), serious trade and budget deficit, macroeconomic imbalance and limited external economic cooperation (Fforde 1997), was on the verge of bankruptcy (Turner and Nguyen 2005). Without a timely reform, a fatal economic collapse and the resulting political chaos were likely to happen.

*1.2 The '*Doi Moi*' (Economic Reform)*

1.2.1 The '*Doi Moi*'

The reform that took place in Vietnam in response to the crisis of the early 1980s has been described as "spontaneous" and "bottom-up" in nature, without proactive actions from the government (Fforde and de Vylder 1996). Fforde and de Vylder (1996) further viewed the transition in Vietnam as a 'historical process' rather than a 'government program'. They described the policies taken as responsive, rather than proactive, to the economic and social pressure resulting from the difficulties in the country at that time. Those political moves clearly portrayed the pragmatic nature of the reform. D. D. Le (1991, p. 79) further elaborated the renovation process in Vietnam as one which is "not based on a given model but is rather than a creative process based on research and experimentation". A process of bootstrapping was undertaken with iterative change and corrections rather than a

Table 1 Price index 1976–1986 (Dang 2004, p. 29)

Year	General	Organised market	Free market	Agricultural products
1976	100	100	100	100
1977	118.6	101.1	138.0	–
1980	189.0	119.7	360.0	253.3
1984	1400.6	1297.8	1540.5	1825.9
1985	2890.2	2737.1	3367.0	3365.0
1986	16,170.0	15,260.0	19,030.0	19,204.0

broad policy shift leading the way. More specifically, “the Vietnamese reform, when viewed as state policy, were more economic than political in character—in other words, perestroika rather than glasnost” (Fforde and de Vylder 1996, p. 15).

There have emerged, however, different ways to describe major phases in the reform process in Vietnam. According to Fforde and de Vylder (1996), the underpinning ideologies for the transition in the country are those of the hard and soft reform Socialism. The hard reform Socialism maintained in the country during 1980–1985 period reinforced the neo-Stalinist system and consequently depressed the private sector development. However the later rise of ‘fence-breaking’ and ‘tactical [policy] concessions to autonomous activities’ and, especially, the failure of price-wage-money measures put an end to the old system and shifted the economy toward the transitional stage. Some even consider the series of fence breaking incidents as a set of mini reforms (Dang 2004). The subsequent soft reform Socialism during 1986–1989 advocated de-Stalinisation and subsequently smoothed the path for private sector and welcomed foreign investment (Fforde and de Vylder 1996).

Researchers have used different chronological periods to describe the process. According to Fforde and de Vylder (1996), the transition process in Vietnam can be broken down into four main stages, namely the pre-stage which was until 1979, fence-breaking stage until 1981, the formal transition until 1989 and the following post-stage instigated until 1992. More specifically, Ardeshir and Akram-Lodhi (2002) divide the reform process in Vietnam into: initial reform (1975–1981), partial reversal (1982–1985), *doi moi* (1986–1988), intensive reform (1989–1993), the FDI boom (1994–1997) and regional slowdown (1998–2001). The reform can also be grouped more simply into 1976–1979 period (economic unification and expansion of the central planning system nation-wide), 1980–1986 period (economic liberalisation with trial-and-error process) and 1986 to present period (strong economic reform) (Vu 1995, p. 18).

Generally, *doi moi* was undertaken in several building blocks: agricultural reform, price liberalisation, foreign trade and payments (Harvie 1996; Arkadie and Mallon 2004). Agrarian reform, with the Decree number 10 in 1988, is considered as the cornerstone of the process with its pervasive impact on a large number of population. The newly changed agricultural system moulded around farm household as the basic productive unit (Arkadie and Mallon 2004; Le 1991). Farmers were given more autonomy to work on their land. It was no longer compulsory for farmers to join cooperative and their right to land use, inheritance and transfer was recognised by the law (Harvie 1996). Planning guidelines for farmers were completely removed by the end of 1988, then replaced by the operation of a functioning market economy (Ardeshir and Akram-Lodhi 2002). The control of prices, except for items essential to the national economy, were also removed (Harvie 1996). The State’s subsidies were abolished paving the way for commodities being priced by the market. Other major reforms in foreign trade were also made including the use of tariff instead of quantitative restrictions, diminution of the State’s control in foreign trade activities and devaluation of Vietnam dong (Ardeshir and Akram-Lodhi 2002).

Besides the internal 'bottom-up, fence breaking activities', the change in the world's political arena after the Cold War put pressure on Vietnam to embark on the new 'open door' policy (Masina 2006, p. 14). The policy was implemented with an aim to diversify external economic relations and boost exports. External economic relations were diversified with a focus on export development (Arkadie and Mallon 2004). Efforts were also made to attract foreign investment by setting up export processing zones and special economic zones (Le 1991).

1.2.2 What Had Been Achieved with '*Doi Moi*'?

Under the *doi moi*, significant achievements had been made. Generally, the country had avoided the risk of economic collapse and even reversed the economic downturn (Mallon 1997). The macroeconomic stabilisation program and fiscal policy adjustment brought back economic stability to the country, substantially reduced hyperinflation, state subsidies and the budget deficit (Wolff 1999). Farmers and households were liberalised to bring into full play their potential. Farming household had been given enough autonomy to buy and sell their products at market prices. Consequently households' incomes were significantly improved (Le 1991). The prices in the open market were reduced by 50 % in some places (Marr 1991). The two-price system was undermined by government policy leading to a more well-functioning market. The trend toward 'pro-market stance' was shaped, and the role of private sector has been recognised in a 'multi-sectoral economy' (Fforde 1997). The country also gained substantial growth and significantly improved the lives of its people. Vietnam successfully controlled hyperinflation, reducing the inflation rate from 487 % in 1986 to only 5.2 % in 1993. At the same time, the growth rate was substantially boosted up to reach 8.1 % in 1993 (Table 2). In general, *doi moi* has been considered successful on most economic development criteria (Irvin 1995).

1.3 Recent Economic Development

Over the two decades from 1990 to 2010, the country enjoyed an average annual growth rate of 7.3 % and increased the income per capita by almost five times (World Bank 2011). The implementation of a number of bilateral trade agreements and especially the accession to WTO in 2006 has marked other major milestones in the reform process of the country. During the 'booming period' from 2003 to 2008,

Table 2 Real GDP growth and inflation, 1985–1993 (Masina 2006, p. 62)

	1985	1986	1987	1988	1989	1990	1991	1992	1993
Real GDP growth	5.7	3.4	3.3	5.1	8.0	5.1	6.0	8.6	8.1
Inflation rate (%)	132	487	317	311	76	67.5	67.6	17.5	5.2

the strong reforming measures and international integration translated into remarkable economic growth rates, large amounts of foreign investment, which peaked in 2007 with the unprecedented amount of 18 % of GDP, tripling export volume and more than doubling total GDP. Besides, this period also experienced the mushroom growth of the stock market, real estate market and investment (World Bank 2011). Vietnam reached the status of 'lower-middle-income-country' in 2009 (World Bank 2010, p. 15).

However, it is probably too early to call Vietnam's story an economic miracle. When the over-excitement is over, the country moved to again facing severe economic problems, including macroeconomic instability, double-digit inflation, weakening currency, capital flight, falling international reserves and consequently shrinking investor confidence (World Bank 2011). Paradoxically, its development model has been shifted from 'growth with limited resources' to 'abundant resources with limited growth' over the last 5 years (World Bank 2011). Over more than two and a half decades of *doi moi*, state ownership is still dominant in Vietnam's economy (World Bank 2011). The other economic sectors are experiencing difficulties as the majority of national resources are channelled to the state sector. It is now perhaps another critical moment for Vietnam to reconsider its development model—should another reform be adopted and how can entrepreneurship be facilitated to revitalise the economy?

2 Characteristics of Entrepreneurship in Vietnam

Vietnam has a long and vibrant entrepreneurship tradition with the development of port systems attracting foreign traders to come and do business (Marr 1991). The trading activities blossomed in the old thriving port cities such as Hoi An and Hung Yen. Throughout its history, experiencing various ups and downs, entrepreneurship in Vietnam has overcome numerous hardships and resiliently nurtured its own set of entrepreneurship characteristics. By the late twentieth century, however, the centrally planned economy had strongly repositioned this historical tradition.

2.1 Entrepreneurship Environment

2.1.1 The Government and Policy Environment

Entrepreneurship development entails consequent institutional change including a legal infrastructure appropriate to market conditions, a pro-entrepreneurship legal framework and the creation of commodity, capital and labour markets (Smallbone and Welter 2001; Nguyen et al. 2008). In Vietnam, unfortunately, those conditions are still being constructed. The old central planning institutions in Vietnam, different from those in other transitional countries, had been renewed, rather than being abolished completely, to work more effectively in the new economic context. At the same time, new market institutions were introduced to ensure a least disrupted transition could be made (World Bank 2011), which were challenged to be effective in that context of reformed central planning.

In fact, Vietnam has pragmatically employed policy changes to response to national circumstances (World Bank 2011). Policy reform in the initial stage of the transition has been made toward reducing government intervention in State-owned enterprises (SOEs), liberalising the private sector, price, trade and labour market (World Bank 2011). Liberalisation was implemented in major areas of the economy and awoke the long nascent potential. The devolution of responsibility to farmers and firms has been considered as one of the key aspects of the momentum leading to Vietnam's economic success (World Bank 2009). Another emerging trend in the institutional environment in the country is the decentralisation of power "to provincial and lower level government, administrative and delivery units, to the courts and the elected bodies and to the media and the civil society" (World Bank 2009, p. 132). More autonomy has enabled local government and other administrative bodies to be more active in carrying out planning activities and creating more favourable environment for businesses and entrepreneurship generally.

Dana (1994), however, contended that the institutional environment in Vietnam was insufficiently supportive to entrepreneurship development. The weak functioning formal institutions in Vietnam lead to the use of informal institutions, such as social networks, to enhance trust building among entrepreneurs (Nguyen and Rose 2009). The economic and financial laws are reported unpredictable (World Bank 2009) and that has caused great challenges for enterprises and investors. More detailed impact of policy reform on entrepreneurship development will be discussed in Sect. 3 of this chapter.

2.1.2 The Socio-cultural Environment

A blend of long embedded Confucianism and relatively new socialist practices, which to some extent can be described as 'Confucius plus Marx' dogma, drives the business culture in Vietnam (Murray 1997). In such a culture, there exists the struggle to harmonise the old and emerging values, accommodating both the twin drivers of collectivism and Confucianism, and a new impetus toward individualism (Ralston et al. 1999; Swierczek and Thai 2003a) in a pragmatic manner (Murray 1997). While there are types of managers who stick to the socialist style, Murray (1997) acknowledged that there had been an emerging generation of young self-assertive short-term oriented entrepreneurs in the country. The impact of family businesses, which are pervasive in other Asian countries, is found less influential in the Vietnamese cultural setting which pragmatically embarks on entrepreneurial values that are "somewhat individualistic and related to profit, collectively providing jobs and growth for the economy" (Swierczek and Thai 2003a, p. 48).

As a consequence of the deeply rooted Confucius thinking, traders and business people in Vietnam were traditionally looked down upon being negatively associated with fraud and cheating. The long suppression by governing bodies of trade and entrepreneurial activities historically shaped an unfavourable social setting for entrepreneurship development. These traditional values continue to assert great influence on Vietnamese modern society and the value systems, and adversely affect entrepreneurial spirit in the country. They negatively shape the people's attitude and perceptions toward the ranking of the society, mentality and determination of the private entrepreneurs (Vuong and Tran 2009). Low quality business education can be attributed to this negative tradition which does not value business or entrepreneurship (Vuong and Tran 2009).

As observed by T. H. Nguyen et al. (2008), though there still exists social discrimination against small and medium-sized enterprises (SMEs) in Vietnam, the prejudice against private entrepreneurs has lessened in its degree over time as the country has continued on its reforming track and opened to the world. There have been novel elements of a new entrepreneurial culture, cultivated through *doi moi*, which consists of emerging money-favoured values and the resultant institutionalisation of those constituents by the establishment of an increasing number of enterprises (Vuong and Tran 2009). With such efforts, the social attitude toward entrepreneurs and private firms has been significantly improved (Agency for SME Development 2008).

2.1.3 The Infrastructure and Business Supports

"Infrastructure is [unfortunately] the second most important constraint to Vietnam's development" (Harvard Vietnam Program 2008, p. 24). Some (Dana 1994; Chu and Katsioloudes 2005) further posit that infrastructure in Vietnam is inadequate for entrepreneurship development, especially the physical, banking and technological infrastructure. Ironically, Vietnam now possesses costly but ineffective infrastructure (Harvard Vietnam Program 2008). Electricity shortages have become a serious threat to economic development, especially when the monopolistic situation is still maintained in this key industry. This threat is becoming apparent especially when Vietnam has been facing an increasing risk of over-reliance on hydropower, which is dangerous when droughts occur and extreme weather conditions come more frequently. The energy development plans have been seen as either lacking strategic vision or being driven by special interest groups (Harvard Vietnam Program 2008). Besides, there seems to exist inappropriate allocation of the state's investment in building the transportation system in the country. The infrastructure in the Southern economic development hubs is at the stage of being "stretched to the breaking point" while the other provinces receive unreasonably generous investments from the government (Harvard Vietnam Program 2008, p. 25). Besides, the expenses for land use are on the rise due to Vietnam's rapidly increasing population and the strong waves of urbanisation. Altogether the poor infrastructure significantly increases costs and poses real challenges for investors and entrepreneurs to grow their businesses.

Efforts have been made by the Vietnamese government to increase the financial support given to the private sector over the last few years. The banks, however, are still not very willing to provide long term loans to the private sector (Agency for SME Development 2008). Effective financial support mechanisms are still absent and the private sector has to compensate for them by seeking credit from informal sources (Nguyen et al. 2008). A clear mechanism used to channel capital to the right investors is still absent (Ronnas 2001). Nevertheless, a systematic support apparatus has been constructed, from the government to ministerial, provincial and local levels (Agency for SME Development 2008).

2.2 A Portrait of the Vietnamese Entrepreneurs

Ronnas and Ramamurthy (2001, p. 328) describe a typical urban entrepreneur in Vietnam as "a middle-aged male with at least 10 years of education and prior experience in similar fields in a position of responsibility". Also according to them, being less advantaged, a typical rural entrepreneur is "a middle-aged male, with at least 7 years of education and previous experience in a position of responsibility". Swierczek and Thai (2003b, p. 47) found that entrepreneurs in Vietnam are "more motivated by challenge and achievement than the necessity for a career and economic security". The majority of the entrepreneurs in large cities start their business principally with a very humble amount of investment and to grow the business they have to deal with poorly developed marketing and information channels (Ronnas 2001). Besides, the lack of capital and marketing outlets largely restrains the development of enterprises (Ronnas and Ramamurthy 2001). Administrative procedures, bureaucracy, complicated taxation policies are also among the prime concerns of the private enterprises (Vuong and Tran 2009).

The Vietnamese entrepreneurs bear well in mind that they run their businesses in a context where deeply rooted Confucian values still widely exist, such as generational order, hierarchy, paternalism and loyalty. Consequently, the way Vietnamese private entrepreneurs manage their firms clearly mirrors the legacy of Confucianism where the management positions stay with family members, relatives and loyal subordinates (Vuong and Tran 2009). At the same time, the central planning's modus operandi, for example delay in decision making due to a preference for hierarchy and concentration of power, tends to be resistant to change (Vuong and Tran 2009). The old working style significantly influences the creativity and dynamism of the enterprises.

The utilisation of relationship, private connections or guanxi (the Chinese equivalent) is not only common in China but is also prevalent in Vietnamese business culture. Ronnas (2001) found that the use of personalised and informal networks is predominant among Vietnamese urban entrepreneurs. Those entrepreneurs have sought for finance from informal sources such as social network and private credit (Nguyen et al. 2008). It is this non-official channel that helps reduce the thirst for capital of small firms when the official credit is more easily accessible to the large and privileged State-owned enterprises. The other aspect of using networks can be seen when private firms also have to rely on typical 'relationship-based bank loans' to compensate for the shortage of capital, once needed. This unequal relationship, in which the banks dominate, still needs to be cultivated by entrepreneurs as they face significant difficulties in accessing other types of financing and government support (Vuong and Tran 2009).

There have been entrepreneurs, however, who have been able to take advantage of the new economic context and the resulting entrepreneurial opportunities (Young 2009). Young (2009) reflects the stories of Vietnamese successful entrepreneurs who have been thriving in the hospitality and construction industries. They have well exploited the opportunities brought by Vietnam's economic development and international integration when there have been a surplus of demand over supply in some certain niches and room for developing new products and services better than those offered by competitors in the market. These pioneering business people of the *doi moi* era do possess typical traits for entrepreneurial success, such as opportunity recognition, intuition, risk taking behaviour, risk management, decision making ability and decisiveness (Young 2009).

2.3 SME Development

Free enterprise seems to be a more important source of success for Vietnam, rather than its orthodox ideology (Dana 1994). Vietnamese SMEs have been playing an increasingly important role in the country's economic development (Kokko and Sjoholm 2006; Dana 1994; Le 2006; Webster 1999), efficient resource allocation, export expansion, income distribution (Harvie 2004), investments (Dinh 2006) and industrial growth (Abrami 2003). They have created millions of jobs, contributed significantly to the State budget annually and been "operating at the forefront of the economic development and business liberalisation process in Vietnam since 2000, when the Enterprise Law was enacted" (Agency for SME Development 2008, p. 6). "A large part (about 95%) of the registered enterprises can be characterised as SMEs" (Hansen et al. 2004, p. 1), and their growth rate is "always higher than 20%" (Le 2006, p. 1). With nearly 349,000 firms in 2009 (Vuong and Tran 2009, p. 56), unarguably, SMEs overwhelmingly "dominate the corporate landscape of Vietnam" (Agency for SME Development 2008, p. 19), and are expected to continue growing (Thai 2008).

Despite significant development over the last two decades, Vietnamese SMEs are still facing many challenges. "Most of SMEs are of small scale" (Le 2006, p. 9) and discrimination still exists among firms coming from different economic sectors (State-owned, non-State-owned and foreign-invested firms) (Le 2006). "SMEs' products are mainly sold in the domestic market, and even in narrow provincial areas" (Agency for SME Development 2008, p. 58). In addition, imported products, especially from China, have adversely affected the market share of Vietnamese SMEs. Being modest in both quality and quantity, SME products are hard to export to international markets. Besides, there have been a number of other constraints on SME development, including the immature regulatory environment, weak institutional support for the private sector (Bekefi 2006), strong market barriers, limited access to land, finance, human resources, infrastructure, poor business services, opaque bureaucracy; SMEs are also found to lack information, have backward technology and confront with the slowly-changed-over-time social attitude toward private sector (Agency for SME Development 2008; Thai 2008; Riedel and Tran 1997).

2.4 SOEs vs. the Private Sector

While the private and foreign sectors have been the main engine for economic development in Vietnam, they are still being unfairly treated comparing with what is given to the SOEs (Harvard Vietnam Program 2008). A large portion of the government's total investment pie is poured into the State sector compared to support that is given to the private sector. It is interesting to note that there seems to exist a 'dualism' in the Vietnamese economy, i.e. while maintaining a strong position of the SOEs, the State is also trying to encourage private sector development (Harvard Vietnam Program 2008; Danna 2007). A real challenge currently to the SOEs is how to increase efficiency and productivity. The state sector, though endowed with overwhelming resources, has not been able to take full advantage of investment, struggling with below expectation performances (Harvard Vietnam Program 2008; Ronnas 2001).

Vietnam started reforming its SOE sector in the early 1980s in the primary areas of management and planning (Le 1996). The state sector reform has then been facilitated with the partial privatisation programme since early 1990s. This process progressed slowly in the initial stage but sped up again in the early 2000s, mainly due to the less hospitable condition in the state sector and the improvement of the private-sector climate (Gainsborough 2010). Gainsborough (2010) also acknowledges that there has been strong association between the gearing SOEs equitisation and the fast growing number of private firms during this period. More recently, since 2005, inspired by the Japanese *keiretsus* and South Korea's *chaebols* models, Vietnam has fostered the formation of State Economic Groups (SEGs) to be the "iron fists" of the economy. Those SEGs are endowed with much of the country's resources, some with "size and influence much bigger than ever imagined" (World Bank 2011, p. 24). However, given the recent failures and disappointing performances of some SEGs such as Vinashin, Vinalines (World Bank 2011), questions have been raised about the efficiency of the State sector, how the national resources can be better allocated and managed and how to achieve a balance in the relationship between State and private sectors.

3 Policy Changes vs. Entrepreneurship Development

3.1 De-entrepreneurship Policies and Their Impacts

There was a time that the Vietnam's government policies were not conducive to entrepreneurial activities. The elimination of the private sector shortly after the national reunification in 1975 left serious consequences on entrepreneurship development in Vietnam (Vo 1990). Before 1975, the economy of the South followed a capitalist path with strong entrepreneurial activities. The service sector in Southern Vietnam including commerce and administration dominated the economy (as cited in Masina 2006).

In order to implement the 'socialist transformation' in the whole country, Hanoi suppressed the service sector, private trade and manufacturing in the South, putting them under State control (Masina 2006). The government exercised discouragement and then incorporation of large scale private firms into state of collective units, maintaining market mechanisms only in small businesses and households (Murray 1997). At the same time, the public sector received full subsidies from the state with losses compensated by and profit reverted back to the state budget. The policy definitely gave SOEs much favourable treatment and the SOEs undoubtedly lost momentum for self-directed development. Those policies "... were not ... conducive to motivating individuals and companies to boost enterprising economic activities. [There was] no room for private individual's creativity or dynamism" (Murray 1997, p. 21).

Arkadie and Mallon (2004) point out some other challenges for private businesses which came under the influence of policies. Those areas of restriction include the disadvantageous position imposed by the government when private firms form partnership with foreign investors, comparing with incentives given to the SOEs. In addition, as stated in the Decree 85-CP dated 17/12/1996, private firms are also not allowed to contribute to a joint venture with foreign partners using land-use right, which is normally considered the most valuable asset of businesses in Vietnam (Arkadie and Mallon 2004). This resulted in a weakened voice of the private firms in the partnership.

3.2 Pro-entrepreneurship Policies and Prospects

McMillan and Woodruff (2002) suggest that there is a lack of formal institutions in transition economies, and this creates big challenges for entrepreneurs. In such context, policy, as a component of formal institutions, has greatly influenced the development of entrepreneurship in Vietnam. Fforde (1991) put forward three sets of policies that were under substantial change during *doi moi*: growth strategy, micro and macro strategy. The growth strategy addresses the level of importance given to different industries and economic sectors of the economy. Macro strategy targets the allocation of national resources and stabilisation of the economy while the micro strategy concerns with "the creation of far greater price/cost sensitivity and the acceptance of 'free' capital outside direct state control" (Fforde 1991, p. 95).

Under the impact of policies, the private sector has been untied and its development has become an engine for economic growth (Murray 1997) and one of the most remarkable achievements of *doi moi* (Hakkala and Kokko 2007). The legal framework has been gradually adjusted to open up more opportunities for the private sector, with the introduction of major laws, such as, the Private Enterprise Law and Company Law in 1990, the Bankruptcy Law in 1993, and especially the official recognition of the role of private sector in the Constitution of 1992 and the implementation of the new Enterprise Law in 2000 and 2005 (Hakkala and Kokko 2007). The new law has helped substantially reduce the set up costs of private firms, broaden the scope of business activities for this sector and created a more levelled playing field between the private and State-owned enterprises (Nguyen and Le 2005). Recently, the role of SMEs and private sector has been well acknowledged in the Socio-economic Development Strategy 2010–2020 in the process of industrialisation and modernisation of the national economy. The 'transparent and predictable regulatory framework' significantly benefits the private sector (Harvie 2004, p. 9). Subsequently, the private firms have become one of the main engines of economic development in Vietnam, creating millions of new jobs, contributing significantly to State budget, export and generally making a more competitively healthy business environment (Nguyen 2006). "Devolving responsibility to decentralized actors, in this case farmers and firms, and allowing them to sink or swim yielded strong results" (World Bank 2009, p. 132). The improvement of the private sector climate has been considered by Gainsborough (2010) as the pull factor for the privatisation (or equitisation) of SOEs in the country. In return, the progress of privatisation is closely related to the fast growth of the private sector after 1999. In addition, with the policy relaxation on private sector, a new generation of entrepreneurs have emerged and their contribution to economic development is well recognised. The commitments and efforts of the government have also changed the attitude of the society toward private enterprises (Agency for SME Development 2008).

Policy has also contributed to macroeconomic stability and consequently nurtured a more favourable environment for entrepreneurship development. Bold political efforts, such as the aggressive IMF-style policy package taken in 1988–1989 including maintaining positive real interest rates, controlling exchange rates and balancing state budget had effectively stabilised the economy, avoiding the risk of economic failure (Arkadie and Mallon 2004). The 'open door policy', which facilitates 'the swift re-orientation and expansion of Vietnamese exports' has "enabled the Vietnamese to withstand the shock of sudden collapse of Soviet support, the continuing effects of the US-led boycott, and the absence of any compensating increase in non-Soviet assistance" (Arkadie and Mallon 2004, p. 85).

Through *doi moi*, the Vietnamese government has also shown strong commitments to supporting SME development in the policy document such as the SME development plan 2006–2010 or the socio-economic development strategy. A network of SMEs support from central to provincial levels has also been set up (Agency for SME Development 2008). At the ministerial level, the Agency for SMEs development was set up under the Ministry of Planning and Investment in 2002. The SME development council was established in the following year to advice the Prime Minister on SMEs development strategic directions and policies. Other support agencies can also be found at the lower levels such as provincial SME development coordinators, technical assistance centres, information centres, business clubs and local associations (Agency for SME Development 2008).

4 The Challenges Ahead

Despite remarkable economic achievements over the last two decades of *doi moi*, Vietnam is now facing severe economic challenges and there have been recent calls for another version of *doi moi*. Thayer (2006) describe the four 'typhoons' that shook the country in late 1990s, including the economic downturn, rural unrest, the worst tropical storm in 50 years and most severely, the Asian financial crisis. The crisis has left Vietnam with a sharp decrease in foreign investment, export and deteriorating economic condition (Thayer 2006). The Vietnamese economy is volatile and "many of the underlying weaknesses that contributed to the 1997 financial crisis are present in Vietnam today" (Harvard Vietnam Program 2008, p. 38). Besides, it is now viewed as being "worst since 1991" (Nguyen 2011). The liberalisation of the farmers' and private households' capabilities in *doi moi* can create no more momentum for growth in the new condition (Mac Lam 2011). Vietnam is under pressure from international donors to facilitate "the sectoral and structural reform" on three areas, SOEs, banking sector and trade (Thayer 2006).

There are still challenges for entrepreneurship development in Vietnam. Hakkala and Kokko (2007) acknowledge that the current major constraints of the Vietnamese private sector include its limited access to resources, land and capital. Furthermore, the private sector development is still considered below its potential (Harvie 2004). Arkadie and Mallon (2004, p. 129) concede that "during the reform process in Viet Nam changes in formal rules have often responded to a spontaneous process of institutional development, accommodating changes in informal practices". In line with them, T. H. Nguyen et al. (2009) contend that the entrepreneurial role of the State is crucial where there is a lack of institutional supports and defective market factors. Regarding the other economic sector, Beresford (2008, p. 226) questions the level of support given to SOEs to "benefit the whole society, without degenerating into cronyism". Besides, there are a number of other constraints to entrepreneurship development in Vietnam including, but not limited to, inadequate high-skilled labour, poor infrastructure, limited access to land, information, credit and foreign markets (Agency for SME Development 2008).

5 "Riding on the Tiger": Entrepreneurship of the Future

The Vietnamese people have an idiom describing a resulting harsh situation which is preceded by adventurous actions, "riding on the back of a tiger". In such circumstance, moving forward is believed to be the most acceptable tactic, and conversely, the withdrawal might result in severe consequences. Vietnam has "ridden on" reforming for more than two and a half decades, and similar to the rhetorical comparison, one might expect more to be done to intensify the country's determination for renovation, having begun on that path.

In light of the impact of *doi moi* on entrepreneurship development and the pressures from recent economic condition, "*doi moi 2.0"* is conjectured as necessary to revitalise the Vietnamese economy, in general, and entrepreneurship, in particular. Kokko's work (1998, p. 326), among the earliest calls for another version of *doi moi* in Vietnam, stressed on the measures to "simplify and liberalise the trade regime, strengthen the financial system, reform SOE management and promote private sector, and increase transparency at all levels of the economy". Recently, some have advocated for a 'major surgery' needed to restabilise the macroeconomic condition, restructure the SOEs, more effectively supervise the allocation of resources and enhance the national competitiveness (Mac Lam 2011; Nguyen 2011). *Doi moi 2.0* can potentially deliver through reforms that enhance entrepreneurship and the growth of SMEs, the type of free market conditions and enhanced competitiveness that provide conditions for growth in discretionary income to support indigenous industry along with export orientated industry development.

If Vietnam doesn't want to miss the next train to a new stage of development, its government should play a more active entrepreneurial role in *doi moi 2.0*. Entrepreneurship in Vietnam needs strong supports from the government to compensate for the weakly-functioning market factors and inadequate institutional framework (Nguyen et al. 2009). More importantly, the significant gap between formulation and implementation of policies should be addressed (Nguyen et al. 2008). In addition, there should be more appropriate policies aimed at creating a more favourable environment for the private sector and entrepreneurs in the country. The de facto discrimination against the private SMEs (Masina 2006) when accessing critical resources, such as credit, is expected to be removed. More comprehensive reform and stricter control should also be imposed on SOEs, especially the giant but crisis-driven corporations, so that the fair allocation of national resources and more equal 'rules of the games' applied for different economic sectors can be maintained. Efforts are particularly needed to build up an adequate legal framework, a pro-entrepreneurship socio-cultural setting, restore the macroeconomic stability, and improve infrastructure and business support system.

6 Chapter Summary

This chapter has drawn attention to the generally positive impact of policy and the importance of further necessary reform needed to facilitate entrepreneurship growth in Vietnam. The reform process in Vietnam, despite some 'twists and turns on the road', is conjectured irreversible. Since the country's reunification in 1975, various policies have been implemented to radically improve socio-economic conditions. While many of the policies are, directly or indirectly, conducive to entrepreneurship development, however, caution is needed as there were some that could be considered de-entrepreneurship, such as the disincentives and restrictions on private firms. At the dawn of the second decade of the twenty-first century, the country is currently experiencing a critical moment in which bold political moves are to be made. *Doi moi 2.0*, therefore, represents a new theoretically-rich context for entrepreneurship scholars. The impact of economic reform consequently requires the critical attention of future researchers.

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Researching the Entrepreneurial Sector in Serbia

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Abstract The aim of the chapter is to identify and analyze the key requirements for the growth of innovative and entrepreneurial businesses in Serbia. We used annual surveys on entrepreneurs and SME owners, conducted by the National Agency for Regional Development. The Agency reports include a number of factors that matter the most to Serbian entrepreneurs, including: government subsidies, banks interest rates, administrative procedures, the efficiency of managing accounts receivable, and the impact of entrepreneurial financial management. We analyze the impact of the selected factors on the gross value added (GVA), as an indicator of the growth of SMEE sector in Serbia, for the period 2004–2012. The composite indicators were created and statistically analysed. Our research suggests that the state incentives and the cost of doing business have the greatest impact on the entrepreneurship and business development/growth in Serbia.

1 Theoretical Background

Entrepreneurship is one of the key driving forces of economic development. It contributes to the process of increasing economic stability and economic development by creating new employment opportunities (Belka 1995; Richter and Schaffer 1996; Sexton and Landstrom 2000), offering a variety of products to consumers (Berkowitz and DeJong 2001), increasing gross domestic product, alleviating poverty and ensuring welfare of society in the long term (Berkowitz and DeJong 2001). In transition economies, the development of entrepreneurship is even more important because it encourages the development of a market economy by creating

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_8

an open competitive market (Megginson and Netter 2001) and contributes to limiting the market power of public companies (McMillian and Woodruff 2002). The particular importance of small enterprises and entrepreneurs in transition countries is that they are very dynamic, fast learners and flexible to change (Čučković and Bartlett 2007), which helps them increase the competitiveness of the entire economy and contribute to accelerating the process of transition (Carlin 2001; Djankov and Murrell 2002).

However, the establishment of entrepreneurial businesses and their development to the level of successful stable organizations is associated with a number of dilemmas and uncertainties, which is why they are influenced by a number of supporting or constraining factors. A number of researchers have engaged in empirical research into the problems faced by entrepreneurs and critical success factors of their businesses based on a particular sample of entrepreneurs. Thus, for example, McLarty et al. (2012), Indarti and Langenberg (2005), studied the key factors influencing the business success of small and medium enterprises and entrepreneurs in the Czech Republic, Bangladesh, Japan, Singapore and Australia. Kauranen (1996) and Pelham (2000) studied the determinants of the future success of firms in the short and long term.

Their research as well as other empirical studies identified a number of constraining factors of starting and developing new business ventures. Some of the most common problems when starting a business, as stated by researchers, are: the provision of seed capital (Arthur 2003; Sievers and Vandenberg 2007), the provision of appropriate technology (Mazzarol et al. 1999), lack of information on market opportunities, standards and regulations (Sievers and Vandenberg 2007), and the lack of knowledge and experience. At the same time, the greatest impact on the success of the business and development of entrepreneurial organizations is exerted by: characteristics of entrepreneurs (Kauranen 1996; Kristiansen 2002), the specifics of the started business (Duchesneau and Gartner 1990; Kristiansen 2002), knowledge and skills in the field of management (Lubatkin et al. 2006; McMahon 2001; Salminen 2000; Swierczek and Ha 2003), the characteristics of products and services (Islam et al. 2008; Wiklund and Shepherd 2004), demands, expectations and consumer purchasing power (Pelham 2000; Reynolds et al. 2001), way of doing business and the ability to cooperate with other organizations and institutions, resource opportunities and financial capacities of entrepreneurs (McMahon 2001; Shen et al. 2012; Swierczek and Ha 2003), strategic focus of business (Gundry et al. 2003; Ortiz and Lombardo 2009), the external environment (Indarti and Langenberg 2005) and so on.

Transition countries are facing a number of additional problems and constraints to the development of entrepreneurship. These countries are mainly characterized by large systemic risk caused by economic, political and legal instability that have a discouraging influence on the establishment of new businesses and slow down the development of existing businesses (McMillian and Woodruff 2002). Entrepreneurs in developing countries feel unprotected, since the laws and the courts are unreliable, which is why they must look for reliable customers that settle their liabilities on time and reliable suppliers that deliver raw materials of adequate quality (Johnson et al. 2002; McMillian and Woodruff 2002). A particular problem that transition countries are facing is reflected in the provision of sources of funding that will be used for starting a business as well as in the later stages of business development (Bygrave 2003; Leeds and Sunderland 2003). When starting a business, potential entrepreneurs in transition economies rely on their own funds, which are mostly made of very modest personal and family savings. Even in the later stages of business development, entrepreneurs in countries in transition cannot rely on external sources of funding as bank loans are usually expensive and completely inaccessible to some entrepreneurs, while informal sources of funding are usually associated with very high risks (Bygrave 2003; McMillian and Woodruff 2002).

With respect to the Republic of Serbia (RS), the macroeconomic environment as a prerequisite for the development of entrepreneurship is not different from the environment of other countries in transition. Although a series of measures aimed at development of entrepreneurship have been implemented in the RS in recent years (Government of the Republic of Serbia 2008), the situation in this sector in Serbia still cannot be considered satisfactory because of the presence of a large number of problems and constraints (Stefanovic et al. 2013). Potential entrepreneurs are faced with many problems in starting a business, such as: difficulties in providing sources of funding, a number of administrative barriers, lack of skilled labor, lack of information on markets and technologies and so on (National Agency for Regional Development—NARD 2012). Furthermore, Serbia is characterized by a high degree of systemic risk caused by political and legal instability, which, together with its grey market and pronounced corruption in all spheres of society, creates constraints for the business of entrepreneurs, such as the difficulty or inability to collect receivables, disregarding deadlines and other contractual obligations by trading partners, non-compliance of the quality of suppliers' raw materials with the regulatory standards, the presence of unfair competition etc. (NARD 2012). In addition, unfavorable macroeconomic indicators further hinder entrepreneurs' business and reduce their competitiveness on domestic and foreign markets.

The above and many other macroeconomic problems, as well as the effects of the global economic crisis, stand for a serious constraint to the development of entrepreneurship in Serbia. However, deeper analysis of entrepreneurs' business in Serbia (Ivanovic-Djukic and Stefanovic 2011) shows that the negative impact on the development of the sector was also exerted by a large number of internal factors, primarily related to faulty decisions entrepreneurs brought in the past, which often resulted in the deterioration of entrepreneurs' performance or business failure. In this chapter, we identify the key constraining factors of the development of entrepreneurship in Serbia and analyze their impact in order to find ways to overcome their negative effects. The aim of this chapter is to encourage the growth of the entrepreneurial sector in Serbia by identifying key prerequisites of the development of entrepreneurship and ways to mitigate the identified problems. In this regard, we will first try to identify the key issues that constrain the development of entrepreneurship in the RS and factors causing these problems. Furthermore, we will employ methods of statistical analysis in order to examine the impact of each of the identified factors on gross value added (GVA) by the SMEEs in the RS, as an indicator of their growth and development. Finally, we will use the obtained results for indicating the implications for managers of SMEs and entrepreneurs and proposing measures to mitigate the problems with the aim of stimulating the development of entrepreneurship.

2 Analysis of Key Problems of the Development of Entrepreneurship in Serbia

Slow growth of entrepreneurship in Serbia was certainly affected by the global economic crisis. However, poor macroeconomic conditions (in 2012, the inflation rate was 12.2 %, the budget deficit was 6.4 % of GDP, the level of investment was 18 % of GDP, and unemployment rate has reached 23.9 %) (National Bank of Serbia—NBS 2013),[1] long-run problems related to inadequate economic structure and system inefficiency of economic entities in Serbia (Stefanovic et al. 2013), as well as a number of faulty decisions of Serbian entrepreneurs that have led to the failure of their businesses, are also responsible for the current state of this sector in Serbia.

In order to identify the key constraints to the development of entrepreneurship and the factors which enhancement can give rise to the improvement of the business, we will start from the data presented in the annual survey, conducted each year (starting from 2009) by the National Agency for Regional Development (NARD 2013).[2] According to these reports, Serbian entrepreneurs identify the following as the biggest problems in doing business: lack of financial resources, administrative procedures and regulations, non-compliance with the standards, lack of information on markets, lack of skilled labor and the lack of information on technologies.

Each of these problems is influenced by a large number of external and internal factors. For example, the provision of additional sources of funding is primarily affected by a large number of external factors, such as high interest rates (78 % of respondents pointed to this factor), high bank fees (38 %), the necessity of collateral—guarantees (33 %), a limited amount of the loan (20 %) and long procedure of loan approval (18 %), as well as internal factors, such as low creditworthiness of entrepreneurs, high indebtedness, insolvency and so on. Reshaping of some of the

[1] That entrepreneurs themselves do not regard the global economic crisis as the main cause of poor performance is evidenced by the fact that based on the survey of owners of SMEs and entrepreneurs in Serbia about the situation, needs and problems in business (NARD 2012), 28 % of entrepreneurs claimed that the crisis did not have significant impact on their business, which is two times more than in 2011 and 180 % more than in 2010.

[2] The research was conducted on the basis of the survey of 2555 owners of SMEs and entrepreneurs. Based on their subjective evaluation, they graded these factors by using grades 1–6, where 1 was the grade assigned to the factor that had the strongest impact and 6 was the grade assigned to the factor with the least impact on the business of entrepreneurs.

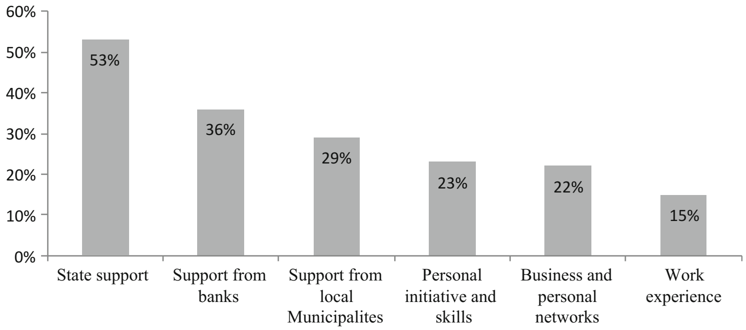

Fig. 1 Factors that need to be improved in the first place (Multiple-choice questions were provided. This is the presentation of the most frequently given answers.) *Source*: NARD (2013)

Table 1 Movement of selected external factors of the business of SMEEs in the period 2004–2012

Factor	2004	2005	2006	2007	2008	2009	2010	2011	2012
Financial support of the Development Fund of the RS (in millions of euros)	133.6	102.1	120.3	190.5	186.0	295.2	184.6	157.2	181.5
Banks' interest rate on loans (%)	15.5	16.8	16.6	11.1	16.1	11.8	17.3	17.2	17.4
The number of procedures to start a business	12	12	11	11	11	11	7	7	7

Source: Ministry of Regional Development and Local Self-Government (2012, 2013), The World Bank (2014), Doing Business (2014), The World Economic Forum (2013)

major external and internal factors can affect the improvement of problematic business segments. Key aspects of the business that need to be improved in the opinion of the respondents are shown in the Fig. 1.

As the Fig. 1 shows, the key factors that can contribute to the improvement of business are state support (53 %), support of commercial banks (36 %), support of the local self-government (29 %). Therefore, in the following segment we will take into account some key macroeconomic factors, such as the state financial support from the Development Fund of the Republic of Serbia, banks' interest rates and the number of procedures to start a business (as given in the table below), as opposed to what will be a detailed analysis of the impact of internal factors on the growth and development of the entrepreneurial sector in Serbia. Data related to the movement of external factors in the analyzed period (2004–2012) are given in Table 1.

It is characteristic that significantly fewer respondents recognize that it is necessary to improve personal initiative and skills (23 %) as well as work experience (15 %), business and personal contacts and networks (22 %). These suggest that Serbian entrepreneurs still believe that factors from the external environment

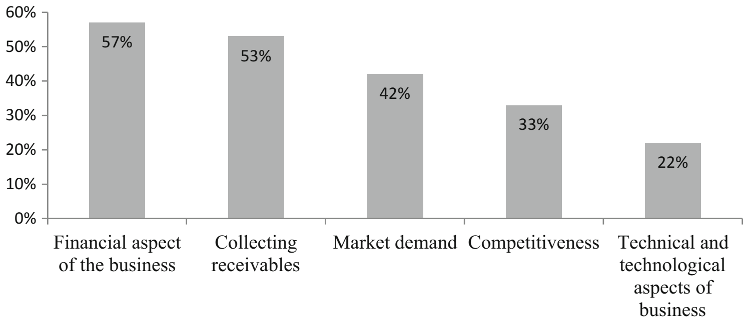

Fig. 2 Aspects of business that need to be improved in the first place (Multiple-choice questions were provided. This is the presentation of the most frequently given answers.) *Source*: NARD (2013)

have a crucial impact on the success of their business, as well as to low willingness of entrepreneurs to realize the problems that stem from their lack of knowledge, competencies, skills, experience and poor business and social networking. In contrast, we believe that internal factors related to entrepreneurs' knowledge, skills and ability to conduct business have a very large impact on the business of entrepreneurs.

In order to identify business areas that create the greatest number of problems for entrepreneurs and constrain the development of entrepreneurship, this chapter will start from the results obtained by surveying entrepreneurs (NARD 2013), which are shown in the Fig. 2, and the results of our previous studies (Ivanovic-Djukic and Stefanovic 2011).

Therefore, the respondents have estimated that the key aspects of business that should be improved are: financial management (57 %), receivables collection (53 %)[3] and improving competitiveness in order to increase demand for their products (33 %). Since most of the respondents have mentioned these three aspects of business as the most important, we will analyze their impact on the growth and development of the entrepreneurial sector in Serbia. Bearing in mind that each of these aspects of business are complex and whose monitoring can involve a large number of indicators, we will first analyze each area individually with the help of partial indicators that are relevant for each area, after which for some of them a corresponding composite indicator will be created.

The first area of business that needs improvement is related to financial management. Deeper analysis of financial indicators points to a conclusion that during the observed period Serbian entrepreneurs experienced serious financial structure changes related to increasing the level of indebtedness, which resulted in the increase of financial risk, reduced earning capacities, increased illiquidity and

[3] Research has also shown that micro and small enterprises and entrepreneurs are the ones that have the biggest problems with these aspects of business, which indicates insufficient capacities of the owners of these enterprises and entrepreneurs to face the problems of financial management.

Table 2 Financial indicators of Serbian SMEEs for the period 2004–2012

Year	Receivables turnover ratio	Current ratio of liquidity	Rate of return on average working capital	Solvency ratio	Debt ratio	Financial leverage	Interest coverage ratio
2004	3.18	0.92	10.54	0.72	0.58	1.11	6.96
2005	2.97	0.96	15.77	0.70	0.59	1.17	7.06
2006	3.05	1.01	16.80	0.73	0.59	1.12	9.65
2007	2.89	1.05	15.94	0.64	0.61	1.09	12.14
2008	2.69	1.00	12.78	0.58	0.63	1.18	6.65
2009	2.28	0.97	9.86	0.57	0.64	1.28	5.50
2010	2.15	0.96	9.48	0.56	0.64	1.24	5.25
2011	2.21	0.94	11.14	0.56	0.64	1.16	5.25
2012	1.96	1.00	9.57	0.59	0.63	1.18	5.75

Source: Authors' own calculations based on the data of Business Registers Agency—BRA (2004–2012)

insolvency of Serbian entrepreneurs, and caused gradual melting of equity and bankruptcy of a number of entrepreneurs (Ivanovic-Djukic and Stefanovic 2011). In this regard, indicators by which we will monitor the success of the financial management of Serbian entrepreneurs will be: debt ratio, the factor of financial leverage and solvency ratio. Dynamics of these indicators, as well as data on the dynamics of earning capacity and losses that caused the melting of the capital in the period from 2004 to 2012 are shown in the Table 2.

The Table 2 shows that the financial structure of the Serbian entrepreneurs was constantly changing in this period. The share of debts in the financial structure continuously increased at the expense of the equity, and indebtedness of SMEEs was getting bigger. Higher indebtedness has led to an increase in the burden of business performance by financial expenses (as evidenced by interest coverage ratio that decreased gradually, starting from 2008) and an increase in financial risk (which is here presented by financial leverage), which resulted in reducing earning capacities and reducing liquidity and solvency of Serbian SMEEs.

Financial leverage in Serbian SMEEs in 2009 has risen sharply, indicating a very high financial risk and pronounced negative effects of the poorly composed financial structure on business performance. This has led to a reduction in the earning capacity of Serbian entrepreneurs and the slowdown of their growth, as well as the reduction in solvency, liquidity and creditworthiness of Serbian entrepreneurs. First of all, insufficient debt-equity ratio increased insolvency of Serbian entrepreneurs by 22 % in the period from 2004 to 2012 and increased debt asset ratio. It follows that the indebtedness of SMEEs in the Republic of Serbia in terms of long-term debts and current liabilities, year after year, permanently increased. Similar trends occurred in the movement of liquidity and creditworthiness of Serbian entrepreneurs.

Another severe problem of Serbian SMEEs is related to collecting receivables. Entrepreneurs in the RS are faced with a very long receivables collection period,

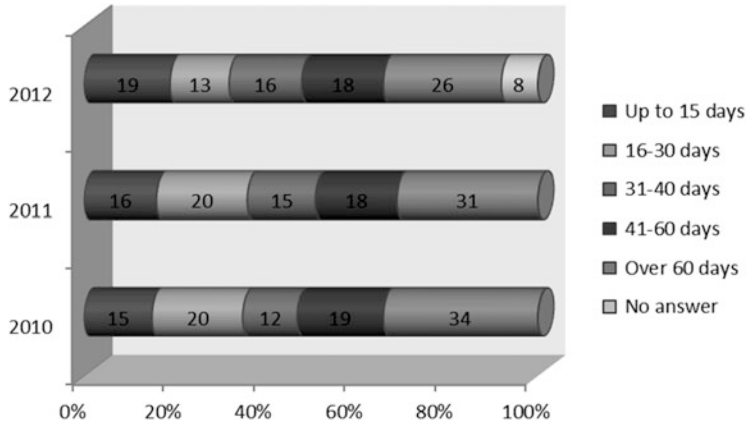

Fig. 3 Dynamics of receivables collection for the period 2010–2012. *Source*: NARD (2010, 2011, 2012) (modified)

and short accounts payable deadlines. Movement of receivables collection period of Serbian SMEEs for the period 2010–2012 (for which data are available) occurred as shown in Fig. 3.

Given the fact that the data on a number of receivables collection days have been presented in NARD reports since 2010, while the time series of other indicators have been monitored for the period 2004–2012, in order to obtain data that would allow statistical analysis of time series of relevant indicators, we chose to monitor the receivables turnover ratio, since it indicates the efficiency of collecting receivables in a firm. As shown in Table 2, receivables turnover ratio decreased by 62 % in the period from 2004 to 2012. The reduction of this ratio indicates that in the SMEE sector in Serbia, year after year, an increasing share of sales revenue remained uncollected at the end of the year, meaning that income from sales became relatively smaller and smaller. Reducing the inflow of sales income (as a key source of funding) caused a decrease in the ability to pay due accounts receivable. This is confirmed by the liquidity ratio that has been recording gradual decline since 2007. Reduced liquidity due to difficulties in collecting receivables forced entrepreneurs to take out loans for maintaining liquidity, often at very high interest rates. Interest expense led to a reduction in earnings per unit of average engaged working capital, as seen by the rate of return on working capital. As can be seen from the Table 2, in the period from 2006 to 2010 this rate gradually decreased, while in 2011 and 2012 it recorded a gradual increase.

The last identified area of concern is related to the competitiveness of Serbian entrepreneurs. According to the World Economic Forum, Serbia is one of the least competitive European countries and its competitiveness is deteriorating. Specifically, based on the Global Competitiveness Report for 2011–2012, Serbia was ranked 95th out of 142 countries. In the Report for 2012–2013, it was ranked 95th among 144 countries, whereas in the Report for 2013–2014 it was ranked 101st out of 148 countries (WEF 2013). Given this data, we have chosen to monitor cost competitiveness indicators of Serbian SMEEs. Cost competitiveness of the non-financial sectors of the Serbian economy is monitored by way of the average labor cost, labor costs per hour and unit labor costs,[4] given in Table 3, on the basis of which we have chosen to calculate the cost competitiveness composite indicator of Serbian SMEEs.

Based on all these data on the dynamics of selected internal and external factors of business and development of the SMEE sector in Serbia, we established statistical research model and performed statistical analysis, which follows below.

3 Hypotheses, Statistical Model and Discussion of Results

Research on the state, needs and problems of SMEEs in Serbia, conducted on the basis of the survey of 2555 SME owners and entrepreneurs in Serbia, identified the following as the most important requirements for business improvement: more support from the government, fewer government restrictions and greater support from commercial banks. At the same time, entrepreneurs attached the least importance to better management. In addition to the undoubtedly great influence of government financial incentives, reduced administrative procedures and favorable conditions of lending provided by commercial banks in the form of interest rates on the establishment, growth and development of the SME sector in Serbia, that is, external factors (Stefanovic et al. 2013), the authors believe that the growth and competitiveness of SMEEs in Serbia requires strengthening entrepreneurs' internal forces. In addition to the development of innovative and knowledge-intensive products and higher exports, the growth of the entrepreneurial sector in Serbia is largely influenced by internal factors reflected in better financial management, efficient receivables collection and higher cost competitiveness. Taking this into consideration, the following research hypotheses have been established:

H1: Financial management in the field of financial structure design affects the growth of SMEEs in Serbia.
H2: More efficient receivables collection encourages the growth of SMEEs in Serbia.
H3: Increased cost competitiveness affects the growth of SMEEs in Serbia.
H4: Higher state financial incentives, particularly from the Development Fund, encourage the growth of SMEEs in Serbia.
H5: Improved lending conditions of banks through lower interest rates have a positive impact on the growth of SMEEs in Serbia.
H6: Reducing administrative procedures affects the growth of SMEEs in Serbia.

[4] Unit labor costs (ULC) stand for the average labor cost per unit of production expressed as the ratio of gross earnings to gross domestic product, that is, ratio of total labor costs to real output. Economy with lower ULC can be considered competitive and is able to increase its international market share.

Table 3 Cost competitiveness indicators of Serbian SMEEs

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012
Average labor costs (in thousands of RSD)	239.4	333.9	428.6	487.3	552.1	599.1	640.8	712.9	783.8
Labor costs per hour (in RSD)	114.6	159.9	205.3	233.4	263.4	286.9	306.9	342.7	375.4
Unit labor costs	0.505	0.580	0.631	0.614	0.619	0.672	0.639	0.639	0.627

Source: MoE, MoRDLS, NARD (2013) (modified)

It should be noted that, due to a large number of indicators reflecting the efficiency of financial management or financial structure design, a composite indicator was created, as was the case with cost competitiveness. Efficiency in receivables collection was monitored through receivables turnover ratio. In considering the indicators pointing to the growth and development of the entrepreneurial sector, we started from a number of possible indicators (the number of newly established SMEEs, the number of new employees in SMEEs, turnover, gross value added). However, in view of the comprehensiveness of the SMEE sector, we decided to monitor the growth of the entrepreneurial sector through gross value added (GVA). Therefore, the gross value added was identified as the dependent variable and observed for the period 2004–2012 while the factors were defined as independent variables. Accordingly, the statistical model is based on the following variables:

Dependent variable: Gross value added of SMEEs.

Independent variables:

- The composite indicator of financial management
- Receivables turnover ratio
- The composite indicator of cost competitiveness
- Financial incentives from the Development Fund of the Republic of Serbia
- Interest rates on loans from commercial banks
- Number of administrative procedures when establishing a business.

By applying principal component analysis and linear aggregation, two composite indicators have been created: financial management and cost competitiveness.

The composite indicator of *financial management* consists of three variables:

- Interest coverage ratio
- Capital structure (debt ratio)
- Financial leverage

The composite indicator *cost competitiveness* consists of three variables:

- Average labor costs
- Labor costs per hour
- Unit labor costs

Prior to the implementation of the principal component analysis, which belongs to the methods of factor extraction in factor analysis, all the above variables were normalized. The modified method of min-max transformation (in accordance with the methodology of the World Economic Forum) was applied. Equation on the basis of which the normalization of variables was performed is:

$$TI_{ji} = 6 \times \frac{I_{ji} - I_j^{min}}{I_j^{max} - I_j^{min}} + 1 \tag{1}$$

where:

Table 4 Composite indicators

Year	Indicator of financial management	Indicator of cost competitiveness
2004	1.710	1.000
2005	2.726	2.866
2006	2.908	4.550
2007	3.925	5.410
2008	4.003	6.168
2009	5.108	6.341
2010	4.592	5.814
2011	3.703	6.638
2012	3.747	6.426

Source: Our own calculations

TI_{ji}—transformed value of variable *j* in year *i*
I_{ji}—the value of variable *j* in year *i*
I_j^{min}—the minimum value of variable *j* in all years
I_j^{max}—the maximum value of variable *j* in all years.

After normalization with the help of principal component analysis, the weights of each variable in the structure of composite indicators were determined. The basis for calculating the weights were factor loadings obtained in applied analysis. After linear aggregation, the values of composite indicators were obtained (Table 4).

Correlation coefficients between the dependent and independent variables were calculated first, and the results are shown in the Table 5.

The Table 5 shows that the strongest direct correlation exists between GVA and incentives from the Development Fund of the RS (which is shown by the correlation coefficient amounting to 0.833). This means that the increase in approved funds from the Development Fund during the observed period was followed by an increase in GVA of the SMEE sector and vice versa. The statistical significance of this correlation is also very high (actual significance level is 0.005), so that the conclusions can be generalized, and we can say that the annual amount of approved funds from the Development Fund is in direct correlation with the amount of gross value added of the SMEE sector. In contrast, the low level of correlation was characteristic of banks' interest rates on loans and GVA (the correlation coefficient is −0.267), meaning that a decrease in interest rates during the period was accompanied by an increase in GVA. Such a weak correlation can be explained by the fact analyzed above, implying that due to unfavourable lending conditions and the long-term impact of the economic crisis, entrepreneurs in Serbia are not inclined to take loans out, relying more on their own resources in business development. Similarly, the reduction of administrative procedures was accompanied by an increase in GVA of the SMEE sector in Serbia (the correlation coefficient is −0.374).

With respect to internal factors, the strongest correlation exists between GVA and indicators of financial management (correlation coefficient is 0.75) and cost competitiveness (0.617), while a slightly lower correlation exists between GVA and

Table 5 Correlation coefficients

	GVA	Receivables turnover ratio	The composite indicator of financial management	Financial incentives from the Development Fund	Lending interest rate	Number of administrative procedures	The composite indicator of cost competitiveness
Receivables turnover ratio	−**0.467**	1.000					
	(0.205)						
The composite indicator of financial management	**0.750***	−0.633	1.000				
	(0.020)	(0.067)					
Financial incentives from the Development Fund	**0.833****	−0.450	0.883**	1.000			
	(0.005)	(0.224)	(0.002)				
Lending interest rate	−**0.267**	−0.600	−0.100	−0.417	1.000		
	(0.488)	(0.088)	(0.798)	(0.265)			
Number of administrative procedures	−**0.374**	0.882**	−0.499	−0.321	−0.615	1.000	
	(0.321)	(0.002)	(0.172)	(0.400)	(0.078)		
The composite indicator of cost competitiveness	**0.617**	−0.850**	0.567	0.483	0.367	−0.811**	1.000
	(0.077)	(0.004)	(0.112)	(0.187)	(0.332)	(0.008)	

Note: Realized level of significance (p-value) are given in parentheses
*Correlation is significant at the level 0.05
**Correlation is significant at the level 0.01

Table 6 Regression analysis

Model	Unstandardized coefficients B	Unstandardized coefficients Std. error	Standardized coefficients Beta	T	Sig.
(Constant)	−12,902.801	13,252.163		−0.974	0.433
Receivables turnover ratio	4275.087	3439.339	0.798	1.243	0.340
Financial incentives from the Development Fund	20.449	21.425	0.474	0.954	0.441
Lending interest rate	140.114	320.072	0.139	0.438	0.704
Number of administrative procedures to register a business	−302.093	503.037	−0.275	−0.601	0.609
The composite indicator of financial management	−406.138	1036.039	−0.172	−0.392	0.733
The composite indicator of cost competitiveness	1595.764	444.160	1.264	3.593	0.069

receivables turnover ratio (−0.467). This means that GVA growth was accompanied by an increase of the composite indicator of financial management, as well as an increase in the composite indicator of cost competitiveness. Since the significance level of each of these indicators is >0.05 the conclusions cannot be generalized, but applied only to the specific period of time from 2004 to 2012.

The results of applied regression analysis show that the estimated model was representative since the coefficient of determination was high and amounted to 0.96, the same as the adjusted coefficient of determination which amounted to 0.839. The estimated values of parameters of the created regression model are given in the Table 6:

Table 6 shows the impact of changes in each of the independent variables on the GVA in the observed period. The increase in the receivables collection ratio by one turnover led to an average increase in GVA by 4275 million euros in the observed period. Given that the receivables turnover ratio decreased (which means that the receivable collection period prolonged) in the observed period, this factor had an extremely negative impact on the GVA and the growth of the SMEE sector, and vice versa, thus confirming the H2 hypothesis.

The situation is similar with the effect of other internal factors. Due to the increase in the debt ratio, which caused an increase in interest coverage ratio and triggered a negative effect of financial leverage, financial management worsened and had a negative impact on GVA, which is confirmed by a negative regression coefficient attached to the composite indicator of financial management. More specifically, this coefficient shows that the deterioration in indicators of financial management by 1 index point in the observed period led to an average reduction of GVA by 406 million euros. This confirms the hypothesis H1. In addition, the increase in cost competitiveness indicators of Serbian SMEEs also affected GVA. More specifically, the increase in the composite indicator of cost competitiveness by 1 index point caused an increment of GVA by 1595.764 million euros, which proves the hypothesis H3.

When analyzing the impact of external factors, the following conclusions can be drawn. Increasing the amount of funds approved by the Development Fund by 1 million euros caused an average increase in GVA by 20 million euros in the observed period. This proves hypothesis H4. The increase in banks' interest rates on loans led to an average increase in GVA by 140 million euros in the observed period. Therefore, hypothesis H5 cannot be confirmed. This result can be explained by the fact that during the observed period interests alternately increased and decreased in certain years, whereas GVA constantly grew. Increasing the number of administrative procedures in the course of establishing business led to an average reduction of GVA by 302 million euros in the observed period, which proves the hypothesis H6.

4 Chapter Summary

It can be concluded that the SMEEs in Serbia in the past had faced a number of problems which mainly had a constraining effect on the development of this sector. Analysis of the impact of external factors confirmed the undeniable fact that the impact of state incentives (primarily financial) is of great importance for the development of the entrepreneurial sector in Serbia. Increasing incentives from the Development Fund (in the form of grants or soft loans for fixed and current assets, establishment of start-ups, encouraging women's entrepreneurship and other incentives) leads to an increase in the GVA, growth and the development of SMEEs. Therefore, the state should make an effort to ensure greater amounts from this fund in the future. In addition to state loans, efforts must be directed towards improving commercial banks' credit conditions for entrepreneurs. Although no statistically significant relationship between banks' credit conditions and GVA has been determined, this result is mainly attributable to variation in interest rates on loans from year to year and a low propensity Serbian entrepreneurs to borrow due to poor credit conditions, rather than to the actual absence of these connections. A similar situation exists in terms of the number of administrative procedures which have a negative effect on the growth and development of the entrepreneurial sector. In this regard, the government has already taken some steps towards reducing these regulations (the so-called program of the "regulatory guillotine").

Besides the negative impact of the factors from the macroeconomic environment, the slowdown of the growth in the SMEE sector was also affected by a large number of internal factors. In this study we investigated the impact of factors related to financial management, receivables collection and cost competitiveness because in the opinion of SME managers and entrepreneurs, improvement of these areas can make the greatest contribution to the development of the SMEE sector. With the help of the regression model we confirmed that the changes in the financial structure, caused by an increase in debt ratio, created a number of problems for entrepreneurs (liquidity reduction, solvency reduction, reduced earning capacity, increased losses above capital etc.), which negatively affected the GVA in the period from 2004 to 2012. In this regard, entrepreneurs in Serbia can be advised to take care of the effects of financial risk when taking out loans in the future, since any borrowing in a situation where the average rate of interest is higher than the rate of return on operating assets causes a negative impact of financial leverage on profitability and liquidity, which is more pronounced if the debt ratio is higher.

Furthermore, this chapter has shown that difficulties in receivables collection created numerous problems to SMEEs in Serbia in the period from 2004 to 2012, so that the reduction of receivables turnover ratio (caused by extending receivables collection period) negatively affected GVA. In this regard, entrepreneurs and managers in the RS may be advised to check customers' liquidity and solvency when allowing deferred payment. Economic policy makers may be advised to impose harsher sanctions for non-compliance with contractual obligations relating to the payment deadlines.

In addition, the study has shown that the serious problems for Serbian entrepreneurs were created by cost increase, that is, decrease in cost competitiveness, which had a negative impact on the GVA. Given that the decrease in cost competitiveness, caused by an increase in average labor costs, labor costs per hour and unit labor costs, had a negative impact on the growth and development of the entrepreneurial sector in Serbia. For better international positioning of Serbian SMEEs in the future, more efficient exploitation of resources in doing business that lead to reduced costs, will be of great importance.

One of the important constraints to the model concerns the fact that it is designed on the basis of available statistical data. Due to a lack of appropriate data for the analyzed period from 2004 to 2012, we were not able to analyze the impact of all relevant factors (for example, number of receivables collection days). What is more, an indicator of financial management can be seen through some other indicators, but not through the analyzed indicators that are related to financial structure design and that we decided to use to achieve the balance of indicators in the model. Since the results of the analysis showed a low level of significance of the observed factors (significance >0.05), conclusions regarding the hypotheses cannot be generalized, thus they can only be referred to the observed period.

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Innovation and Firm-Performance Correlations: The Case of Central and South Eastern Europe Countries

Hyrije Abazi-Alili, Veland Ramadani, and Shqipe Gërguri-Rashiti

Abstract The aim of this paper is to investigate the determinants of innovation activities and their impact on firm performance. For the empirical analysis of the study we employ Business Environment Enterprise Performance Surveys (BEEPS) firm-level data. To examine the relationship between innovation activities and firm performance we apply instrumental variable (IV) technique, which enables us to control for the endogeneity between innovation activities undertaken by entrepreneurial businesses and their performance. Our findings suggest that enterprises' size, R&D intensity, competition, skilled workers and export activity have positive and significant impact on their incentive to undertake innovation activities. Considering the determinants of productivity, we find evidence that enterprises that have undertaken innovation activities (instrumented variable) and having higher degree of skilled workers and that are European Union member country enterprises perform better.

1 Introduction

Based on the statistics showing that US experienced increasing average annual labour productivity from 1.2 % in the 1973–1995 period to 2.3 % from 1995 to 2006, whereas in 15 EU countries (members up to 2004) occurs productivity growth slowdown with annual rate of 2.4 % in the 1973–1995 period to 1.5 % from 1995 to 2006 one can say that there is evidence for US experiencing higher labour produc-

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_9

tivity growth than EU (Ark et al. 2008). Several studies have shown that the US increase in labour productivity is attributable to intensive development of innovation activities (O'Mahony et al. 2010; Crescenzi and Rodriguez-Pose 2011; De Faria and Mendonca 2011). In order to increase the innovation activities undertaken by firms in the EU the Lisbon Strategy set a goal for Europe to become "the world's most competitive and dynamic knowledge-based economy in the world, capable of sustaining growth with more and better jobs and greater social cohesion" by 2010. This aspiration also presents the first priority area of the 'Europe 2020' Strategy, which is 'smart growth' through the development of knowledge, innovation, and education (European Commission 2010). Accordingly, EU has set itself an ambitious target—the Barcelona objective—of increasing R&D expenditures to 3 % of GDP in particular by improving the conditions for R&D investment by the private sector, and developing a new indicator to track innovation (European Commission 2010; Ramadani and Schneider 2013). In order for accomplishing these goals the OECD (2005) has prepared an 'innovation strategy', containing the following major themes: (i) the "openness" of innovation; (ii) the central role of entrepreneurship; (iii) creating and applying knowledge; (iv) applying innovation to address global and social challenges; and (v) improving the governance of policies for innovation. Entrepreneurship and innovation activities in transition economies are discussed in Ateljevic (2013), Tesic (2012), Dana (2010) and Smallbone and Welter (2009).

The literature on the correlation between innovation activities and firm performance (henceforth innovation-performance correlation) varies on different ways of defining innovation and on the measures employed, with challenges faced related to the problem of finding relevant variables for measuring innovation activities. The most often employed measures in the empirical literature are: R&D expenditure—as a measure of input; patents—as a measure of output; and introducing new product/new process—as output accepted by the market. Further we investigate the empirical evidence on the correlation between innovation activities and firm performance. The main focus is on the data and methodology used in these studies. This stream of literature mainly applies structural approach for modelling innovation.

For the purpose of the chapter we empirically investigate the innovation-performance correlation. A dataset derived from the Business Environment and Enterprise Performance Survey (BEEPS) of 2002, 2005 and 2009 is employed, and we apply instrumental variable technique.

The structure of the chapter is as follows. In Sects. 2 and 3 we review the literature related with the innovation-performance correlation, with main focus on the model and the determinants of innovation activity. Section 4 elaborates the sample and the data. Section 5 considers the methods of investigation and the empirical estimations. The interpretation of the results and conclusions are provided in Sect. 6.

2 Theoretical Background

2.1 Transition Process in Central and South Eastern Europe Economies: Reflections[1]

Few months ago, the world celebrated the 25th Anniversary of Berlin Wall downfall and starting the transition process of former socialist countries—an event fueled by expectations and hopes for a better life. Reflecting upon this event from today's perspective rise a lot of questions: Did the transition meet the expectations? Whether the defined aims and goals are really accomplished? Were there formulated clear strategies and approaches on how these countries will deal with the new circumstances? Did the transition process started too early and found them unprepared? Do the people live better after the transition? Did the people of these countries expected too much? Is still present the nostalgia for the past? What we have learnt from the transition? . . . and too many other questions, which are or still waiting to be answered.

On May 6–7, 2014, in Budapest, Hungary was organized a 2-day symposium, entitled *'Transition in Perspective'*. It was organized by Peterson Institute for International Economics and School of Public Policy at Central European University. The aim of the symposium was to assess the lessons learnt from the transition process and 'builds' a road ahead. Some of conclusions from this symposium are summarized as follows (Aslund 2014):

- In terms of economic performance can be concluded that the overall transition was a success since each sub-region has increased its share of the global economy;
- Avoiding rent seeking and gradualism was seen as the key for success to ensuring a parallel movement political and economic reforms;
- The most crucial part of the transition process was the privatization of *all* state-owned enterprises;
- The privatization process still remains a sensitive and controversial matter, for instance Russia and Hungary stand out as examples of the fragility of the post-socialist transition and the fact that privatization can be reversed.
- It was concluded that the European Union and the International Monetary Fund are important tools, however, they cannot do the job on their own;
- There is still a clear division between the Central and East European countries that have or are on that track to become members of the EU and the former Soviet republics, which are far more corrupted;
- An important issue was the disrupting of the old communist elites, who were corrupted by their hypocrisy of obedience to an ideology that nobody believed in. A part of them, especially in Russia and Bulgaria, has turned out to be the

[1] Based on Dana and Ramadani (2015).

secret police, being the least transparent, the most lawless, the most ruthless, and also the most international.

- During the transition process a positive impact of a strong civil society and national cohesiveness was emphasized;
- Poland and Estonia were accentuated as the greatest economic and political successes seen from today's perspective;
- Even though Hungary and Poland were recognized as reform leaders in the 1990s, however, since 2001 these countries have regressed;
- Even though Slovakia was delayed in economic reforms in the 1990s, however, it managed to catch up by adopting reforms in 2003–2004, producing the highest economic growth in Central and Eastern Europe in 2000–2010;
- It was emphasized that Georgian Rose Revolution in 2003 contributed greatly to improvement; some improvement was experienced in Moldova while adjusting to the European Union.

Although in the first years of transition, most of Central and South Eastern Europe (CEE and SEE) countries were experiencing very disordered and uneven economic performance, however, in general, it can be concluded that they perform better today than before 1989 (Arriba Bueno 2010). Almost each of them has increased its GDP/per capita, i.e. only five countries have not reached their GDP per capita level of 1990 as yet (Aslund 2014). These countries are Macedonia, Kyrgyzstan, Moldova, Tajikistan and Ukraine (Wyplosz 2014). The pace of GDP/per capita in transition economies is presented in Table 1.

Good protection of property rights, effective execution of contracts and the law is directly related to fostering and development of the economic activities. The protection of property rights remains to be a real challenge for CEE and SEE economies. Based on International Property Rights Index 2013, from 131 analyzed countries, the most of CEE and SEE countries are ranked in the 'second part' of the list. These issues are broadly discussed in Di Lorenzo (2013). Even that in some countries in transition, such as Estonia, Slovakia, Czech Republic, Poland, Bulgaria and Romania, is identified a slight progress (Di Lorenzo 2013), the judicial system is still inefficient and subject to political influence (Ramadani 2013; Ramadani and Schneider 2013).

As it was noted in the conclusions of the above mentioned symposium, the privatization of state-owned enterprises was among the most important, but in meantime, the most contentious aspect of the transition process. Nowadays, the privatization process remained controversial, raising concerns about fairness, justice, and trust for the reason that a lot of state-owned enterprises have been handed to oligarchs and insiders in most of the countries, especially in Russia and Hungary (Aslund 2014). Here should be mentioned that each country has applied different privatization methods (see Table 2).

Long administrative and bureaucratic procedures represent a serious obstacle of doing business. Fiti and Ramadani (2013) noted high correlation between the administrative and bureaucratic procedures (expressed by the number of necessary procedures and required days for starting a new business) and corruption—the more procedures, the more opportunities for corruption. Regarding this issue, most of

Table 1 GDP/per capita in transition economies (1989–2013)

Country name	1989	1990	1991	1999	2000	2007	2008	2012	2013
Albania	723	639	349	1.105	1.193	3.639	4.423	4.406	4.652
Armenia	–	637	589	597	621	3.079	3.917	3.354	3.505
Azerbaijan	–	1.237	1.209	574	655	3.851	5.575	7.394	7.812
Bulgaria	2.450	2.377	1.268	1.611	1.579	5.581	6.917	7.022	7.296
Bosnia and Herzegovina	–	–	–	1.249	1.436	3.950	4.802	4.396	4.656
Belarus	–	1.705	1.747	1.210	1.273	4.736	6.377	6.722	7.575
Czech Republic	–	3.787	2.783	6.045	5.734	17.524	21.708	18.690	18.861
Estonia	–	–	–	4.132	4.063	16.405	17.786	16.887	18.478
Georgia	–	1.611	1.310	629	692	2.318	2.920	3.529	3.602
Croatia	–	5.185	4.026	5.068	4.862	13.372	15.694	13.159	13.530
Hungary	2.783	3.186	3.288	4.714	4.543	13.535	15.365	12.560	
Kazakhstan	–	1.647	1.512	1.130	1.229	6.771	8.514	12.120	13.172
Kyrgyz Rep.	–	609	576	258	280	722	966	1.178	1.263
Kosovo	–	–	–	–	1.088	2.736	3.303	3.567	3.816
Lithuania	–	2.841	2.777	3.113	3.267	12.102	14.775	14.172	
Latvia	2.884	2.796	2.549	3.049	3.309	13.073	15.464	13.947	
Moldova	–	972	835	321	354	1.231	1.696	2.047	2.230
Macedonia	–	2.225	2.342	1.806	1.748	3.892	4.686	4.548	4.851
Montenegro	–	–	–	–	1.610	5.946	7.336	6.514	7.126
Poland	2.166	1.694	2.187	4.340	4.477	11.157	13.886	12.721	13.432
Romania	1.790	1.651	1.254	1.584	1.662	8.170	9.949	8.437	9.499
Russia Fed.	3.429	3.485	3.427	1.331	1.772	9.145	11.700	14.091	14.612
Serbia	–	–	–	2.338	809	5.277	6.498	5.294	5.935
Slovak Rep.	1.852	2.211	2.474	5.550	5.330	15.649	18.201	16.893	
Slovenia	–	8.699	6.339	11.250	10.045	23.441	27.015	22.059	

(continued)

Table 1 (continued)

Country name	1989	1990	1991	1999	2000	2007	2008	2012	2013
Tajikistan	–	496	468	178	139	523	709	953	1.037
Turkmenistan	854	881	848	551	645	2.607	3.919	6.798	7.987
Ukraine	1.597	1.570	1.490	636	636	3.069	3.891	3.873	3.900

Source: World Bank (2014)

Table 2 Privatization methods

Country	Primary method	Secondary method
Czech Republic	Mass	Direct sales
Slovak republic	Direct sales	Mass
Slovenia	MEBOs	Mass
Hungary	Direct sales	MEBOs
Poland	Direct sales	MEBOs
Estonia	Direct sales	Mass
Latvia	Direct sales	Mass
Lithuania	Mass	Direct sales
Bulgaria	Direct sales	Mass
Romania	MEBOs	Direct sales
Albania	MEBOs	Mass
Croatia	MEBOs	Mass
Macedonia	MEBOs	Direct sales

Source: Bennett et al. (2004)

transition countries have marked significant improvements—most of them are in a better position comparing to some European Union (EU) countries, such as Spain, Greece and Malta (Doing Business 2014). If we see the Doing Business ranking list, from the group of transition countries, in Top five countries are ranked: Georgia (8th place), Lithuania (17th), Estonia (22nd), Latvia (24th) and Macedonia (25th). Here should be pointed that the introduction of the so-called one-stop system contributed significantly to shortening the procedures and timeframe to start a new business.

According to reports of the EBRD (2013), although in CEE and SEE countries there was a certain reduction of corruption in its three basic forms of existence: *bribe tax* (as a percentage of total sales of enterprises), *kickback tax* (as a percentage of the value of contracts in the form of additional and unofficial payments to ensure receipt of contracts) and *bribery frequency* (as percentage of respondents who said they accepted to pay bribes in customs, tax administration etc.), it still presents a serious problem. Shkolnikov and Nadgrodkiewicz (2010) stated that high-level scandals continue to blow up elsewhere. For example, corruption continues to devour Bulgaria and Romania, and for this reason they have been subjected to strong criticism from EU, who decided to withhold Bulgaria's development funds; in the Czech Republic, officials from Defense Ministry were accused of corruption in connection with commissioning overpriced public contracts; in Hungary, the nation was shocked when the government admitted to lying about economic performance in order to win elections, in Poland have been identified many cases of excessive pressure of private interests on legislation; etc. Transparency International Corruption Perceptions Index 2013 shows that countries in transition are mostly ranked in positions from middle to high corrupted countries (Transparency International 2014).

Although progress is evidenced in almost all spheres of economic and politic life, nostalgia for the past in post-socialist countries still remains strong—most of the people feel that new system didn't achieve to realize the expected and hoped results (Ellman 2012; Arriba Bueno 2010). Different surveys that were conducted in post-socialist countries can confirm this. For instance, in Hungary, 70 % of the people who were already adults at the time of the Berlin Wall fall are dissatisfied with the transformations in the political system; in Bulgaria, around 60 % of citizens believe they lived better under communism; in Poland, 44 % of people have positive thoughts about former communist rule—the numbers go higher among the elderly, 54 % (Shkolnikov and Nadgrodkiewicz 2010). Anelia Beeva, a Bulgarian girl around 30s once stated: "[Before] we went on holidays to the coast and the mountains, there were plenty of clothes, shoes, and food. And now the biggest chunk of our incomes is spent on food. People with university degrees are unemployed and many go abroad" (Mudeva 2009). Even though a lot of weaknesses and obstacles occurred during the transition process however, transition has had a lot of positive impact on the development of many post socialist countries.

2.2 Innovation and Performance

Firms today act under a big pressure by other firms, which offer the same or similar production or service, or they are under the pressure of the customers who expect more and more from the product they consume. In order to face with the new conditions and situations, firms are made to continuously search for new ways of production, namely offering new products or enhancing existing ones (Ramadani et al. 2013; Gerguri et al. 2013; Kariv 2010; Baronet and Riverin 2010). In other words, they should continuously introduce innovations. But, what in fact do innovations represent?

Schumpeter (1934, p. 66), defined innovation in a broad sense, as "carrying out of new combinations" that include "the introduction of new goods (. . .), new methods of production (. . .), the opening of new markets (. . .), the conquest of new sources of supply (. . .) and the carrying out of a new organization of any industry". He was the first to develop a three-stage classification: invention, innovation and diffusion, known as Schumpeterian trichotomy (Jaffe et al. 2004; Clausen 2011). Innovation in the Schumpeterian scheme encompasses one of the three stages, however it is often used broadly to refer to all stages of the technological change process. Lionnet (2003, p. 6) defines innovation as a process by which a novel idea is brought to the stage where it eventually produces money. It is a dynamic technical, economic and social process involving the interaction of people coming from different horizons, with different perspectives and different motivations. Ramadani and Gerguri (2011, p. 102) define innovations as "a process of creating a new product or service, new technologic process, new organization, or enhancement of existing product or service, existing technologic process and existing organization".

According to Drucker (1993) there are four basic types of innovation:

- Incremental Innovation—Doing more of the same things you have been doing with somewhat better results.
- Additive Innovation—More fully exploiting already existing resources, such as product lines extensions, and can achieve good results. These opportunities should rarely be treated as high priority efforts. The risks should be small—and they should not take resources away from complementary or breakthrough opportunities.
- Complementary Innovation—Offers something new and changes the structure of the business.
- Breakthrough Innovation (Radical Innovation)—Changes the fundamentals of the business, creating a new industry and new avenues for extensive wealth creation.

The theoretical developments focused on firm performance started about 20 years ago (Romer 1986; Leeuwen 2008). Firm performance could be measured by different indicators, such as: profit, revenue, growth, productivity, efficiency, stock price, new markets, export, etc. Murphy et al. (1996) and Sohn et al. (2007) noted that firm performance is a multidimensional concept, whose indicators can be departmental, related to production, finance or marketing. Wolff and Pett (2006) say that performance indicators are consequential, related to growth and profit. Castany et al. (2005), Van Biesebroeck (2005), Pagés (2010), Geroski (1998), and Tybout (2000) in their studies concluded that firms which have better access to technology, managerial skills, finance, learning, flexible non-hierarchical structure perform better than the others.

Regarding innovation-performance correlation of firms, Tiwari and Buse (2007) developed a model, known as BCF model (better, cheaper and faster) which means that innovations make firms to produce better quality products and services, with lower costs and faster. Those companies that succeed to produce products with better quality, with lower costs and place them on the market faster than the others increase the possibility to build better competitive position in the market, to increase its profitability and to strengthen its stability. So, all this enables firms to enhance their overall performance. We measure these changes of the firms by the innovation variable which indicates the improvements in products and services, changes in process, new technology, skilled workers, etc.

As it was mentioned, there are different types of innovations. They also have different impact on enterprise's performance. Goedhuys and Veugelers (2008), based on their research in Brazil concluded that: "Product innovation also translates into superior sales growth rates. This is particularly so when it is combined with process innovation. Process innovation alone, without the introduction of new products, runs the risk of being associated with lower growth performance. It is indeed possible that the benefits of more cost efficient production are only reaped after an initial period of restructuring, beyond what we can measure with our data set. Alternative measures, such as productivity, productivity growth, or profitability, may capture the beneficial influence of process innovation more rapidly" (p. 18). These issues are discussed also in Hervas-Oliver et al. (2014), Czarnitzki and Delanote (2014), Britton (1989), and De Propris (2002).

3 Empirical Evidence on Innovation Activities

The empirical literature on investigating innovative behaviour and its effect on firm performance face two major methodological challenges: (i) of how to measure innovation or technological change and (ii) with estimation technique to apply for taking into consideration the endogeneity problem. The first methodological challenge is accompanied with the difficulty of getting appropriate data which correspond to the definition of innovation. Consequently the empirical studies have mainly adjusted their analysis of innovation depending on available measure of innovation, by using proxies which reflect some aspects of the innovation process.

Based on these definitions, the most common measures used in the literature for analyzing the innovative process are as follows: (i) a measure of the inputs into the innovative process, such as R&D expenditure, (ii) an intermediate output, such as the number of inventions which have been patented, and (iii) a direct measure of innovative output, new product or new process. These proxy measures for the innovation process have their limitations. Not all R&D expenditures end in innovation output since this measure reflects only the resources committed to producing innovative output, but not the innovative process. The number of patents does not indicate whether this output has a positive economic value or whether it has successfully been introduced in the market. Whereas the new product and/or process is acknowledged as a proxy that directly quantifies the effect of innovation and its success in the market.

Considering the other methodological challenge, one can put it into two dimensions: (i) the determinants of innovation, and (ii) the impact of innovation on productivity, firm performance and economic welfare (Battisti and Stoneman 2010).

R&D activities are expected to be a major factor leading to product and process innovation and, therefore, R&D intensity has been used by the majority of studies (Crepon et al. 1998; Damijan et al. 2008; Falk 2008; Hashi and Stojcic 2013). There is a review of about 100 studies on innovation by Becheikh et al. (2006), summarizing the empirical studies investigating product/process innovations as dependent variable, conclude that 80 % of the studies find that R&D investment has a positive and significant effect on innovation activities. Acs and Audretsch (1991) find that the number of innovations increases with increased industry R&D expenditures but at a decreasing rate.

The firms export intensity is another frequently employed determinant that may affect innovation behaviour. The reasons to expect that exports stimulate innovation activities of firms are: (i) exporting firms can benefit more from the knowledge abroad (learning-by-exporting) for their innovation activities than non-exporting firms; (ii) they are exposed to more intense foreign competition which requires continuous upgrading of their products and processes; and (iii) they will gain more profit by introducing the innovative product to foreign markets. The empirical evidence reports a positive relationship between export intensity and the incentive to innovate (Lööf and Heshmati 2006; Alvarez and Robertson 2004; Damijan et al. 2005, 2008).

There is evidence in the empirical literature that skilled labour facilitates and induces innovation activities of firms (Kanter 1983). Studies investigating the relationship between human capital factors and innovation conclude that the ability of firms to innovate depends on the employees' level of education (Kanter 1983; Gupta and Singhal 1993). Acs and Audretsch (1991), too, show a positive and statistically significant impact of skilled labour on innovative output.

Another problem of investigating innovation is identifying appropriate models to empirically investigate the process of technological change and its impact on performance. Studies that empirically examine the relationship between innovation activities and productivity can be divided into two major groups: (i) studies based on the multistage model of innovation (Crepon et al. 1998; Lööf and Heshmati 2006; Griffith et al. 2006; Hashi and Stojcic 2013), and (ii) studies that apply single model equations (Acs and Audretsch 1991; Domadenik et al. 2008; Damijan et al. 2005, 2008).

The most widely used analytical approach to investigate innovation is the multistage approach. These so-called CDM models are based on, and extend, the model originally developed by Crepon et al. (1998). It is a structural model with four stages formalized in four equations: (i) the firm's decision to engage in innovation activities; (ii) the intensity with which the firm undertakes R&D; (iii) the innovation or knowledge production function; and (iv) the output production function, where knowledge is an input. By employing the CDM model these studies are also able to control for the endogeneity of innovation.

Hall and Mairesse (2006) summarise papers that have employed models similar to CDM for their analysis of innovation. They conclude that important progress has been made in modelling and employing appropriate econometric estimation methods by using innovation survey data. They emphasize that better results are obtained when researchers combine the survey data with census-type information on the accounting data of the firms, which enables the measurement of final outcomes in the form of profitability and productivity. Most of these studies conclude that innovation has a positive impact on productivity or productivity growth.

The other approach used by empirical studies investigating innovation activities is the single model equation. Acs and Audretsch (1991) and Scherer (1965, 1980) examine the relationship between firm size and innovation output, with cubic and quadratic regressions. Damijan et al. (2008) estimate the growth accounting model including R&D capital by applying OLS approach together with matching techniques and propensity score to discriminate between innovating and non-innovating firms and to explore whether innovation activity is the decisive factor driving firms' productivity growth.

Damijan et al. (2008) combined firm-level data on innovation activity with financial data for a sample of Slovenian firms in the period 1996–2002 to investigate whether and to what extent firm's ability to innovate is induced by its own R&D activity and to what extent by factors external to the firm. The empirical estimation is performed in two steps: (i) the impact of internal R&D capital and external R&D spillovers on innovation activity is estimated (probit model); then

(ii) the impact of innovation activities on productivity growth is estimated (Cobb-Douglas production function).

Because of the data limitations we were unable to employ a CDM-type model and have had to examine the correlation between innovation activities and firm performance by following studies applying singe-equation models (Damijan et al. 2005, 2008). We first estimate the impact of R&D intensity on innovation activities in a probit model, and then continue with the estimation of the impact of innovations on productivity (using the predicted values of the first model). By employing the BEEPS data we have the advantage of performing the analysis in more than one country.

4 The Sample and the Data

For the empirical analysis of this study we use World Bank/EBRD's Business Environment Enterprise Performance Surveys (BEEPS) firm-level data conducted in 2002, 2005 and 2009. Out of the overall BEEPS dataset we make use of the data on 14 Central Eastern and South-Eastern European Economies. Since there are European Union member countries, we are able to provide comparative analysis between countries that recently joint EU (list of nine EU countries—CEE (alphabetic order): Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, and Slovakia) and those in South-eastern Europe (list of five South-East European countries—SEEs (alphabetic order): Albania, Bosnia and Herzegovina, Croatia, Macedonia FYR, and Serbia & Montenegro). The major advantages to be emphasized for this dataset are that: (i) it provides large number of observations comparable for SEEs for 2002, 2005 and 2009; and (ii) it includes 3 year retrospective information for each survey round which makes available data on firms over a 9-year period. The BEEPS questionnaire consists of questions which allow us to specify the variables of our interest by following the theory. For the purpose of the investigation we employ the pooled data for 2002, 2005 and 2009 in order to utilize the advantage of a larger number of observations having the final sample consisted of 7225.

One of the challenges faced by studies investigating innovation activities has been the identification of the determinants of innovation. These studies also highlight the impact of additional firm-characteristic such as ownership structure, export activity, R&D intensity, management skills, and others that may affect innovation activities. Factors that influence innovation activities also affect firm performance (productivity).

Considering the correlation between ownership structure and innovation activities, it is expected that foreign-owned firms, which can draw on the technical and management know-how of their parent companies, will be more efficient than their domestically owned rivals. In line with this, Falk (2008) using firm-level data of the third Community Innovation Survey (CIS) covering 12 European countries, found that foreign owned firms are more innovative than domestic firms (Love et al. 1996). Guadalupe et al. (2011), using a panel dataset of Spanish manufacturing firms (1990–2006), suggest that foreign ownership leads to a specific type of process innovation, involving both new machines and new methods of organising production. Domadenik et al. (2008), using a sample of Slovenian firms, found that domestic ownership display significantly higher R&D activities comparing to other types of ownership. On the other hand, there are a number of studies that did not find a significant difference between foreign owned and domestic firms (Chudnovsky et al. 2006).

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The firms export intensity is another frequently employed determinant that may affect innovation behaviour. The reasons to expect that exports stimulate innovation activities of firms are: (i) exporting firms can benefit more from the knowledge abroad (learning-by-exporting) for their innovation activities than non-exporting firms; (ii) they are exposed to more intense foreign competition which requires continuous upgrading of their products and processes; and (iii) they will gain more profit by introducing the innovative product to foreign markets. The empirical evidence reports a positive correlation between export intensity and the incentive to innovate (Lööf and Heshmati 2006; Alvarez and Robertson 2004).

There is evidence in the empirical literature that skilled labour facilitates and induces innovation activities of firms (Kanter 1983). Studies investigating the correlation between human capital factors and innovation conclude that the ability of enterprises to innovate depends on the employees' level of education (Kanter 1983; Gupta and Singhal 1993). Acs and Audretsch (1991), too, show a positive and statistically significant impact of skilled labour on innovative output.

The variables used in models estimating the determinants of innovation activities vary according to the studies and the data available. Most often as a dependent variable in this correlation are used: R&D intensity, share of innovative sales, labour productivity and others. Lööf and Heshmati (2006) apply a version of CDM model to Swedish data for the mid-1990s on both manufacturing and service firms. They employ a richer list of variables to measure the success of innovation output: value added per employee, sales per employee, profit before and after depreciation, and the sales margins. They differ from other papers using this model with their measure of innovation input—the total sum of expenditures on eight different categories of innovation engagements including: (i) R&D based products, services or process innovations within the firm, (ii) non-R&D based innovation activities, (iii) purchase of services for innovation activities, (iv) purchase of machinery and equipment related to products, services and process innovations, (v) other non-machinery and equipment-related innovation activities,

(vi) industrial design or other preparations for production of new or improved products, (vii) education directly related to innovation activities, and (viii) introduction of innovations to the market—as a more comprehensive indicator than simple R&D expenditure, including innovation activities based on non-R&D spending. Table 3 gives the description of the variables employed in the model.

According to the statistics the average labor productivity has increased for 25 % from 2002 to 2005, while it has doubled it mean from 2005 to 2009. The average size of the companies in the sample is 22 employees. On average firms R&D investments are approximately 4 % (R&D expenditure to sales ratio). The average of firms that have exported directly is 10–12 %. Firms are established mainly 16–20 years ago (the 1980s–1990s). For companies surveyed in 2002, on average 33 % of the employees have university degree, and this percentage drops to 14 % for 2009. Considering innovation activities, 62 % of the companies have indicated that they have introduced new product and/or process in 2002, and the number of innovative firms has increased for 25 % by 2009. The next section continues with the empirical investigation of the determinants of innovation activities and their impact on firm performance. Pooled data procedures on CEE and SEE countries are applied.

Table 3 Description of the variables

Variable name	Variable definition	BEEPS question
Age	Firm's age	2010 minus the year when the firm was established. In what year did your firm began its operations in this country?
Agesq	Firm's age squared	
Direct exports	% of establishment direct exports	What % of establishment's sales were direct exports?
Dummy invest in R&D		Has this establishment invested in research and development (in-house or outsourced) in last 3 years?
Export exp	Experience in export	2010 minus the year when the firm first exported. In what year did this establishment first export directly or indirectly?
Foreign competition	Pressure from foreign competition	The effect of pressure from foreign competitors on the decisions to develop new products (measured on scale 1–4)
INNOV		Dummy variable = 1 if new product/new process = 1
Productivity	Sales/labour in Euro per head	
Size	Number of employees	No. of permanent, full-time employees of this firm at end of last fiscal year
Share of workers with university degree		% employees at end of fiscal year with a university degree

5 Methodology and Empirical Findings

In order to explain the extent of innovation activity in CEE and SEE countries, we empirically investigate the correlation between firm's innovation and labour productivity. A major problems that arises in the literature investigating the correlation between innovation activities and firm performance is endogeneity (Peters 2008). Considering the endogeneity problem, innovation activities and firm performance are determined simultaneously, i.e. innovation activities are endogenous. This implies that endogeneity should be taken into account when investigating the correlation between innovation activities and firm performance. Endogeneity appears in equations where there is correlation between an independent variable and the disturbance term.[2] When there is endogeneity among the variables, Baltagi et al. (2003) show that there is substantial bias in OLS and the random effect estimators and both yield misleading inference.

One solution to the problem is the use of instrumental variables (IV), which is consistent and has a large-sample normal distribution (Baum 2006). Satisfactory instruments with meaningful economic rationale are not always easy to find, especially not valid ones that satisfy the two key properties—that it must be uncorrelated with the error term but correlated with the independent variable. The simple IV estimator assumes the presence of independent and identically distributed (i.i.d.) errors.

The test of endogeneity of the innovation activity variable shows that it must be considered endogenous in the fitted model, as one can be seen below:

H0: Regressor is exogenous

Wu-Hausman F test:	9.46999 F(1,1209)	P-value = 0.00214
Durbin-Wu-Hausman chi-sq test:	9.48188 Chi-sq(1)	P-value = 0.00208

We apply the instrumental variable (IV) technique, as one of the solutions of the problem (Green 2012). The empirical estimations of the innovation-performance correlation are generated in two steps. The first model presents the probability of the firms to innovate (probit model) which reveals the importance of individual factors on firms' innovation activity. The second estimations present a semi-logarithmic specification of the productivity model, which incorporates the predicted values of the first regression in conjunction with other firm characteristics.

The general model we will refer to can be written as follows:

[2] The violation of the zero-conditional-mean-assumption ($E[u|x] = 0$) can also arise for two other causes than endogeneity: omission of relevant variables and measurement error in regressors.

$$\begin{aligned} Innov\_activity_{it}{}^{*} = \; & \phi_0 + \phi_1 R\&Dinv_{it} + \phi_2 Direct\_export_{it} \\ & + \phi_3 FRGNcomppressi_{it} + \phi_4 Skilled\_workers_{it} \\ & + \phi_5 e\_mailCOM + \phi_6 managerexp + \varepsilon_{it} \end{aligned} \tag{1}$$

$$\begin{aligned} LNproductivity_{it} = \; & \theta_0 + \theta_1 PrInnov\_activity_{it} + \theta_2 Skilled\_workers_{it} \\ & + \theta_3 EU\_members + \varepsilon_{it} \end{aligned} \tag{2}$$

The impact of individual factors, such as share of R&D expenditure on total sales (or dummy invested in R&D variable), direct exports, pressure from foreign competitors, share of employees with university degree, on the probability to innovate of a firm *'i'* in period *'t'* are examined. Innovation activities as dependant variable present product and/or process innovation.

Following the methodological approach applied in the literature and because of the suspected endogenous correlation between innovation activities and firm performance the IV technique is applied. The regression coefficients and corresponding p-values of the probit model regression of the probability to innovate together with the empirical results of productivity model are presented in Table 4.

Table 4 The determinants of the probability to innovate and the productivity model

	Dependant variable			
	Innovation activities		LNproductivity	
	Probit model		IV regression	
Independent variables	Coeff.	ρ-values	First stage coeff.	IV coeff.
Innov_act (instrumented)				0.88***
Inv_RnD	1.02***	(0.000)		
Direct_export	−0.001	(0.495)		
FRGNcomppress	0.016	(0.597)		
Skilled_workers	0.001	(0.319)	0.006***	0.000
e_mailCOM	0.448***	(0.000)		
managerexp	0.009***	(0.009)		
EU_members	0.25***	(0.001)	0.038**	0.038**
Constant	−19.05	(0.010)	31.7***	31.7***
Observations	1794			1461
Instruments:				
Inv_RnD			√	√
Direct_export			√	√
LR chi2	178.26			
Pseudo R2	0.0931			
R-squared				0.064
F-statistics				12.46
df_r				
Log likelihood				−1916
Sargan statistics				0.333
Cragg-Donald Wald F statistic			20.20	20.20

Note: Standard errors in parentheses, and ***$p < 0.01$, **$p < 0.05$

Before going to the interpretation of the coefficient, the diagnostics of the regressions are provided. The obtained results indicate that we have insufficient evidence to reject null hypothesis that the model has correct functional form at 5 % level of significance. The diagnostic tests suggest that there is insufficient evidence to accept the null hypothesis that the residuals have normal distribution. Furthermore, there is insufficient evidence to reject null hypothesis of homoscedasticity in the model.

Considering the instrumental variable regression, the validity test of the instruments employed, F-test, shows that they are jointly significantly different from zero. The statistics of 20.20 indicates the strength of the instruments.

6 Discussion and Conclusions

Two major models are estimated using the BEEPS 2002, 2005, and 2009 dataset: (i) the innovation probit model—with the undertaken innovation activities (dummy variable) employed as dependant variable and (ii) the productivity semi-logarithmic model—with the labor productivity as dependant variable. The probit model results—show significant effect of some of the innovation activities determinants, which are in accordance with the theoretical literature.

The R&D variable in the regression appears to have positive and significant correlation with innovation activities. The firms' innovative activities are higher if the firm has competitive pressure from foreign firms. The coefficient of the level of education of the employees as the share of employees with university degree is significant and positively related to the decision to innovate. The regression results show positive significant impact of export intensity on innovation activities when using R&D intensity as independent variable.

The interpreted coefficients are statistically significant at 1 % level of significance, offering evidence that the H0 hypothesis, ($\theta_{it} = 0$) can be rejected for these cases. According to chi2 statistics the explanatory variables are jointly significant (since Prob > chi2 = 0.000) at 1 % level of significance, therefore the null hypothesis that all regressors are jointly insignificant may be rejected.

Productivity model regression—is estimated using instrumental variable techniques (instruments used for innovation activities are R&D intensity and direct export). The results show positive and statistically significant impact of instrumented variable, undertaken innovation activities, on firm performance. This impact confirms our hypothesis that more innovative firms' tend to perform better.

The EU membership dummy variable is positive and significant, showing that EU member state firms perform better than the ones that operate in non-EU countries.

Summarising these findings it is evident that the firms in SEEs have improved their performance during the transition period, which is also reflected by the increase in the average labour productivity by 25 % from 2002 to 2005, and doubled its mean from 2005 to 2009. Since improved performance of firms in the transition period are due to factors such as innovation activities, R&D investment, managers experience, EU membership, etc. one can highlight the need for policies to assist these firms to improve their products and services and those that are not EU members to foster their accession.

Specifically, the results indicate that innovation activities undertaken by firms have a positive impact on firm performance. The investigation on SEEs shows that R&D intensity positively influences the firm's innovativeness. This implies that R&D should be supported by the government through mechanisms such as innovation vouchers, matched funding of R&D expenditure, tax credit for R&D spending, etc. Other ways of fostering R&D may be through getting businesses to work more closely with universities and research institutions and helping researchers, innovators and businesses bring together specific knowledge, skills, technical resources. Since R&D intensity is higher in EU member economies, they should be a leading example for other non-EU countries.

Our empirical investigation also found education as another significant determinant of innovation activities of firms. Policies for improving the education system should be created to support new generations of skilled workers, ensuring a sufficient supply of individuals with science and engineering skills by making education more relevant, change the system from the traditional rote learning method to methods encouraging independent thinking, etc.

This study extends and reviews the empirical literature with respect to the incentives of firms to undertake innovation activities and to investigate how these changes affect firm performance. Our findings (using BEEPS 2002, 2005, and 2009 in CEE and SEE countries) show that R&D intensity, foreign ownership, age, export activities, skilled workers and pressure from foreign competitors are significant and positively related to firm innovation activities. We further examine the impact of (the predicted values of) innovation activity model on performance and thus conclude positive and significant correlation. Additional to the impact that arises from the innovation model, we conclude that foreign ownership and skilled workers have positive and statistically significant impact on performance. Summarizing these findings it is evident that the firms in CEE and SEE countries have improved their performance during the transition period.

Out of these results we come to the recommendation that R&D investments should be supported by the government through mechanisms such as innovation vouchers, matched funding of R&D expenditure, tax credit for R&D spending, etc. Other ways of fostering R&D may be through getting businesses to work more closely with universities and research institutions and helping researchers, innovators and businesses bring together specific knowledge, skills, technical resources. Since R&D intensity is higher in EU member economies, they should be a leading example for other non-EU countries.

Another recommendation is that policies for improving the education system should be created to support new generations of skilled workers, ensuring a sufficient supply of individuals with science and engineering skills by making education more relevant, change the system from the traditional rote learning method to methods encouraging independent thinking, etc.

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Psychological Climate in the Organization: A Determinant of Entrepreneurial Behavior

Božidar Leković and Slobodan Marić

Abstract Entrepreneurial behavior is reflected through independent individuals/entrepreneurs who are ready to start new enterprises and therefore take risks in newly created circumstances. Increasing, dynamic markets, and competition create powerful pressure on organizations by enforcing them to continually grow and develop as a basic condition to survive. Innovation is the biggest potential for growth and thus becomes a continual business need in the cited circumstances so participants can have the necessary flexibility, competitiveness and adequate answers in the face of change. Circumstances considered as favorable to generate innovations within the organization are dominantly entrepreneurial because of their features, necessary creativity of active people and readiness to take risk and they are strong enough to generate 'something new', as the most authors in this field define internal entrepreneurship.

While analyzing motivators that cause internal entrepreneurship, on the one side there is the organizational context (psychological climate of organization) or management style and personal interests of internal entrepreneurs/employees on the other. According to past research, an entrepreneurial climate is essential for awakening the individual entrepreneurial potential of employees such as innovativeness, risk taking and being proactive. These characteristics require the following organizational factors to flourish: management support for new ideas and projects, participation in strategic decisions, tolerance of risk-taking, autonomy and resource allocations.

The primary purpose of this research chapter is to present an empirical study framed by the theory that task-oriented and relations-oriented leadership behaviors (or different leadership style) are positively related to the employees' perceptions of organizational climate. The study introduces this theoretical perspective and examines the relevant literature that supports the significance of leadership behavior and the organizational climate. Results of empirical research will be presented in the second part of the chapter.

Many authors identified leadership/management behaviors as an emergent process that acts on both the organizational climate and conditions for

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_10

entrepreneurship. An organizational climate has been conceptualized as a mediator of the relationship between leadership style and organizational entrepreneurship.

1 Problems

Schumpeter (1934) was the first economist to explain, in an unconventional away and outside usual forms of statistical comparative analyses, the connectivity of entrepreneurship and economic growth, he defined an entrepreneur as the agent of change. Today, long-term global studies spanning over the last two decades have not exhausted all research questions in the field of entrepreneurship. They offer valuable quantitative research results, identifying the entrepreneurial economy as having big potential for economic growth. Such a research orientation identifies the entrepreneurial sector, as a specific form of doing business and thus neglects the size of the company, sort of activities, economic sector, goals and business motives.

Stimulation and development of entrepreneurship among employees represents one of the most important goals of every enterprise, as entrepreneurial behavior is the key source of competitive advantage. Trying to provide the necessary conditions and adequate support to entrepreneurial initiative and activity, every organization, disregarding the size, should develop the appropriate organizational climate. Also, entrepreneurial resources are equally important and have their values in the sense of potential of economic growth, neglecting general system environment, in the sense of development degree of some economy, emphasizing the special place and role in the processes of economic restructuring and transition (Lekovic et al. 2014).

Organizational climate reflects the perception, values, beliefs and attitudes of its employees and in this way, it represents positive or negative power in shaping individual business intentions of internal entrepreneurs. In the absence of mentioned support in the internal environment of the enterprise itself, numerous examples and significant massiveness of spin-off entrepreneurial projects are noticed, which have not met with favorable ambient for implementation within the current enterprises but instead have found conditions for realizing business ideas in the external environment. This confirms the importance of the organizational climate, as the key factor in realizing entrepreneurial intentions within the current organizations. The role of an individual is also important as a holder of entrepreneurial activities, without which the appearance of entrepreneurship and mentioned effects for business performance would not come.

The essential problematic of this chapter is dedicated to the identification of the basic conditions of entrepreneurial behavior in the organizations from which the following **research goals** are set:

- Identify the nature and volume of observed features—leading style, motivation level, organizational climate and inclination to risk in selected organizations;
- Establish the power and direction of connection between observed research variables.

The nature and structure of available data, then the basic problem orientation with set research goals, as well as connection and analysis of observed variables of the research refer to the application of non-parameter statistical techniques and coefficients to the Spearman's rank correlation, as the selected methodology, in order to obtain research results.

2 Evidence

The circumstances treated as favorable for generating innovations within an organization are dominantly entrepreneurial and exclusive because of their characteristics. The key characteristic is creativity and readiness to take risk, as they are able to generate 'something new', as many authors in this field define internal entrepreneurship.

Many attitudes in the literature on entrepreneurship and management that consider the category of internal entrepreneurship and/or corporative entrepreneurship point to the need of a precise definition and comparison of different attitudes in order to offer adequate answers to previously asked questions. However, the category of internal entrepreneurship has different interpretations by some authors; therefore, the level of observation significantly generates some inference, so treating things in this way is quite justified.

Entrepreneurship can be observed as the process of creating some new values though investment of necessary time and effort and taking financial and social risk with a view of acquiring reward in the form of material and moral satisfaction (Hisrich et al. 2004). This interpretation of entrepreneurship contributes to understanding this process and its role in the context of the business system. Contrary to the mentioned entrepreneurship is the act of developing a new project outside the existing organization. Internal entrepreneurship helps managers to renovate and revitalize their business, to innovate but also to improve their general performances (Kuratko et al. 1990; Antoncic and Hisrich 2001).

In order to successfully represent the concept of internal entrepreneurship, it is necessary to differentiate to the categories of entrepreneurship. Recent research on entrepreneurship defines internal entrepreneurship in two fundamentally different ways. On the one side, internal entrepreneurship reflects the quality of the organization itself (organizational level) confirmed by the attitudes that entrepreneurial organizations are small (Aldrich and Austen 1986), focused on fast growth (Drucker 1985), more innovative, more flexible and adaptive (Birch 1987). According to the second definition, entrepreneurship is considered a characteristic of employees' behavior and managers in the enterprise, not as a characteristic of the enterprise itself. Enterprising people look for opportunities in order to acquire added value both for them and the enterprise (Burgelman 1983), where, for the first time, there appears the idea on internal entrepreneurship and/or 'corporate entrepreneurship; or entrepreneurship in the big corporate environment as it is often named. Internal entrepreneurship—also known as corporate entrepreneurship or corporate undertaking—is the practice of development of the new project within the existing organization, with a view of using new chance to create new economic value (Parker 2011).

In analyzing the motivators causing the appearance of internal entrepreneurship, on the one side there is organizational context or management style, while on the other side, they come from personal interests of internal entrepreneurs/employees. For example, organizational support for internal entrepreneurship can be reflected in an appropriate environment where the entrepreneur can easily approach necessary organizational resources, but also the presence of necessary conditions for developing and implementing innovative ideas and projects results in overall organizational innovativeness (Alpkan et al. 2010).

The author who tries to explain entrepreneurial behavior based on personal characteristics of individuals exclusively makes the difference between entrepreneurs and non-entrepreneurs. As for the concept of internal entrepreneurship, this argument is not enough to analyze the behavior of employees within the existing organizations. It often happens that internal entrepreneurs leave existing enterprises in order start their own business because the reward in the form of symbolic tribute is not enough in relation to the risk they bear by taking some initiatives on themselves. We can only say that all the factors cited above are essential for the development of internal entrepreneurship in existing organizations, but none is enough to explain the cause of the appearance itself.

Clearly none of the offered reasons for understanding entrepreneurship are completely acceptable. Taking into consideration experiences and opportunities in the domestic business environment, we can say that the truth is somewhere in the middle. To show the 'phenomenon' of internal entrepreneurship in the right form, the existence of favorable business climate is necessary and employees with some inclinations and characteristics that make them entrepreneurs. This includes the existence of favorable external political, social and economic environment. This can be seen in the data on significant reaction of the volume and structure of entrepreneurial activities according to the stages of entrepreneurial process depending on the economic conjuncture (Lekovic and Maric 2012). In other situations where one of the mentioned fundamental conditions are missing, entrepreneurship will not appear in the form described in the previous part of the text. Horizontal individuality can explain internal entrepreneurship in the form of support by the organizational climate (Abraham 1997). Hornsby et al. (1993) cite a selection of factors that are the prerequisite for the success of internal entrepreneurship, which are:

- Management support or stimulation of innovation through fast accepting new ideas and capital availability for experimental projects;
- Autonomy/work of discretion, which relates to the autonomy in work and design without punishment for experimenting;
- Reinforcement where the reward should recognize real accomplishments and provoke tasks;

- Available time—without time limitations with sufficient flexibility that enables individuals to solve problems of long duration;
- Organizational barriers, work outside formal administrative procedures.

An essential determinant of entrepreneurial behavior, disregarding to the circumstances of entrepreneurial inclination to risk, is understanding the psychological characteristic of an individual in relation to the level of tolerance to risk, i.e. how much subjective perception influences the process of business decision-making. According to Petrakis (2005), the key factors exerting influence on risk taking are:

- Environment (economic, political, social, cultural);
- Economic branch (competition, buyers, suppliers, limitations);
- Characteristics of business (entrepreneurial) project;
- Characteristics of problematic situations;
- Level of risk and potential loss.

Of all previously cited factors of tolerance to risk, cognitive possibilities (knowledge, skills and capabilities), motives and personal characteristics have the biggest influence. Internal motivation particularly stimulates the inclination to risk, as a voluntary experimentation with new ideas (Dewett 2007). In the context of the group, the organizational inclination to risk, determined by the level of consciousness and the process of risk management, directly influences the behavior of employees in the process of decision-making. Developing risk awareness with all the team members, as a constituent element of business environment, as well as the concept of risk management as an obligatory of subsystem management, determines competition of the business system. Decision-making in the conditions of risk is the function of perceived probability of alternatives, perceived consequences and psychological inclination of individuals to take risks. However, risk perception is subject to changes because of appropriate market circumstances, as well as closer conditions of the economic branch which are often irrational.

The positive result of a well-perceived risk as a reward for bigger inclination to risk must be adequately distributed between the organization and the individual that took the initiative to risky business operations. The individual deserves adequate praise because of additional efforts done in taking risk and realizing business idea. At the same time the organization realizes the right to participate in the positive result based on available resources put for the development of ideas and an adequate environment to take over the potential negative result of business projects.

An important dimension of the organizational climate to be taken into consideration the inclination to risk is the trust between managers and employees as an indicator of tolerance to faults as prerequisites and the indicator of the organization's readiness to take risk. Individuals unwillingly take risks in the conditions of limited tolerance to faults, formal relationships, and the absence of trust. These factors create a discouraging organizational climate relating to the risk taking. This set of factors of the working environment exerts influence on behavior and motivation of every individual. As an internal working environment is dominantly determined by the relationship management-employees, it greatly influences employee behavior. Organizational climate, as the most important indicator of organizational culture, points to the nature of the internal relationships present in the organization. The basic characteristics of organizational climate according to Marshall Poole (1985) are:

- Characteristics of the organization and its parts;
- The organization and its parts;
- Routine activities of the organization;
- Behavior and attitudes of the staff.

The climate of the organization is a reflection of perceptive attitudes. It is still spoken about precise elements of which it is constituted. Therefore, we find the most common factors of the psychological? Climate:

- Structure—perception of the formal organizational structure and administrative regulations;
- Support and warmth—employee readiness to help and the feeling of interpersonal relationships in the organization;
- Risk—organizational readiness and tolerance for risk-taking;
- Identity—feeling of belonging and loyalty to the organization
- Standards—perceived importance of set goals (Konrad and Kline 1986).

The climate is determined by all the aspects of psychosocial relationships developing within the organization (Patterson et al. 2005). The climate influences psychological processes in the organization such as communication, problem solving, decision-making, conflict management, learning and motivation. From all this, we can notice that the climate directly or indirectly influences the efficiency of the organization and its capability to create innovations which is the key source of competitiveness. The organizational climate represents a general psychological atmosphere in the organization felt by each individual, which is an important factor to understand organizational behavior. A positive organizational climate is directly connected to the success of the organization. The stimulation of initiatives by the company management leads to new ideas, innovations and better performance. Another form in which organizational climate can be stimulated is through psychological security, when it supports open interaction and trust inside the working environment and thus leads to easer problem solving, faster learning, bigger inclusion of employees and finally risk reduction. In these working circumstances, employees can experiment with new methods for attaining goals and show creativity when faced with problems. On the other hand, rigid and nonflexible managers control the methods of work and do not give their employees enough confidence, which does not stimulate successful results. With this style of leadership, employees get sanctioned for showing individuality and these results in the absence from work, psychological insecurity, and the absence of creativity in work.

We have thus far shown that organization leaders shape the organizational climate to a great extent. Organizational climate, as a derivative of leadership style, directly influences the motivation of employees and performance of the organizations. If the organizational climate is positive, it is more probable that employees will identify their own goals with the goals of the organization due to a higher level of motivation. The positive organizational climate is characterized by good colleague relationships and a reward system that increases innovative accomplishments, as the consequence of information availability and exchange. These elements point to colleague leadership style where authority and power are equally distributed between workers, which are quite the opposite of the authoritative style that promotes hierarchical relationships. Leadership is as an important factor of organizational climate as it influences individual perceptions of the working environment as well as the success and results of the organization itself. Numerous studies confirm that the philosophy, policy and activities of leaders have a significant influence on the satisfaction and productivity of employees and impacts the organizational climate on the whole (Klem and Schlechter 2008).

3 Theme in Practice

3.1 The Sample and Data Collecting

The data on was collected though selected questionnaires from 270 employees in management positions (operative and medium level of management) in 18 companies. The observed research variables were leadership style, motivation, organizational climate and inclination to risk. The companies were selected at random with different sector distribution, which are, according to the administrative classification (Law on\Accounting and Audit—Sluzbeni glasnik RS, br. 46/06 and 111/09) classified as large companies. Respondents gave adequate answers enabling them to express subjective preference and evaluation of observed patterns. Through a specific methodology, the available data enabled the realization of set research goals.

3.2 Methodology

As for the methodology, it is important to note that the nature of observed pattern and research intentions, points to the need of reporting individual, subjective perceptions as well as inclinations at the aggregate level, i.e. the level of the enterprise. Therefore, some individual attitudes in the form of medium values were aggregated at the enterprise' value so that the research would make sense. As we talk about patterns whose character is important in the form of prevailing nature of the observed events at the level of the enterprise, not in individual case.

The evaluation of observed patterns at the individual level cannot contribute to answering the basic research questions and set research goals. In accordance with it, disregarding the number of respondents (270) and the size of patterns, the number of enterprises is relevant (18) in the form of observation which are processed in the pattern and it seeks the application of non-parameter statistical techniques. Analysis of observed research variables and the analysis of available data are performed by means of the Spearman's rank correlation coefficient.

The set research object, as well as the basic research intention point to the following research supposition in the form of the basic research hypothesis, which is:

H0: Leadership style (management structure) determines necessary conditions of entrepreneurial behavior of existing organizations in the form of positive organizational climate by which stimulating circumstances are created for ideas development and innovation because of inclination to risk as basic dimensions of entrepreneurial projects are:

3.3 Variables and Measures

Measuring organizational climate in the enterprise causes some methodological problems appearing in the following forms:

- Problems connected to limited psychological climate from job satisfaction;
- Problems of aggregation of individual evaluations of psychological climate in the united measure of organizational climate;
- One of possible problems that can appear relates to the existence of more than one climate within the organization, i.e. the climate varies according to one's position in the hierarchical structure of the organization.

Organizational climate was measured by means of questionnaire called the "Evaluation methods of psychological climate in the organization" by A.F. Fidper. Within the defined methodology in the form of a questionnaire, organizational climate is evaluated by respondents in the form of subjective observation according to selected dimensions (friendly—spite, agreement—disagreement, satisfaction—dissatisfaction, productivity—unproductivity, warmness—coldness, cooperation—disharmony, support—unwelcome, interested—indifference, dedication to job—uncommitted to job, successfulness—unsuccessfulness). It was measured on a scale from 1 to 8, where smaller grades mark positive observations.

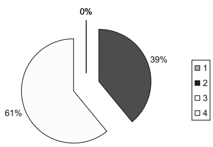
Inclination to risk was measured in the form of the test named "Evaluation methods of risk inclination" by Schubert. In the form of the test, the respondent answered 25 questions on a scale of from 1 (I agree completely) to 5 (I do not completely agree) according to defined values in relation to the situation that is evaluated. Obtained results, first at the level of individual respondents, later aggregated at the level of the enterprise, were classified in three categories: small, medium and high inclination to risk. *Motivation* was measured by using the "Methods of diagnosing people on the motivation to attaining success", by T. Elers. Obtained results, individual and collective were classified to four categories of motivation dependent on the obtained research results. *Leadership style* (individual and dominant) in the organization was identified by means of the "Methods for identification of leadership style" by V.P. Zaharov and A.L. Zuravljev. Based on obtained answers of respondents, the research results, individual and in the form of dominant style in the organization, were classified to three categories: colleague (democratic, indulgent (combined) and direct (autocratic).

4 Outcomes

The selected research approach and the evaluation methods of observed features of leadership style, motivation level, organizational climate and risk inclination, enabled the realization of set research goals and expected results. Subjective perception, values, beliefs and employees' attitudes as respondents were successfully united and reported at the aggregate level per observed research variables.

The cited values are illustrated in Tables 1, 2 and 3 as described statistical indicators of categorical research variables of leadership style, motivation and risk inclination at the level of observed enterprises, in the form of prevailing category for every observed enterprise as an individual observation in the sample. These descriptive statistical indicators of selected research variables in the form of frequencies do not have analytical importance. It is enabled by the impression on basic characteristics of observed patterns within this research, which are represented in the form of prevailing categories.

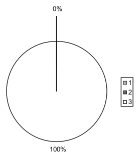
Table 1 Motivation

		Frequency	Percent	Valid percent	Cumulative percent	
Valid	1. Low motivation	0	0	0	0	
	2. Medium motivation	7	38.9	38.9	38.9	
	3. Mod. high motivation	11	61.1	61.1	100.0	
	4. High motivation	0	0	0		
	Total	18	100.0	100.0		

Source: Author's calculation

Table 2 Leadership style

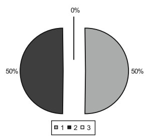
		Frequency	Percent	Valid percent	Cumulative percent
Valid	1. Direct lead. style	0	0	0	0
	2. Indulgent lead. style	0	0	0	0
	3. Colleag. lead. style	18	100.0	100.0	100.0



Source: Author's calculation

Table 3 Risk inclination

		Frequency	Percent	Valid percent	Cumulative percent
Valid	1. Small risk inclination	8	44.4	50.0	50.0
	2. Med. risk inclination	8	44.4	50.0	100.0
	3. Big risk inclination	0	0	0	
	Total	16	88.9	100.0	
Missing	System	2	11.1		
Total		18	100.0		



Source: Author's calculation

So, in Table 1, we can see that a high motivation of employees dominates in 61.1 % of cases, while the category of medium motivation constitutes 38.9 % of observations in the sample. The category of low motivation and high motivation appear in no case as a dominant category.

As for the analysis of presence of some leadership styles, whose descriptive indicators of this category variable are represented in Table 2, the picture is very simple. In all analyzed cases of samples (100 %), colleague leadership appears as exclusively dominant in style. These surveys have no intentions to fog obtained research results; on the contrary, by abstracting the details they enable observation that provides a clear picture of the observed patterns.

In Table 3, dominant categories of risk inclination within analyzed sample are represented, where we can see that in the equal number of cases (50 %) categories of low and medium risk inclination dominate. Generally, considering enterprises in the sample through the dimension of risk inclination, we cannot say that entrepreneurial orientation is shown. Another medium value points to it; it is organizational climate, which is, to medium estimate, insignificantly evaluated as positive. For deeper analyses and thorough conclusions, the second part of the chapter is reserved.

In this way, a presentation of the observed patterns indicates the correlation connection that will be tested by complex procedures. A detailed structure of research variables represented by the central and dispersive parameters, then the parameters of asymmetry and flattening (Attachment 1) enables a complete perception of the nature of the research variables. From the aspect of priority of this chapter, it is enough to emphasize medium values of all the observed variables in order to get a basic impression of the pattern researched.

Thus, categories of leadership within the observed sample have the following values. Direct leadership style is represented in 15.26 % of cases; indulgent style is present with 10.78 %, while colleague leadership style reaches 73.66 %. As for motivation, the dominant level is moderately high with 40.92 %, medium motivation is present in 34.53 % of cases, while a high motivation level appears in 23.79 % of cases on average. A low motivation level reaches an insignificant level, on average it is present in 1.48 % of cases. Organizational climate is generally evaluated as positive on average, with the medium value of 3.17 % on a scale from 1 to 8, where smaller values are positive. As for the evaluation of risk inclination, an insignificant value of observed pattern dominates, at 53.81 %, while the medium significant risk inclination appears at 42.09 %, and significant risk inclination is irrelevant as it is present in 4.09 % on average.

Central attention is oriented to the results of the correlation analysis of selected research variables and obtained values according to the Spearman's rank correlation coefficient, illustrated in Table 4. Results obtained by the application of selected method for testing the connectivity of selected research variables point to the following factual state. The connection between direct leadership style and low motivation level is expressed in the form of strong and positive correlation $r = 0.548^*$, at the level of statistical significance. This relationship confirms the opposite type of connection of medium strength/intensity, $r = -0.337$, direct leadership style and medium high motivation. Reliability of obtained research results is confirmed by the correlation connection between the colleague leadership style and low motivation level, $r = -0.484^*$, which has negative, medium strength at the level of statistical significance. The same leadership style according to medium high motivation is explained by the medium powerful positive correlation, $r = 0.249$.

The logical connection between leadership style and organizational climate is confirmed; where there is direct leadership style, their negative weak correlation is present, $r = -0.070$, and for colleague leadership style, positive weak correlation is present, $r = 0.055$, with a positive organizational climate. In the final instance, the analysis of the connection between leadership style and risk inclination confirm the previous results because there is increasing tendency between the category of colleagues leadership style and risk inclination from insignificant through medium and to significant, reflected by the following values of coefficient ro, $r = -0.073$, $r = 0.067$ and $r = 0.097$.

Based on the previous analysis of result correlation between leadership style, motivation level, organizational climate and risk inclination, we can say that the

Table 4 Correlations

Spearman's rho	Motivation	Motivation medium	Motivation moderate high	Motivation high	Organizational climate 1(+)–8 (−)	Risk insignificant inclination	Risk medium significant inclination	Risk sig. inclination to risk
Direct leadership style								
Correlation coefficient	0.548*	−0.155	−0.337	0.447	0.070	0.028	−0.012	0.049
Sig. (2-tailed)	0.019	0.540	0.172	0.063	0.788	0.917	0.965	0.858
N	18	18	18	18	17	16	16	16
Indulgent leadership style								
Correlation coefficient	0.222	−0.207	−0.070	0.254	0.153	0.131	−0.129	−0.169
Sig. (2-tailed)	0.376	0.411	0.782	0.310	0.557	0.630	0.634	0.530
N	18	18	18	18	17	16	16	16
Colleague leadership style								
Correlation coefficient	−0.484*	0.218	0.249	−0.439	−0.055	−0.073	0.067	0.097
Sig. (2-tailed)	0.042	0.385	0.318	0.068	0.832	0.789	0.806	0.720
N	18	18	18	18	17	16	16	16

Source: Author's calculation
*Correlation is significant at the 0.05 level (2-tailed)

basic hypothesis of this chapter is confirmed. We can also say that leadership style (management structure) determines the necessary conditions of entrepreneurial behavior of existing organizations in the form of a positive organizational climate. This creates stimulating circumstances for the development of ideas and innovation due to a stronger inclination to risk. In addition, through analysis of obtained results as well as previously applied methodological procedures, research goals were realized for observed patterns, which were selected within the research concept, identifies and quantitatively expresses, measured and it enabled the determination of mutual connection of strength and course of connection.

5 Concluding Remarks

Starting from the basic benefits of entrepreneurial behavior, we emphasize that creating new business projects and innovation within existing organizations, advances competition and performance. In accordance with the importance of entrepreneurship, especially internal entrepreneurship and the provision of a favorable business climate for its institutionalization, this chapter researches the relationship between leadership style and basic dimensions of entrepreneurial behavior, risk inclination by means of the level of motivation of employees, and organizational climate as the basic determinant of entrepreneurial initiative.

Obtained research results, after the application of selected statistical procedures, point to the positive correlations between leadership style, moderate high motivation, positive organization climate and medium and significant inclination to risk. The results of correlation analysis argue that leadership is the key determinant of the internal environment, due to the organizational climate being the key factor in developing new ideas through readiness to take risk and innovation as the principal entries of entrepreneurial behavior of an individual. Within existing organizations, the support coming in the form of organizational ambient is very important for decision-making on implementation of new business projects.

In addition, the selected methodology enabled the adequate evaluation of observed patterns through aggregation of subjective estimates of respondents, which resulted in the previously cited conclusions. The aggregate level of individual estimations of observed patterns enabled the limitation of the level of motivation present in the organization and the identification of the ruling organizational climate, and was thus a significant prerequisite to realize the set research goals. By the same approach, the dominant leadership style was identified, as well as the level of inclination to risk within the enterprise. In this way we had all the necessary elements to realize our basic research intentions.

Appendix: Descriptive Statistics

	N	Range	Minimum	Maximum	Mean	Std. deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	Std. error	Statistic	Std. error
Direct. lead. style	18	33.00	0.00	33.00	15.2683	12.14350	147.465	0.178	0.536	−1.398	1.038
Indulgent. lead. style	18	39.50	0.00	39.50	10.7867	12.02514	144.604	1.213	0.536	0.677	1.038
Colleague. lead. style	18	63.00	37.00	100.00	73.6661	18.31733	335.525	−0.178	0.536	−0.513	1.038
Motivation low	18	20.00	0.00	20.00	1.4817	4.88077	23.822	3.664	0.536	13.877	1.038
Motivation medium	18	67.00	0.00	67.00	34.5367	17.66626	312.097	−0.213	0.536	−0.143	1.038
Motivation moderate high	18	47.00	20.00	67.00	40.9261	14.52225	210.896	0.368	0.536	−0.647	1.038
Motivation high	18	33.00	7.00	40.00	23.7961	9.52167	90.662	−0.097	0.536	−1.172	1.038
Organizational climate 1(+)–8(−)	17	2.86	2.05	4.91	3.1700	0.71013	0.504	0.630	0.550	0.975	1.063
Risk insignificant inclination	16	93.00	7.00	100.00	53.8125	30.95043	957.929	0.203	0.564	−1.119	1.091
Risk medium sign. inclin.	16	93.00	0.00	93.00	42.0938	31.34763	982.674	0.055	0.564	−1.279	1.091
Risk sign. inclination	16	23.00	0.00	23.00	4.0938	7.10450	50.474	1.720	0.564	2.286	1.091
Valid N (listwise)	15										

Source: Author's calculation

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Financing Preferences of European SMEs

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Abstract In spite of being the most numerous enterprises in all economies, reaching up to 99 % of the businesses, SMEs have limited access to external finance and a narrow palette of available external financial instruments. Amid growing number of banks that pay attention to SMEs as one of their strategic sectors, many guarantee and grant programmes are designed for innovative, technology and renewable resources oriented SMEs, either at the EU member-countries or at the European level. The analysis presented in this chapter is based on the ECB's SAFE (Survey on the access to finance) results obtained from August to October 2013. It focuses on entrepreneurial preferences towards certain financial instruments rather than on realised, statistical data. Research reveals that debt markets are preferred by both companies in private and public companies, which calls for the policy makers to create and/or revive public equity markets for SMEs to enhance the freedom of capital movement goal throughout the EU.

1 Introduction

According to the EC report (A recovery on the horizon? 2013a) SMEs account for 99.8 % of 20.4 million enterprises in the EU-27. While 92.1 % or 18.78 million are micro enterprises, 6.6 % (135 million) are small-sized, and 1.1 % or 0.22 million enterprises belong to the middle-sized class of firms. Based on the EU recommendation (2003/361/EC), SMEs encompass all the enterprises employing up to 250 workers and either have an annual turnover of less than 50 million euros or total assets of less than 43 million euros. Firms are divided into size classes, mostly based on the number of their employees. Micro enterprises encompass companies that have up to 9 employees; small companies may have up to 49 employees while 249 employees is the threshold for distinguishing middle from large enterprises.

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_11

A growing number of academic, working and policy papers emphasises the importance of SMEs to the overall growth of national economies (Balling et al. 2009). Nevertheless, Beck (2007) showed that there is not a robust relationship between the size of the SME sector and economic development. Rather, the institutional and business environments in which firms operate seem to be crucial for economic development.

More developed financial systems enable a wider and broader palette of external financial instruments to enterprises of all sizes. However, only larger, older and reputable companies can apply for different external financial instruments, while access to finance to small and medium sized enterprises (SMEs) is limited, even in the most developed financial systems. It is especially true for young and small SMEs that rely mostly on internal funds and retained earnings (Cull et al. 2006). Access to finance relies on physical proximity, availability, affordability and suitability of formal sources of finance to SMEs (USAID 2012, p. 17). SMEs' access to finance is closely linked to the cost of financing arrangements, financial and credit track records, and the type of business and collateral offered by the applicant. According to Beck (2007) transaction costs and asymmetric information between lenders and borrowers are the most important explanatory factors for limited access of SMEs to external finance.

2 Key Concepts on SME Access to Finance

Research on corporate capital structure and SMEs' financing constraints has been a focus in the last 15 years (Jensen and Uhl 2008; Hernádi and Ormos 2012) amid some academics (Berger and Udell 1998, 2006; Beck et al. 2005, 2008b; Beck and Demirgüç-Kunt 2006) and policymakers. After the financial crises and recession in Europe, financial conditions and credit availability to SMEs has worsened. In line with more stringent capital adequacy Basel III requirements, banks confirmed that they require more stringent collaterals, personal guarantees and lower loan-to-value ratios for real estate (Bain and Company 2013). Bank lending also shifted from financing investments to working capital financing in major European countries (ibid 2013). It may mean that SMEs are expanding to other markets and broadening their customer base, but it may also mean that SMEs are faced with more delayed payments keeping technology development on halt. Some authors argue that banks are reluctant to approve loans to SMEs as opposed to larger enterprises in the countries with weak creditor protection and less efficient judicial systems (Galindo and Micco 2005). However, research shows that most banks put the SME sector as strategic one when designing their market channels and policies (De la Torre et al. 2010).

The role of SMEs in spurring economic growth is being recognised throughout the European Union. Increasing number of guarantee programs and grants are available to SMEs, especially innovative, both in member-countries or at the European level. The European Commission (EC), for instance, launched a joint initiative with the European Investment Bank (EIB) and the European Investment

Fund (EIF) for facilitating access to finance for SMEs in the 2014–2020 financial period (EC 2013b). There are three main options to improve SME financing conditions: more direct lending by public institutions or public guarantees for lending by commercial banks[1]; enhanced securitisation of SME loans through either guarantees or ECB asset purchases[2]; and long-term central bank funding at a low interest rate conditional on the expansion of net lending. These options are not mutually exclusive and could be applied simultaneously and their importance varies in different European countries. However, all these options are targeted in order to reduce SME financial constraints, to decrease SMEs' dependence on commercial banks' lending policies, and to provide national guarantees for encouraging entrepreneurship. Such policies do not suggest anything about the preferred financial instruments by SMEs.

The research presented in this chapter questions whether firms in certain European countries exhibit the same external financing preferences. It also questions for differences in external financing preferences between privately held and publicly listed SMEs. All empirical analyses are based on the European Central Bank's Survey on the access to finance of SMEs in the euro area (SAFE) conducted from April to September 2013 (ECB 2013).

3 Problems in SME Accessibility to Financial Instruments

To a great extent SMEs finance themselves internally, both from the business owner and from retained profit. The World Bank's Enterprise surveys showed that SMEs of all sizes finance investments primarily from internal funds, followed by bank lending, leasing and factoring, supplier credits and equity. Complementary are findings of Kraemer-Eis and Lang (2012) that, based on various surveys on access to finance data, conclude that bank loans and overdrafts are the most widespread debt financing tools for SMEs, whereby alternative sources of debt like leasing and factoring also have relevance.

The stock of SME loans[3] in 27 EU countries is estimated to 1.7 trillion euros in 2010 (Darvas 2013). The largest share of SME loans are in the countries with strongest SME sectors such as Spain (356 billion euros), Germany (270 billion

[1] With a blend of 75 % guarantees: 15 % securitisation, 10 billion euros from European Structural and Investment Fund (ESIF) and 420 million euros from COSME and Horizon 2020, EC (2013a, b) estimates that lending to SMEs would amount to 55–58 billion euros.

[2] Securitisation transactions based on SME loans and/or leases can play an important role in contributing to the indirect access of SMEs to the capital markets. EC, EIF, EIB, ESIF, COSME, Horizon 2020 and national development banks' funds are planned to be used for securitisation of portfolios of existing SME loans which would eventually release additional funds of around 65 billion euros for further lending. An option of risk pooling would also be available for even higher lending of up to 100 billion euros (EC 2013b).

[3] Loans up to 250 thousand euros are used as proxy for SME loans.

euros), Italy (206 billion euros), France (201 billion euros) and the UK (131 billion euros). SME loans in the SEE region is set back due to impaired bank balance sheets, economic recessions, and the bleak economic outlook (Darvas 2013).

Studies in various countries have found that trade credit used by small businesses is of the same order of magnitude as bank borrowing (Berger and Udell 2006). An analysis conducted by Deutsche Bundesbank (2012) showed that trade credit is the second most important source of finance for non-financial enterprises after intra-group loans in Germany and the most important source of short-term financing, reaching an average ratio of 15.8 % of companies' assets. Ferrando and Mulier (2012) emphasised the importance of financial system development arguing that the sensitivity of firm growth to trade channel is smaller in countries where bank loans are more accessible.

Despite the importance of SMEs for national economies, financing choices for SMEs remain limited and restricted to several financial instruments in most European countries. Many SMEs lack financial literacy and are not aware of the importance of sound business plans when applying for funds. Despite piles of documentation collected by tax, statistics, banks' and business registries, the records are often not related, have different formats or they are not timely adjusted. Furthermore, central credit registries that follow firms' credit track record with numerous banks do not exist in many countries (Bain and Company 2013).

In order to facilitate access to finance, the EU has created various guarantee mechanisms for SMEs that are also introduced in national policies of their member states. They, in line with private credit insurance, facilitate additional external financing. However, despite institutional efforts, various European programmes for SME financing have reached only a tiny fraction of SMEs so far. Furthermore, it is always unclear whether publicly funded programmes reach those SMEs that face financing difficulties, or those SMEs that have better financial fundamentals and thus can get financing anyway. Although public programmes should be offered to all SMEs, companies younger than 2 years typically do not have access to them, since minimum financial track record is required. Moreover, public programmes in essence enable financial intermediaries to share lending risks, so it is doubtful whether publicly guaranteed money is allocated in the right way.

Equity funding is generally not encouraged throughout Europe and it is mostly related to founder's and founder's family capital as if it is forgotten that highly capitalised firms have easier access to debt markets. Public authorities can stimulate more equity investment by tax allowances.[4] While it can be admitted that banks are faced with risks arising from the lack of data, one of their roles in economy is identifying, taking on, (re)packaging and allocating risks in exchange for a fee. The problems of asymmetric information have always been present and it is

[4] To reduce tax discrimination between debt and equity financing, Belgian corporate tax code allows investors to deduct a fictitious interest calculated on the shareholders' equity (net assets) as of 2007. The notional interest rate is determined annually and capped to 6.5 %. In Italy 3 % income tax allowance is available for newly paid-in equity capital.

questionable about what should banks, as specialised financial intermediaries, do if all the information on clients would be known in advance and would it mean that the financial crisis is an excuse for cutting relationship-lending costs and being more competitive as compared to other financial intermediaries? Thus, a far more convincing argument for credit restrictions to SMEs is that SMEs often do not come to bank representatives with business and financially viable projects to finance. It is also partly justified that banks try to annul the increasing regulatory costs through publicly organised low cost information gathering about their clients.

The EU has recognized a regulatory burden in terms of access to finance for SME development (CEC 2008). In order to facilitate policymakers' decision-making, as of 2009 surveys have been conducted about SME access to finance that also question the public policy effects on financing. Despite the growing number of papers that compare the financing conditions of SMEs, SME preferences regarding the external financial instruments have been neglected. There is only one research by Daskalakis et al. (2013) that deals with financing preferences of SMEs in Greece.

4 Evidence

Research on corporate capital structure and SMEs' financing constraints in developing countries has grabbed more academic and policymakers' attention in the last 15 years (Berger and Udell 1998, 2006; Beck et al. 2005, 2008; Beck and Demirgüç-Kunt 2006; Jensen and Uhl 2008; Hernádi and Ormos 2012). While internal funding is the main source of income, some SMEs also use external sources of finance. They can be both informal (family's and friends' funds, business angel investment), and formal (bank loans, leasing, trade credits, factoring and venture capital funds). The need for finance varies across the firms, their age and size and the stage of their growth cycle, while the accessibility of financial instruments corresponds with the stage of the lifecycle of the firms and financial development (Fig. 1). Companies have been split according to their age also: infant companies in start-up phase (from 0 to 2 years old), adolescent companies in the early-growth phase (3–4 year old),[5] middle aged or sustainable growth companies (5–24 year old)[6] and mature companies (older than 25 years). The start-up phase is usually associated with a business plan that can be used as a sales document to obtain angel finance in the developed markets. The fact that young firms easily end up in distressed situations, places younger businesses in an unfavourable position when negotiating trade and financing terms. The phases of growth are not strict among

[5] According to many surveys, the common threshold for adolescent companies is up to 5 years.

[6] Most companies up to 10 years would, according to the surveys, fall within this category, whereby old companies would be those older than 10 years.

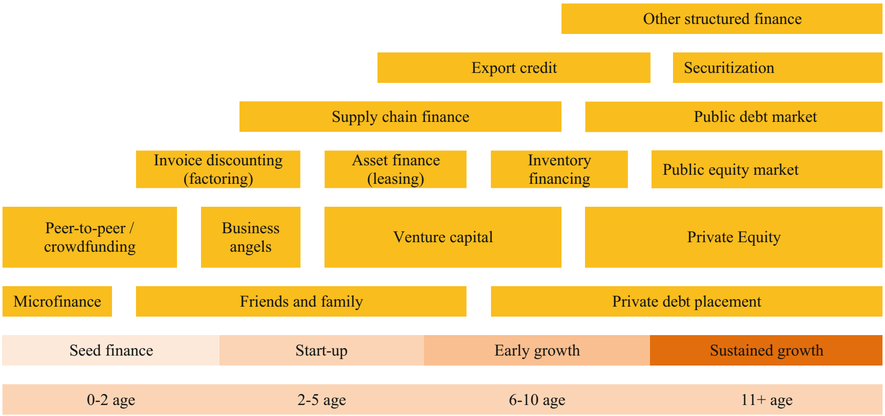

Fig. 1 External financial instruments for SMEs according to the stages of development. *Source*: Illustrated according to Bain and Company (2013), p. 33

different companies and different sectors, meaning that, depending on the type of business, a company aged between 4 and 5 years may still be in the start-up phase.

According to Berger and Udell (1998) supplier credit is applicable to small firms in all stages of growth, but it basically depends on the country in question, financial system development and availability of short-term debt instruments such as commercial papers and liquidity credits, (in)formal conventions for timely payment of invoices and internal needs for cash (working capital). Mezzanine finance, characterised by preferred stock and subordinated debt presence, occurs between the start-up and early growth phases. Figure 1 does not account for public assistance in forms of loan subsidies, grants or credit guarantees that are extensively offered in Europe, because public financing in practice stands for the absent private equity and loans at early stages of business development. The need for public support ceases when the firm steps in the sustained growth phase when it can approach capital market investors.

Microcredits are loans to businesses for up to 25 thousand euros, approved for a period of up to 5 years. Microloans are approved mostly by non-government institutions or foundations (22 %), followed by non-bank financial institutions (20 %), microfinance associations (14 %), community development financial institutions (12 %), credit unions or cooperatives (10 %), banks (7 %) and other (16 %). In Western Europe, microloans have been praised for annulling the effect of financial crisis related constraints for young SMEs (Bendig et al. 2012). Countries with the highest value of microloans approved were Germany, France, Spain, Poland and Bosnia and Herzegovina. Interestingly, Bosnia and Herzegovina takes the leading role in number of approved microloans to businesses (39 thousand). Microfinance is a growing sector in Europe in the last 20 years and its activity is captured by the EMN (European Microfinance Network) survey.

Peer-to-peer (P2P) lending or crowdfunding is mainly based on online platforms that collect funds from investors and transfer them to the borrowers for a fee.

Lenders and borrowers may not be from the same country. It is an emerging channel of lending in Europe from 2005 onwards (Ashta and Assadi 2009) that is nowadays available in all larger countries. Interest rates on loans vary from very low (4 %) to very high (22 %), but on average they are more favourable than in banks, while additional servicing fees range from a fixed amount to 0–2.5 % of lent funds (Ashta and Assadi 2009). Official data on the size of the P2P market does not exist. However, this emerging online market moves the boundaries of conventional banking and the boundaries between financial systems between the particular countries further.

Leasing is a very popular asset-based form of financing. Due to the fact that during the lease term ownership over the assets stays with the lessor, a leased asset serves as collateral that enables the lessee to generate cash flows for debt repayment at the same time. Leasing also enables borrowers with a limited financial and credit track record and collateral to invest in the purchase of capital equipment (Bakker et al. 2004; Berger and Udell 2006). Leasing is suitable for enterprises with different growth characteristics with similar approval rates throughout various countries (OECD 2012). The high importance of leasing in Eastern Europe is attributed to under-developed creditor rights' protection (Bakker and Gross 2004).

Factoring is also an asset based financing scheme, but it is typically an arrangement under which a financial intermediary (the factor) collects the receivables of its clients in return for a service charge in the form of a discount. According to the EU Federation for the Factoring and Commercial Finance data, five countries account for 80 % amount of factoring in the European market, i.e., the UK (23.5 %), Italy and France (each 15.3 %), Germany (13.8 %) and Spain (10.7 %).

European Private Equity and the Venture Capital Association reported that all private equity funds' investments in Europe were worth 36.5 billion euros in 4975 European companies in 2012 which makes an average amount of 7.3 million euros investment per company.[7] The total market capitalisation on SME segments of all stock exchanges stood at 146.5 trillion euros with 1478 companies listed at the end of December 2013. That gives an average market capitalisation of over 99 million euros per company. Only six stock exchanges have special market segments for SMEs (BME—Spanish Exchanges, Deutsche Börse, NASDAQ OMX Nordics and Baltics, NYSE Euronext, Oslo Bars and Warsaw Stock Exchange). Bearing in mind that total market capitalisation of the European Federation of Stock Exchanges members was 7759.3 billion euros at the end of 2013, it becomes obvious that even the most developed European stock exchanges cannot be praised for offering funding alternatives to a large number of European SMEs. This can be compared, for example to factoring activity that climbed to 1207.3 billion euros in 2012 or to 9.36 % total share in European GDP, both private equity industry and stock issuance are a meagre part of SMEs external financing.[8] However, it is proven

[7] EVCA data, http://evca.eu/media/12067/2012_Pan-European_PEVC_Activity.pdf

[8] EU Federation for the Factoring and Commercial Finance Industry, http://www.euf.eu.com/total-factoring-volume/facts-and-figures/total-factoring-volume/menu-id-24.html

that the SME sector is stronger in market-based financial systems since these financial systems enable a liquid exit to private equity funds from their investments with limited horizon (Bijlsma and Zwart 2013). Thus, several European countries tried to establish SME capital markets during the dot-com era, i.e., France (Nouveau Marché 1996), Germany (Neuer Markt 1997), Italy (Nuovo Mercato 1999) and Spain (Nuevo Mercado 2000) that ceased to exist after a couple of years. However, their long-term contribution has been in enabling financing to young and innovative firms through initial public offerings at second tier segments of local stock exchanges, that influenced positive venture capital fund presence and investments in these countries (Saillard and Url 2011).

A small number of European countries created capital market alternatives to bank lending for SMEs. One exception is Stuttgart Börse that introduced the Bond*m* model in 2010. It enables SMEs to issue corporate bonds worth between 25 and 150 million euros by circumventing underwriters, i.e., offering bonds directly to retail investors. The popularity of the Bond*m* trading segment has spread throughout Germany and into France, inspiring SME debt markets in Frankfurt, Düsseldorf, Hamburg, and Munich.[9]

5 Sample Data and Practical Issues

Survey data on the access to finance of SMEs in the EU can shed some light on preferred external financial instrument significance for SMEs. This survey covers micro, small, medium-sized and large firms and provides evidence on the financing conditions within the EU and the rest of Europe. A part of the survey is run every 6 months to assess the latest developments in financing conditions for firms. Survey responses collected between August and October 2013 have been used for this research (ECB 2013). The number of respondents varies by countries and it is based on the overall size of national economies in the European context. The largest samples come from the UK, Poland, Germany, France, Spain and Italy with 1000 enterprises surveyed. Economies of middle size are Austria, Belgium, Bulgaria, Denmark, Finland, Greece, Hungary, Ireland, the Netherlands, Romania, Portugal and Sweden with about 500 enterprises surveyed. Croatia, Montenegro, Macedonia, Serbia and Albania each have 90 enterprises in the entire sample. The survey was targeted to 14,769 enterprises from 36 European countries excluding Switzerland.[10] Starting sample characteristics are shown in Table 1 with regard to financial autonomy, annual turnover, number of employees, firm age, the main business and owner type.

[9] http://www.forbes.com/sites/insead/2013/02/27/smes-embrace-the-bond-markets/. Accessed in March 2014.

[10] Enterprises from Israel have also been surveyed, but they are excluded from the analysis because they do not belong to the European continent. Due to small number of firms (answers), Lichtenstein is also excluded from the analysis.

Table 1 Sample characteristics with and without public administration

Characteristics		Enterprises surveyed, all businesses		Differences between the countries		Enterprises surveyed, without public administration		Differences between the countries	
		Number	%	df	Pearson χ^2 test	Number	%	df	Pearson χ^2 test
Financial autonomy	Full	12385	83.9	140	11,751.2***	11601	85.4	140	11,092.1***
	Not full	2340	15.8			1934	14.2		
	Non-profit and unknown	44	0.3			43	0.3		
Annual turnover in million euro	Less than 2	7017	47.5	140	1078.6***	6997	51.5	140	1039.7***
	From 2 to 10	3834	26.0			3737	27.5		
	From 10 to 50	2461	16.7			2041	15.0		
	More than 50	1027	7.0			402	3.0		
	Unknown	430	2.9			401	3.0		
Number of employees	From 1 to 9	4654	31.5	105	547.2***	4653	34.3	70	321.8***
	From 10 to 49	4845	32.8			4844	35.7		
	From 50 to 249	4081	27.6			4081	30.1		
	More than 250	1189	8.1				0.0		
Firm age	Older than 10 years	10727	72.6	210	7226.5***	9763	71.9	210	6688.7***
	5–10 years old	2078	14.1			1971	14.5		
	2–5 years old	1120	7.6			1083	8.0		
	Less than 2 years	307	2.1			294	2.2		
	Not known	537	3.6			467	3.4		
Main business	Mining	3468	23.5	140	1640.1***	3468	25.5	105	1403.1***
	Construction	1561	10.6			1561	11.5		
	Manufacturing including utilities	3875	26.2			3875	28.5		
	Wholesale or retail trade	4674	31.6			4674	34.4		
	Public administration	1191	8.1				0.0		

(continued)

Table 1 (continued)

Characteristics		Enterprises surveyed, all businesses		Differences between the countries		Enterprises surveyed, without public administration		Differences between the countries	
		Number	%	df	Pearson χ^2 test	Number	%	df	Pearson χ^2 test
Owner type	Public shareholders	890	6.0	210	3459.6***	680	5.0	210	3476.7***
	Family or entrepreneurs	6799	46.0			6401	47.1		
	Other firms or business associates	2045	13.8			1690	12.4		
	Venture capital funds or business angels	138	0.9			138	1.0		
	A natural person	4226	28.6			4226	31.1		
	Not known	671	4.5			443	3.3		
Total		14769	100.0			13578	100.0		

Source: Calculated based on SAFE survey
*1 % level of significance
**5 % level of significance
***10 % level of significance

The survey is mainly based on the answers of enterprises operating more than 10 years (73 %), since they are able to compare market conditions in the financial market. Most enterprises come from trade (32 %), followed by manufacturing and construction (26 %), and mining (23.5 %). The majority are owned by family or relatives (46 %), a natural person (29 %), or other firms (14 %). There were only 6 % publicly listed enterprises, i.e., 5 % after excluding public administration as the main business. After removing public administration, this is a pure SME survey targeted to 13,578 firms in total, since only 8 % of the firms that belong to public administration have more than 250 employees. In the adjusted sample size, the shares between the companies slightly changed. It is worth noting that small sized enterprises comprise 70 % while 30 % of enterprises are of middle size. Only 1 % of companies in the sample are supported by venture capital, so that the majority of the SMEs may not be fast growing and thus of no interest to mid-term return oriented investors.

As measured by the Pearson chi-square test, the differences between the countries are significant at the level of 1 % with regard to each of the chosen characteristics. This was as expected since business funding sources differ between countries due to different enterprises' and sectorial characteristics, financial system development and costs of funds, as well as due to the governing regulatory and institutional environment. However, only 38 % enterprises said that access to finance is very to an extremely pressing problem for them as compared to 50.6 % enterprises that see the largest problem in fierce competition.[11]

The goal of empirical analysis is to compare external financing preferences between privately held SMEs and public SMEs, in order to identify countries with similar external financing preferences of their enterprises and to compare financing preferences between public SMEs and private SMEs within countries. Special attention has been drawn to financing preferences of younger SMEs of up to 5 years that are believed to be fully privately-held. The starting research hypotheses are:

1. Privately held SMEs and public SMEs have different stances towards preferred external financial instruments and towards the factors that contribute to various external financial instrument accessibility
2. Different groups of countries can be identified based on the SMEs' preference for external financing, and
3. Preference for external financing instruments differs between privately held SMEs and public SMEs

[11] The most pronounced problems SMEs cited are competition, followed by finding customers and costs of labour and production. Next came regulation, followed by problem in finding experienced staff while access to finance was the last. The order of pressing problems is logical since SMEs are heavily dependent on domestic markets. If there is a drop in demand due to cost cutting strategies of businesses, customers and governments, the economy is glooming, costs are cut by customers, and price competitiveness gets relatively more importance over quality competitiveness.

6 Outcomes

With respect to the first hypothesis, there are slight differences between privately held and public companies in their external financial instrument preference (Table 2). Both types of companies are more prone to loan financing, while privately held companies would first go to banks to require funds. Loans availability is very important to privately held SMEs. However, the SMEs do not differ in stances on the most important limiting factors to acquire either debt or equity funds. According to both private and public companies surveyed, the most important factor influencing external financing is the policies for obtaining the existing public measures easier, followed by tax incentives. Interestingly, publicly held firms feel more confident to talk with creditors, while private companies are more confident to negotiate with equity investors and venture capital funds. This warns about the asymmetric information problem with privately held SMEs and there are thus more financing constraints on the side of those SMEs. It is consistent with Berger and Udell (1998) findings that cite informational opacity as the most important characteristics defining small business finance.

The results presented in Table 1 showed that tax incentives, accessibility of existing public measures and business advisory activities are more important to privately held SMEs that direct measures for facilitating access to finance. In support for this result, the analysis of Bain and Company (2013) confirmed that regulation in some countries discourages growth.[12] Similar research should be conducted in other countries because it is not only important that a certain public measure exists, but whether it is enforceable.[13] Equity encouragement measures are more important than export credits or guarantees to both privately and publicly held SMEs, which means that most SMEs are oriented towards domestic markets. It brings a strong message to public authorities to first facilitate administrative measures and tax policy before solving financing constraints. However, caution is needed since these responses may mean that SMEs have expectations for further and stronger public measures that are not always good for strengthening competitiveness.

The sample is further decreased to 388 valid answers (60.4 %) from publicly listed companies and to 7160 valid answers (55.5 %) from privately held companies, based on whether the firm has preferences towards certain financial instrument (s). Overall, bank loans are the most preferred financial instruments (39.1 % answers), while loans from other sources take second place with 7.3 % answers.

[12] For example, there are roughly 60 % fewer companies with 50 employees than those with 49 employees in France which is explained by 34 additional regulatory requirements that middle-sized companies have to fulfil which increases their costs for about 4 % of total payroll on average.

[13] An example of a successful public measure was Portugal's SME Invest launched in 2008 and superseded by SME Growth in 2012. As of October 2012, SME Invest and SME Growth lines provided 9.2 billion euros to 17 % of SMEs in Portugal. The key of success of this measure was in lower interest rates, lower fees, focus on export and investment credits and easy access to guarantee lines directly through banks.

Table 2 Differences in financing stances between privately and publicly held SMEs

Characteristic	Ownership type	Number	Mean	St. dev.	Equality of variances	t-Test for equality of means	
					F	t	df
Preferred external financing choice for growth	Public	388	1.81	1.173	0.630	2.950***	7546
	Private	7160	1.63	1		2.969***	431
How important are guarantees or loans to your company?	Public	611	5.43	3.181	7.695***	−3.400***	12936
	Private	12327	5.86	3.058		−3.281***	667
How important are measures to facilitate equity investments?	Public	583	4.38	3.004	0.135	1.582	11730
	Private	11149	4.18	2.988		1.574	644
How important are export credits or guarantees?	Public	574	3.98	3.023	0.000	2.050**	11435
	Private	10863	3.71	3.024		2.050**	635
How important are tax incentives?	Public	618	6.21	2.944	0.135	−3.627***	12918
	Private	12302	6.65	2.944		−3.627***	680
How important are business support services?	Public	610	5.26	2.799	0.372	−3.568***	13038
	Private	12430	5.68	2.822		−3.595***	671
How important is making existing public measures easier to obtain?	Public	616	6.08	2.840	2.155	−5.818***	13016
	Private	12402	6.75	2.771		−5.689***	674
The most limiting factor to get a bank or other loan	Public	305	4.93	3.051	0.070	0.773	6269
	Private	5966	4.79	3.019		0.766	335
The most limiting factor to get a equity or mezzanine financing	Public	61	4.97	2.516	0.843	0.947	773
	Private	714	4.67	2.354		0.896	69
Are you confident to talk about financing with equity investors or VC firms to obtain desired results?	Public	642	4.77	2.889	33.528***	−2.647***	13527
	Private	12887	5.06	2.737		−2.521**	700
Are you confident to talk about financing with banks and to obtain desired results?	Public	642	2.29	2.350	45.286***	3.373***	13527
	Private	12887	2.01	2.070		3.007***	691
What is the size of the last loan of any kind that your firm obtained in the last 2 years	Public	642	3.43	2.627	50.313***	4.398***	13527
	Private	12887	3.00	2.411		4.070***	696

Source: Calculated based on SAFE survey
*1 % level of significance
**5 % level of significance
***10 % level of significance

These findings are consistent with Daskalakis et al. (2013). Equity preference is at third place with 3.5 % answers, while 2.3 % firms prefer mezzanine finance, and 3.7 % would opt for other sources of finance. While 44.2 % of SMEs have not answered the question on their preferred financing instrument, it is interesting that 46.4 % SMEs have not taken any loan in the last 2 years. In addition, the most frequent loan size has been greater than 25 thousand and up to 100 thousand euros (13.5 %), followed by loans from 250 thousand to 1 million euros (11 %), followed by loans between 100 and 249.99 thousand euros (9.9 %), while loans over 1 million euros are at 7.2 %, and microloans stand at 9.2 %. It again confirms the fact that loans are mostly approved to larger companies.

The results in Table 3 shows that four groups of countries can be distinguished with regard to the preferred financing instruments by SMEs. Hereby two groups have two subgroups, making this number to increase to six country groups in total. ANOVA tests have been performed to sort the countries into similar groups. In line with Levene statistics, the Welch test was used to check variance homogeneity robustness. Welch statistic is insignificant for both Levene significant test values. With respect to preferred external financing instruments, there are only bank-based and loan-based groups of countries in Europe. Equity tilted countries are Romania and Montenegro (ME) only, but since these countries do not have developed capital markets it is probably related to informal equity financing. Although Serbia seems to be an outlier with SMEs that mostly prefer subordinated loans, it may mean that its companies are engaged in informal debt financing contracts.[14] Companies' preference for certain external financial instruments has a lot in common with regulation. Interest on debt is tax deductive, making companies prefer debt instruments. A detailed analysis of national tax codes is needed to assess whether equity investing is supported by regulation or not.

The results in Table 3 show that the strongest bank-based countries are: Italy, Spain, Portugal, Luxembourg, Croatia, Slovenia, Slovakia, Czech Republic and Greece. Bank-based countries that also allow for other loans and equity are: Austria, Belgium, France, Ireland, Finland, Norway, Poland as well as Albania, Cyprus and Malta.

Pure loan-based countries, defined as countries with strong reliance of SMEs on debt regardless of lender type, are the Netherlands and Turkey, then the UK, Sweden, Denmark, Iceland, Estonia, Lithuania, Latvia, Hungary, Bulgaria and Macedonia. However, caution is needed as the survey often puts together rather different, both formal and informal financial instruments together, and it may be helpful if external financial instruments would be split in more detail.[15] Figures 2

[14] According to USAID (2012) SMEs have poor access to formal sources of finance in Serbia and six out of ten enterprises do not even try to take a loan. One reason are high costs of finance that climbed to more than 16 % for borrowing in local currency at the end of 2011, in front of Albania's 12 %, Romania's 10.46 %, Bulgaria's 9.5 % and Hungary's 9.12 %.

[15] For example, other loans include all the loans other than bank loans while it is not clear what companies mean under other sources of finance. The distinction between formal and informal sources of finance should be done, and instruments of public support should be clearly distinguished from commercial financing.

Table 3 Groups of countries structured according to the preferred external financial instrument

Country	Country code	N	Mean	Std. dev.	ANOVA df	ANOVA F-value	ANOVA Levene statistic	Group of countries according to the preferred external financing instrument by SMEs
Czech Republic	CZ	177	1.46	1.050	9	0.901	2.154**	Moderately bank-based countries (group 1)
Germany	DE	556	1.46	0.981				
Spain	ES	447	1.52	1.002				
Greece	GR	191	1.45	0.862				
Croatia	HR	45	1.44	1.179				
Portugal	PT	239	1.49	1.107				
Slovenia	SI	49	1.49	1.102				
Slovakia	SK	158	1.41	1.065				
Luxembourg	LU	48	1.42	0.895				
Italy	IT	450	1.34	0.892				
Total		2360	1.45	0.989				
Albania	AL	58	1.57	1.126	9	0.735	1.207	Slightly bank-based countries (group 2)
Austria	AT	273	1.60	1.120				
Belgium	BE	272	1.54	1.129				
Cyprus	CY	14	1.50	0.941				
Finland	FI	317	1.54	1.077				
France	FR	425	1.50	1.080				
Ireland	IE	299	1.51	1.028				
Malta	MT	51	1.33	0.841				
Norway	NO	96	1.42	0.991				
Poland	PL	528	1,60	1.082				
Total		2333	1.54	1.076				
Bulgaria	BG	276	1.86	1.315	9	1.037	2.099**	Moderately loan-based countries (group 3)
Denmark	DK	270	1.72	1.205				
Estonia	EE	42	1.64	1.226				
Hungary	HU	227	1.85	1.467				
Iceland	IS	69	1.86	1.331				
Lithuania	LT	173	1.69	1.218				
Latvia	LV	72	1.65	1.037				
Macedonia	MK	63	1.92	1.371				
Sweden	SE	269	1.64	1.213				
The United Kingdom	UK	578	1.70	1.261				
Total		2039	1.74	1.274				

(continued)

Table 3 (continued)

Country	Country code	N	Mean	Std. dev.	ANOVA df	ANOVA F-value	ANOVA Levene statistic	Group of countries according to the preferred external financing instrument by SMEs
The Netherlands	NL	271	2.03	1.438	1	0.698	2.697	Purely loan-based countries (group 4)
Turkey	TR	190	1.93	1.219				
Total		461	1.99	1.352				
Montenegro	ME	71	2.68	1.471	1	1.808	0.379	Equity tilted countries (group 5)
Romania	RO	226	2.38	1.627				
Total		297	2.45	1.594				
Serbia	RS	58	3.26	1.278				Subordinated loan tilted countries (group 6)
Total		7548	1.64	1.182				

Source: Calculated based on SAFE survey
*1 % level of significance
**5 % level of significance
***10 % level of significance

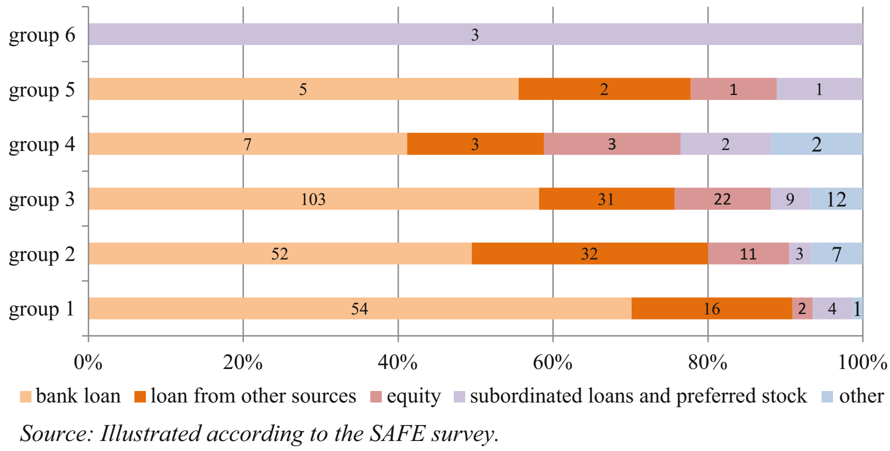

Fig. 2 Preferred financing instrument by publicly listed companies. *Source*: Illustrated according to the SAFE survey

and 3 graphically show the preferences for external financing instruments between privately and publicly held SMEs in designated groups of countries.

The independent samples test on preferred financing instrument between privately and publicly held companies reveals that there are statistically significant

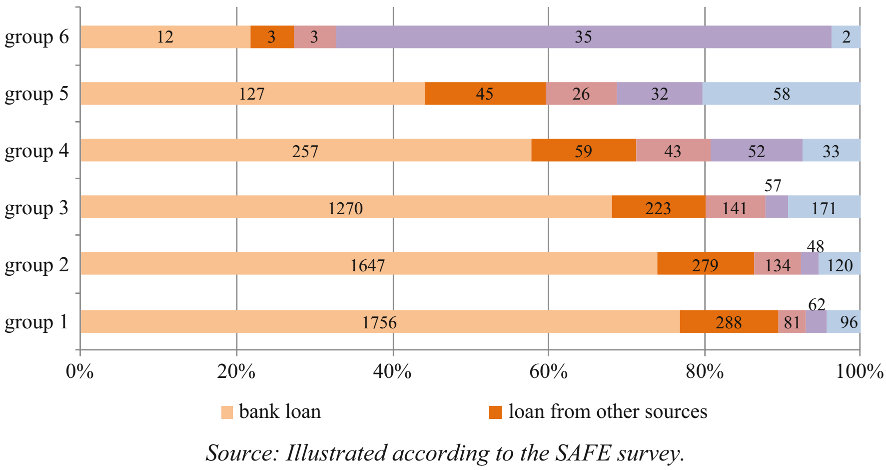

Fig. 3 Preferred financing instrument by privately held companies. *Source*: Illustrated according to the SAFE survey

differences (1 %) in group 2 and group 6 of countries provided that equal variances are assumed. Overall, there are no differences between preferred external financial instruments between privately and publicly held SMEs in a major number of identified groups of countries and thus the third hypothesis is rejected. The most significant difference between privately and publicly held companies appears to be in Serbia, where the number of publicly held enterprises is very small. Except for Serbia, privately held companies are in general more prone to taking loans with banks regardless of the group of countries they belong to.

7 Conclusions and Further Research

This chapter presents external financial instruments available to SMEs in European countries and the willingness of SMEs to use them. Data analysed in this chapter come from SME responses from SAFE surveys conducted from August to October 2013. The entire analysis is based on the preferred rather than real external sources of finance to European SMEs. Although access to finance is perceived as one of the leading problems of European SMEs, public authorities should also focus on tax incentives and enforceability of the existing public measures that indirectly influence external finance needs. This is in line with Beck's (2007) research on the importance of the institutional and business environment for economic growth.

Although the survey responses are limited in terms of the number of publicly listed enterprises, the number of firms younger than 5 years as well as in terms of more detailed external financial instruments categorization, several groups of countries with similar external financing preferences have been identified based on the ANOVA test. It is confirmed that SMEs from all European countries primarily rely on banks before relying on funds from other financial intermediaries. Although privately held companies are generally more prone to taking loans from banks, there are no differences in preferred external financial instruments between privately and publicly held SMEs in a major number of designated groups of countries. The role of public equity is generally neglected and national tax codes should be carefully scrutinised to determine whether and why the debt is more favoured over external equity in most European countries.

A more detailed SAFE survey that would involve a greater number of enterprises would be desirable to distinguish between firms' specific preferences for external financing in various countries in order to target specific public measures to firms that genuinely need them and not exclusively to the firms that are simply eligible for them. Such research results could help in reducing financing preferences between European SMEs for the sake of enhancing their competitiveness and growth.

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The Role of Human Resource Management in Small and Medium Sized Companies in Central-Eastern Europe

Gizela Štangl Šušnjar, Agneš Slavić, Nemanja Berber, and Bojan Leković

Abstract Human resource management (HRM) in contemporary economics is linked to a company's success measured through numerous organizational measures (profitability, productivity, rate of innovation, market share, environmental performances, etc.). The role of HRM in large enterprises is relatively known, especially when the competitiveness and sustainable development are in question. On the other hand, small entrepreneurial and medium sized (SME) companies have not been greatly studied in relation to the HRM in the past. Although there is a lack of literature and empirical research in this area, several studies in the past decade and recent years emphasized the importance of the HRM for the survival and success of the SMEs. The reason why more and more authors today are arguing about the success of the SMEs is the perceived advantages of SMEs in a turbulent and unpredictable business environment. SMEs are seen as the driving force for vulnerable economies, a source of innovation, employment, and flexibility. Bearing in mind SMEs and their advantages, the authors have focused their attention on the economies in the Central and Eastern Europe countries (Slovenia, Serbia, Hungary and Bulgaria) where the SMEs are recognized as potential possibilities for economic recovery and development. Since human capital is recognized as one of the most important factors of enterprise success, the aim of this work was to explore the role of HRM in SMEs in the economies of Serbia, Bulgaria, Hungary and Slovenia, to determine the type of linkage between HRM and the success of small and medium-sized companies that operate in the CEE region, in light of the Cranet 2008/2010 survey data. The objective in this chapter was the exploration of the existence of organizations' business strategy and HR strategy in SMEs, as well as HR departments, and the role of HRM in the business of the SMEs. The special task in this research was the exploration of the HRM activities and trends (recruitment, selection, compensation, performance management, training and development, human resource information system, etc.) that are present in the SMEs in the CEE region. The ranking of the SMEs' performances is also presented and the relations between the existence of HRM and the several performance measures in

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_12

these companies. Descriptive statistical methods, t-test of independent samples and ANOVAs tests have been used during quantitative analysis to explore the presented relations.

1 Key Concepts of a Subject Team

In the contemporary business environment, human capital is seen as a crucial factor for the success of the entire business system and development of organizations (Buller and McEvoy 2012). HRM is understood as the concept of managing organization's people which includes certain functions such as planning, staffing (recruitment, selection and orientation), training, development and career development, performance measurement, compensation and benefits, leaving the organizations, industrial relation and the like. With an adequate structuring of the HRM sector, organizations can provide significant improvements in business in terms of higher performances (Berber et al. 2012, 2014; Huselid 1995) and the competitive advantage of organizations (Campbell et al. 2012; Wright and McMahan 2011; Progoulaki and Theotokas 2010; Lado and Wilson 1994; Schuler and MacMillan 1984).

Keeping in mind the stated influence of the HRM on the organizational effectiveness, regarding researches on HRM, it is important to emphasize that the most of them have been made for large enterprises (Tanova 2003). Authors Jack et al. (2006) stated that the knowledge, experience and prescriptions for HRM are mostly formed from research in large firms. On the other hand, there is little knowledge about how the theories developed actually extend to small entrepreneurial ventures and medium firms. And why is this important? The reason why today more and more authors are arguing about the success of the SMEs is due to the perceived advantages of SMEs in turbulent and unpredictable business environment. SMEs are seen as driving force for the vulnerable economies, a source of innovation, employment, and adaptability to quickly react to changes. Since there are practical evidences for the positive influence of the HRM on organizational success (Slavić and Berber 2013; Crook et al. 2011; Zheng et al. 2006; Youndt et al. 1996; Huselid 1995), it is interesting to explore the influence of the HRM activities in SMEs and on the SMEs' success.

The purpose of this chapter is to explore the role of HRM in SMEs in the economies of Serbia, Bulgaria, Hungary and Slovenia, to determine the type of linkages between HRM and the success of small and medium-sized companies that operate in the CEE region, in light of the Cranet 2008/2010 survey data. The chapter objectives are to explore the organizations' business strategy and HR strategy in SMEs, HR departments and the role of HRM in the business of the SMEs. Special tasks in this research were to explore the HRM activities and trends [recruitment, selection, compensation, performance management, training and development, human resource information system (HRIS), etc.] that are present in the SMEs in the CEE region. Authors decided to make this exploration for the mentioned region, since the Republic of Serbia belongs to the group of the former socialistic republics in the CEE region. Much research in the past few years (see Parry et al. 2013; Poor and Capo 2013; Poor et al. 2011, 2012; Kittler et al. 2011; Festing and Sahakiants 2010; Kazlauskaite and Buciuniene 2010; Brewster et al. 2010; Karoliny et al. 2009) has been conducted with the aim to explore and present the specific HRM practices in this region, and if we bear in mind stated sentence about the influence of the HRM on organizational effectiveness, authors of this chapter found research objectives as very important, especially in the condition of the contemporary economic, political and social challenges.

2 Problems

The two main problems in focus of this research were the analysis of the nature of HRM in small and medium sized enterprises in the region of Central and Eastern Europe and exploration of the relation between HRM and organizational performances in SMEs in the mentioned region. Namely, many SMEs perform different, ad hoc and usually informal HR activities (Saridakis et al. 2013; Slavić and Berber 2013; Greenidge et al. 2012; Mayson and Barrett 2006; Kotey and Slade 2005; Bacon and Hoque 2005). Since there is evidence of the positive influences of HRM on the performances of SMEs (Muogbo 2013; Zolak-Poljašević and Petković 2013; Galang and Osman 2013; Slavić and Berber 2013; Zheng et al. 2006; Hayton 2003), the authors decided to explore the nature of HRM in SMEs in the specific region of Central and Eastern Europe and its role in the business of SMEs regarding organizational performances measured trough profitability, productivity, innovation and service quality.

Based on the stated problems of research, authors presented some theoretical evidences and developed two research hypotheses.

3 Evidence

3.1 Informal and Strategic Approach to the HRM in SMEs

Firstly, it is important to emphasize one common thought about HRM in SMEs. Namely, there is a common thought that many of the HRM activities in SMEs are usually informal (Saridakis et al. 2013, p. 445; Kok and Uhlaner, 2001) and ad hoc (Mayson and Barrett 2006, p. 449). This means that there is no strategic approach to the HRM in SMEs. Namely, small firms, those that are growing or growth oriented, make an important contribution to the performance of developed and developing economies around the globe. Business growth, the key to firm sustainability and economic development, necessarily assumes the effective use of resources, including human resources, to create and exploit new opportunities. A critical issue is how to ensure the growth and sustainability of the firm if there is the informality of the HRM practice in SMEs and the absence of knowledge about the benefits of a more strategic approach to HRM (Mayson and Barrett 2006). In relation to the mentioned informality of HRM in SMEs, author Hayton (2003) found in the study of 99 SMEs that HRM practices that promote employee discretionary behavior, knowledge sharing, and organizational learning are positively associated with the entrepreneurial performances.

The most common HRM practices in small firms reflect operational needs and pragmatic concerns, such as record keeping, staffing activities and, to a lesser extent, motivation and retention activities (compensation) (Barrett and Mayson 2007). A lot of small firms rather use informal HRM activities like *training* (on the job training) (Kotey and Slade 2005) than some formal training having in mind the costs and the lack of the knowledge about the benefits that can be achieved (Mayson and Barrett 2006). Similarly, Bacon and Hoque (2005) and Greenidge et al. (2012) found that there is a far greater degree of informality in *employment* (recruitment) practices in SMEs than in larger workplaces. Barrett and Mayson (2007) found that small firms exhibit poor HRM practice regarding *recruitment and selection* process. In case of *compensation*, recognition and reinforcement, pay rises or job security were commonly used reward systems (McEvoy 1984). Compensation is a particularly important topic because often compensation significantly affects recruiting and retention efforts of small firms; if they cannot pay applicants enough, then they cannot recruit or retain critical skills or knowledge they need to operate effectively (Cardon and Stevens 2004). *Performance appraisal* practices in small firms tend to be informal and continuous and are often used for monitoring and control rather than development purposes (Gilbert and Jones 2000; Barrett and Mayson 2007, p. 310).

In relation to the informality of HRM in SMEs, authors Slavić and Berber (2013) state that modern human resource management literature and the actual management practice both emphasize the strategic approach to a company's most important assets, its human resources. This is very important for large but also for small and medium enterprises. In this sense, strategic human resource management (SHRM) is seen as "the pattern of planned human resource deployments and activities intended to enable an organization achieve its goals" (Wright and McMahan 1992, p. 298). Strategic approaches to HRM shift the theoretical focus away from examining individual HRM practices in isolation, an approach commonly found in the small firm literature, to an integrated framework for understanding the strategic contribution of human capital organized through HRM systems to enable firm growth and performance (Mayson and Barrett 2006, p. 448). As the opposite side of the informality, strategic approach to HRM, a well-planned and systematically organized functions, can be useful in achieving a higher level of performance, even in small companies. Ananthram et al. (2013) state that the maximum value of human capital is realized when 'a coherent system' of HR strategies and processes is implemented, inferring the need for the horizontal alignment (or fit) of HRM processes and their vertical alignment with business strategies and functions. This approach accords with overall strategic HRM theory, as it reflects a focus on organizational (rather than individual) performance, emphasizes the role of HRM systems as solutions to business problems, and therefore contributes to building sustainable competitive advantage.

During the exploration of the HRM in SMEs it is also very important to investigate the factors that influence the adoption of HRM activities in these enterprises. According to Kok et al. (2003, p. 6) contextual determinants of adoption of HRM in SMEs are: *firm size, business plan, export, franchise, family business, and unionization*. In their study authors, using data on more than 700 Dutch small firms, found that, within this sample of small firms, larger firms apply more formalized HRM practices than smaller firms do. Firm size is a determinant of the probability that an HRM department is present, which in turn is related to the formalization of all HRM scales. Family businesses apply less formal HRM practices, as do businesses without a business plan. Reid et al. (2002) state that family business practices within HRM are different than their non-family counterparts. The presence of an HRM department or manager is related to more formal HRM practices, which implies that firm size, family business, and the availability of a business plan are both directly and indirectly related to the formality of HRM practices (Kok et al. 2003). According to other authors, the adoption of formal HRM practices in SMEs occurs at a rapid rate in the early stages of the growth process and in a slower rate in the later stages (Kotey and Slade 2005). Related to the sector of business, SMEs involved in exporting, franchising or cooperation with larger firms differ from the rest of the firms with respect to HRM. Exporting is positively associated with the adoption of formal recruitment and selection practices (Kok et al. 2003). The presence of a large firm associate (supplier, customer, or franchise) has significant influence on the level of formalization of training in small firms. Franchise organizations apparently stimulate the training and development of the personnel of their franchisees, but do not encourage the formalization of the other HRM categories (Kok et al. 2003). Similarly, Urbano and Yordanova (2008) proposed a conceptual model based on the resource-based view for exploring the factors that influence the adoption of formalized HRM in SMEs. This model contains the following factors related to the adoption of HRM practices: *firm size, presence of HR department, cooperation with other organizations, ownership by a larger company, and two characteristics of the person responsible for HRM within the firm (previous experience on similar positions and education and/or training in HRM)*. This model was tested with quantitative data from 164 tourism's SMEs in Catalonia (Spain). According to their results, the adoption of HRM practices is positively associated with the presence of an HRM department. Also, SMEs in which the person responsible for HRM has previous experience in similar positions are greater adopters of HRM practices. SMEs which cooperate with other organizations are more likely to implement HRM practices (Urbano and Yordanova 2008, p. 167).

3.2 The HRM Activities in SMEs and Relations with the Organizational Performances

The most important HRM activities in contemporary business are HR planning, recruitment, selection, orientation, training and development, performance management, compensation, industrial relations, retirement, etc. For the purpose of this chapter the authors emphasize those activities related to the four main areas of HRM: *staffing, training and development, motivation and retention* (Štangl Šušnjar and Zimanji 2006, p. 19).

As a process of recruitment, selection and orientation, staffing process in SMEs is usually performed in the light of informal techniques. Recruitment techniques used in SMEs were newspaper ads, word of mouth, and walk-ins while for selection techniques were application blanks, reference checks, job try-outs, and face to face interviews. Also, staffing practices are found as convenient, inexpensive and directly controllable by the firm (Barrett and Mayson 2007). Smaller organizations prefer referrals, which are recommended job applicants and/or applicants familiar to the owner/manager of the enterprise. Recommendation is one of the most prevalent forms of recruitment in small organizations. The use of more formal sources and methods of recruitment, such as agencies for employment mediation or advertising of job vacancies, increases with enterprise growth which is relatively understandable, because with business growth informal sources of potential employees (friends, relatives and acquaintances) are exhausted and cannot adequately respond to the development needs of the enterprise (Zolak-Poljašević and Petković 2013, p. 307). According to mentioned authors, it is desirable to use a combination of several selection techniques, such as standardized checking of biographical information, interviewing the candidates, and testing knowledge and skills which candidates claim to have. Regarding training practice, formal training is less likely to be provided in SMEs. It was found that recruitment processes in Barbados' small businesses are likely to rely on informal recruitment methods and informal training practices compared with large businesses (Greenidge et al. 2012). Usually the reason for informal practice of training is explained in terms that the small firm employer has not estimated the benefit of training or that costs of training are high (Storey 2004). In the research of Barrett and Mayson (2007) there was found that 45 % of the explored SMEs used off-site training or work-related education as informal training practices, while Panagiotakopoulos (2011) emphasized training seminars (private or state-funded) as a way for knowledge development in SMEs. On the-job training was found to be a predominant method (Kotey and Slade 2005).

In relation to the compensation process, small firms' ability to attract, motivate and retain employees by offering competitive salaries and appropriate rewards is linked to firm performance and growth (Barrett and Mayson 2007). Since SMEs often cannot compete with large organizations in terms of compensation that they can offer to their employees, small and medium-sized enterprises should focus on the creation of a pleasant working environment and on the increase of employees' satisfaction with their tasks and roles in the organization. In addition, smaller organizations have a wide variety of intangible motivation strategies such as job enrichment, participative management style, employee participation in the decision-making process, flexible working time, recognition of achievements, and other forms of raising motivation and building loyalty of employees (Zolak-Poljašević and Petković 2013, p. 309).

Based on the aforementioned, authors decided to explore literature source of HRM and organizational performances in these organizations. Namely, the main role of HRM in organizations is to improve employee's productivity and performances, and those improved performances contribute positively to the overall organization's performances.

Regarding SHRM and its role in SMEs, author Slavić and Berber (2013) showed that in the majority of Serbian small and medium-sized companies HR function is integrated into the strategy formulation process. The integrative linkage has a positive effect on the companies' success as it raises its profitability. The results of Mann-Whitney's nonparametric test used on the sample of 30 SMEs showed that there is a statistically significant relationship between the presence of the person responsible for HR function at the strategy formulation process and the profitability of the company. Namely, in case of the level of productivity, there were no significant relationships while differences between companies' profitability are significant. The obtained data proved the authors' hypothesis—there is a significant relationship between the role of HR in strategy formulation and the companies' success expressed by profitability.

Galang and Osman (2013) showed that the adoption of strategic HRM by SMEs in both Malaysia and the Philippines is predicted from the positive effect of legal and regulatory requirements, the importance of business environment challenges, and the strategic role of the HR professional. In both countries SMEs with strategic human resource management have better organizational performance in terms of human resource outcomes, operational outcomes, and financial outcomes. One similar research project was performed in Nigeria in 2013. The population of 128 workers of selected paint manufacturing firms in Anambra State was explored with the general objective to investigate the place of Strategic Human Resource Management in improving corporate performance among SMEs in the Anambra State Nigeria. The results obtained from the analysis showed that there is a strong positive correlation between strategic HRM and performance level of competition in SMEs. The major finding of the research work is that SHRM is an important and indispensable tool for any organizations' performance and for any organization that wants to gain competitive advantage (Muogbo 2013).

Zheng et al. (2006) explored the performance effects of HRM practices in 74 Chinese SMEs. Four high performance HRM practices were identified: performance-based pay, participatory decision-making, free market selection, and performance evaluation. Regression analysis results supported the conventional idea that the adoption of HRM practices generates better HRM outcomes and, in turn, better HRM outcomes contribute positively to firm performance. Among the Chinese SMEs investigated, a high level of employee commitment was identified as being the key HRM outcome for enhancing performance. Hayton (2003) found in a study of 99 SMEs that HRM practices that promote employee discretionary behavior, knowledge sharing, and organizational learning are positively associated with entrepreneurial performance. One more interesting article examined the human resource management practices in small and medium-sized enterprises in the UK, on the basis of 336 SMEs, utilizing the Dun & Bradstreet database. Significant simultaneous and longitudinal relationships between HRM practices and specific performance indicators were found. Controlling for past performance and thus, testing for the potential for reverse causality, does not eliminate the significant relationship between human resource practices and performance. The use of human resource practices is found to positively enhance sustained competitive advantage (Sheehan 2013).

All mentioned research in the past year speak in favor of the adoption of SHRM in SMEs especially when the performances are in question, rather than informal HRM activities. These literature sources directed authors' attention to the research of the role of HRM in SMEs in specific region of Central and Eastern Europe.

4 Theme in Practice

4.1 Methodology and Hypotheses

The research was performed on the basis of the CRANET database and obtained in the research period between 2008 and 2010. The Cranfield Network of International Human Resources Management (Cranet) was established in 1989, and is now a collaboration of more than 40 universities and business schools, representing countries from all over the world. This international organization organizes comparative researches on the policies and practices of human resource management, using a standardized questionnaire, every 4 years (Steinmetz et al. 2011; Brewster et al. 2011).

In this chapter the authors analyze the data of the latest Cranet survey round (2008–2010), when the European sample was created by the respondent companies from 20 EU countries and 5 other European (Norway, Iceland, Russia, Serbia and Switzerland) countries. The total number of organizations that participated in the research was 6415 in 32 countries, while in this study authors used only data for SMEs, for four countries, Slovenia, Serbia, Hungary and Bulgaria, with total of 443 SMEs (Table 1).

For the purpose of this study authors used several statistical methods: *descriptive statistics, ANOVA test and T-test*. These tests were implemented for obtaining results related to the HRM activities in SMEs (staffing, compensation, training, career development, performance management). Also, in relation to the research, organizational performances were used as dependent variables while the existence of the HR department, HR strategy and business strategy, and several HRM

Table 1 Sample of the countries with the percentage of SMEs participated in the research

Country	Frequency	Percent	Valid percent	Cumulative percent
Bulgaria	195	44.0	44.0	44.0
Hungary	86	19.4	19.4	63.4
Slovenia	131	29.6	29.6	93.0
Serbia	31	7.0	7.0	100.0
Total	443	100.0	100.0	

Source: Authors' research

activities were used as independent variables. Most of the variables related to the HRM activities were dummy variables (1 = yes; 0 = no) while variables related to the organizational performances (profitability, productivity, rate of innovation and service quality) were ordinal (from 1 to 5).

Based on the previous mentioned subject and goal of the research, as well as the mentioned literature sources, the authors defined hypotheses:

- *H1: There are statistical significant differences regarding organizational performances of SMEs between SMEs that have formal HRM and those that do not have it.*
- *H2: SMEs from the CEE region use informal HR activities more than formal ones regarding staffing, training and development, compensation, and performance management.*

5 Outcomes

5.1 The Nature of the HRM in SMEs in the CEE Region

The first important result was obtained through the usage of the descriptive technique. Authors explored the existence of the HR department, HR and business strategy and the role of HR manager in most important HRM activities.

From Table 2 it is obvious that in the observed sample of SMEs more organizations do not have an HR department (58.7 %). The smallest percentage was found in Bulgaria (35 % of organizations), while Slovenian SMEs in 52.3 % of organizations have an HR department, which is usually unfamiliar for this kind of organizations.

From Table 3 it can be concluded that the executive manager (almost 68 % of organizations) has the main role in HR issues if there is no HR department in SMEs in the CEE region. The second person is the general manager, in 11.9 % of organizations. These results are expected, since in SMEs there is a narrower range of management, and usually, the general manager manages the entire firm.

From Table 4 it is obvious that in the observed sample of SMEs more organizations have HR strategy in written form (31.2 %) and in unwritten form (38.3 %),

Table 2 The existence of the HR department in SMEs (%)

Country	Do you have an HR department?		Total
	No	Yes	
Bulgaria	65.1	34.9	100.0
Hungary	61.6	38.4	100.0
Slovenia	47.7	52.3	100.0
Serbia	56.7	43.3	100.0
Total	58.7	41.3	100.0

Source: Authors' research

Table 3 Responsibilities for HRM if there is no HR department (%)

Countries	Chief executive/ managing director	Administrative director	Finance director	Production director	Marketing/ sales director	General manager
Bulgaria	73.5	6.2	1.8	1.8	2.7	14.2
Hungary	81.1	1.9		1.9		15.1
Slovenia	47.5	9.8	1.6	4.9		
Serbia	62.5	6.3				31.3
Total	67.9	6.2	1.2	2.5	1.2	11.9

Source: Authors' research

Table 4 The existence of HR strategy in SMEs (%)

Country	Does your organization have a personnel/HR strategy?			Total
	No	Yes, unwritten	Yes written	
Bulgaria	38.2	34.1	27.6	100.0
Hungary	36.1	36.1	27.7	100.0
Slovenia	16.9	44.6	38.5	100.0
Serbia	20.7	41.4	37.9	100.0
Total	29.9	38.3	31.8	100.0

Source: Authors' research

which means that 70 % of organizations from the sample have HR strategy. Approximately 30 % of respondents do not have HR strategy. These unwritten forms of HR strategy may refer to the improving role of HRM function and predict future domination of companies with a detailed written HR strategy (Slavić and Berber 2013). Again, Slovenia has the largest percentage of SMEs which have written and unwritten HR strategies (about 79 % of organizations). Having in mind previous tables, it can be concluded that SMEs in Slovenia, the most developed country regarding sample, definitively reached the highest level of HRM development.

In Table 5, the authors presented issues related to the presence of HR manager in top management of SMEs. In 56 % of SMEs in CEE region person with HR responsibilities has its place in top management of the organization. This

Table 5 The presence of the HR manager or person who is responsible for HRM in top management of the organization (%)

Country	Does the person with responsibility for HR issues have a seat on the Board or equivalent?		Total
	No	Yes	
Bulgaria	69.9	30.1	100.0
Hungary	13.2	86.8	100.0
Slovenia	23.8	76.2	100.0
Serbia	33.3	66.7	100.0
Total	44.0	56.0	100.0

Source: Authors' research

Table 6 The primary responsibility for major policy decision making on compensation (%)

Country	Who has primary responsibility for major policy decisions on pay and benefits?				Total
	Line management	Line management in consultation with HR	HR in consultation with line management	HR	
Bulgaria	80.7	15.5	3.7		100.0
Hungary	78.6	13.1	8.3		100.0
Slovenia	53.6	24.8	16.0	5.6	100.0
Serbia	77.4	19.4		3.2	100.0
Total	72.1	18.0	8.0	1.9	100.0

Source: Authors' research

Table 7 The primary responsibility for major policy decision making on staffing (%)

Country	Who has primary responsibility for major policy decisions on recruitment and selection?				Total
	Line management	Line management in consultation with HR	HR in consultation with line management	HR	
Bulgaria	63.8	26.5	8.1	1.6	100.0
Hungary	65.1	20.5	10.8	3.6	100.0
Slovenia	29.7	35.2	26.6	8.6	100.0
Serbia	61.3	19.4	16.1	3.2	100.0
Total	53.6	27.4	14.8	4.2	100.0

Source: Authors' research

percentage of SMEs is the largest in Hungary, followed by Slovenia and then Serbia. Only Bulgarian SMEs showed that only 30 % have HR manager who is present in the top management of the organization.

Tables 6, 7 and 8 presented responses of organizations related to the question of primary responsibility regarding decision making in compensation, staffing, training, and development. It is obvious that out of four countries usually the line manager is responsible for these activities. This is somewhat expected since in

Table 8 The primary responsibility for major policy decision making on training and development (%)

Countries	Who has primary responsibility for major policy decisions on training and development?				Total
	Line management	Line management in consultation with HR	HR in consultation with line management	HR	
Bulgaria	62.7	24.9	10.2	2.3	100.0
Hungary	61.9	15.5	21.4	1.2	100.0
Slovenia	25.0	39.1	28.1	7.8	100.0
Serbia	58.1	22.6	12.9	6.5	100.0
Total	50.7	27.1	18.1	4.0	100.0

Source: Authors' research

Tables 2 and 3 organizations emphasized that a majority of them do not have an HR department and that the chief executive is responsible for HRM. Also, it is interesting to see once more that Slovenia has more SMEs where HR manager cooperate with line manager during decision making process regarding HR activities. In case of staffing, in Slovenia there were 29.7 % of SMEs where the line manager is making decisions, while in almost 60 % these decisions are made in consultation between HR and line manager. In 8.6 % of SMEs HR department is making decisions about staffing alone. This trend is similar for training activities in SMEs in Slovenia, while in the case of compensation, all countries pointed to the line manager as decision maker. This can be explained with the problem of scarce financial resources and the need of very careful cost management, since employees' compensation can come up to 60 % of total operational costs in companies (Štangl Šusnjar and Leković 2009).

5.2 HRM Activities in SMEs in the CEE Region

After the first part of the analysis, dedicated to the formalization of HRM in SMEs, the authors explored the HRM activities in SMEs:

- Staffing (Recruitment and Selection);
- Performance management;
- Training;
- Compensation;

From Table 9 it can be seen that SMEs from the CEE region mostly use *advertising* as the recruitment method (77.8 % of organizations use this technique when recruiting professional workers), *internal recruitment* (66.3 %) and *word of mouth* (60.7 %). There were present differences between countries. For example, while in Bulgaria word of mouth is used only in 44.3 % of companies, in Serbia this recruitment method is used in 87 % of organizations (it is also the most used

Table 9 The usage of recruitment techniques in SMEs, for recruiting professional workers (%)

C	Internal recruitment	Recruitment agencies	Advertising	Word of mouth	Company website	Commercial jobs site	Educational institutions	Speculative applications	Jobs centers
Bul	61.4	29.1	78.0	44.3	23.1	33.6	15.8	30.4	48.5
Hun	57.6	35.9	68.6	56.9	53.7	33.3	39.4	50.0	40.0
Slo	78.7	24.0	83.6	77.9	55.3	58.5	41.7	59.6	59.8
Ser	62.5	35.3	76.0	87.0	35.0	41.2	50.0	47.1	69.6
Total	66.3	29.2	77.8	60.7	41.2	42.3	31.7	45.2	52.0

Source: Authors' research

technique in Serbian SMEs). As it is said in the introduction and theoretical part of the chapter, SMEs usually use some informal recruitment methods, and in this case, advertising, internal recruitment and word of mouth are also informal methods. The formal recruitment method is the usage of recruitment agencies, and SMEs stated that only 29 % of them (in total sample) use them for recruitment.

Table 10 presents the mostly-used selection techniques in SMEs. It is obvious again that the informal techniques are used in advance. One to one interviews (89.2 % of organizations), references (71.8 %), and application forms (54.7 %) are used most in this sample. Some more formal techniques (which imply knowledge and skills for usage) like different types of tests (ability, technical, psychometric) or graphology are used at a very low level, or not at all in Serbian SMEs. Again, between countries there is a large diversity—but generally all countries show a low level of the usage of the more complex techniques.

From Table 11 it is interesting to see that about half of all organizations from the sample have a formal system of appraisal. This is very important since the appraisal of performances is one of the most important HRM activities. Only Bulgarian SMEs showed a lower level of formal appraisal systems. In the case of techniques for formal appraisal, it is obvious from Table 11 that the most used formal appraisal is done by an immediate supervisor (90 % of all organizations) and the supervisor's supervisor (61.7 %). Peers and subordinates are scarcely used.

Regarding training activities, from Table 12, SMEs showed that around 4.5 % of total payroll costs are spent on training and that there is an average of 8.24 days spent annually for training of professional worker. Serbia has the lowest percentage of annual payroll costs spent on training, which stands at 2.5 %. On the other hand, while spending less money on training, Serbian SMEs offer more days for training in contrast to other countries. This can be explained by the fact that usually SMEs use some informal, on-the-job training methods, so they do not need to spend lot of money on it.

From Fig. 1 it is clear that Slovenia has a higher average regarding the usage of career development methods (grades from 0 = not used at all to 4 = used to a very great extent). The most used is project team-work (1.52), followed by special projects (1.38) and then mentoring (1.17). As in other activities, there is diversity between countries. Bulgarian SMEs use all mentioned techniques in figure at very low level, while Hungarian and Serbian SMEs have somewhat similar results in this area of HRM in SMEs (Table 13).

In the case of compensation system, SMEs in the CEE region follow trends of the total CRANET sample from the research period 2008/2010. Performance-based pay is mostly used in almost all countries, 58.9 %. Besides performance-related pay, bonuses based on individual goals are used in 52.9 % of organizations, and those bonuses are used more than team bonuses, which stand at 34.5 %. Flexible benefits are used to some larger extent in Hungary and Slovenia (around 42 %), while in Bulgaria and Serbia those benefits are used less. Financial participation (stock options, profit sharing, and share schemes) is used at a very low level while only profit sharing is used in more than 10 % of SMEs.

Table 10 The usage of selection techniques in SMEs, for selection of professional workers (%)

C	Interview panel	One to one interviews	Application forms	Psychometric tests	Assessment centers	Graphology	References	Ability tests	Technical tests
Bul	12.3	95.1	54.9	3.7	3.8	0.9	59.4	30.3	23.1
Hun	22.1	76.7	44.2	9.3	9.3	1.2	60.5	22.1	17.4
Slo	60.9	89.4	57.0	17.3	3.0	3.0	90.7	18.4	9.7
Ser	29.4	91.7	85.0	38.9	0.0	0.0	88.0	47.1	41.2
Total	32.1	89.2	54.7	11.7	4.8	1.6	71.8	25.3	18.3

Source: Authors' research

Table 11 The existence of formal appraisal system in SMEs and techniques for performance appraisal for professional workers (%)

Country	Formal appraisal system	Immediate supervisor	Supervisors supervisor	Employee	Subordinates	Peers	Customers
Bulgaria	37.5	98.2	67.5	34.4	14.3	28.1	21.4
Hungary	50.0	90.2	47.2	36.8	8.1	13.5	26.3
Slovenia	67.3	86.0	66.0	24.4	7.1	17.1	20.5
Serbia	62.5	66.7	71.4	33.3	–	33.3	42.9
Total	50.7	90.1	61.7	31.4	8.8	19.8	23.9

Source: Authors' research

Table 12 Percentage of annual payroll costs spent on training in SMEs and average days per year training for professionals (%)

Country	Annual payroll costs for training		Days per training for professional yearly	
	Mean	Std. deviation	Mean	Std. deviation
Bulgaria	4.70	10.253	9.37	18.612
Hungary	5.42	6.879	7.15	9.462
Slovenia	3.90	3.675	7.00	11.254
Serbia	2.54	4.998	11.50	11.594
Total	4.46	7.589	8.24	14.107

Source: Authors' research

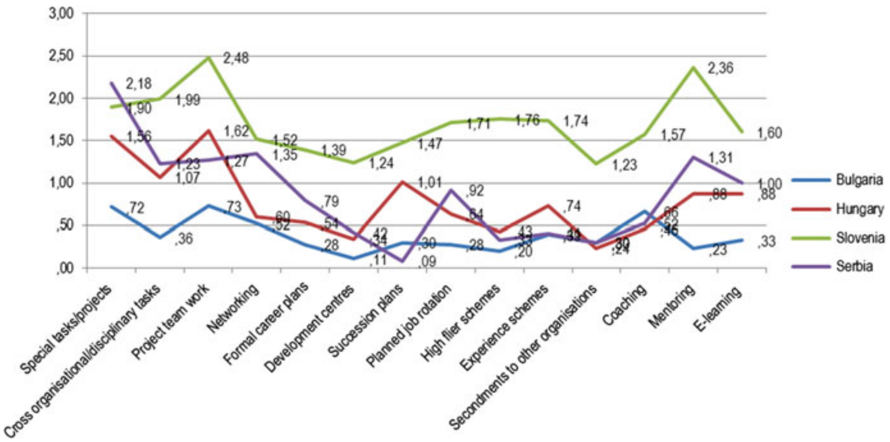

Fig. 1 The level of the usage of methods for career development in SMEs (average). *Source*: Authors' research

Table 13 The usage of variable pay in SMEs (%)

Country	Employee share schemes	Profit sharing	Stock options	Flexible benefits	Performance related pay	Bonus based on individual goals	Bonus based on team goals
Bulgaria	3.5	11.7	4.9	18.5	53.8	44.2	34.7
Hungary	9.3	16.3	2.3	44.2	40.7	43.0	25.6
Slovenia	10.0	15.1	3.8	42.6	76.3	72.5	43.1
Serbia	5.0	5.0	5.0	10.0	70.4	45.0	25.0
Total	7.0	13.4	4.0	31.4	58.9	52.9	34.5

Source: Authors' research

5.3 *HRM and Organizational Performances in SMEs in the CEE Region*

In this part of the chapter authors performed the t-test and ANOVA test. The authors explored differences in performances between SMEs that have an HR department, an HR strategy and the presence of an HR manager in the top management of the company.

Tables 14 and 15 show that there is a significant difference between SMEs that have an HR department for the *rating of profitability* ($M = 3.36$, $SD = 0.905$) and those SMEs that do not have an HR department ($M = 3.02$, $SD = 0.874$), $t(364) = 3.543$, ($p < (0.00)$ two-tailed). SMEs with an HR department have a higher rating of profitability. Also, there was a significant difference between SMEs that have an HR department for the *rating of rate of innovation* ($M = 3.28$, $SD = 0.995$) and those SMEs which do not have an HR department ($M = 3.00$, $SD = 1.029$), $t(363) = 2.546$, ($p < (0.011)$ two-tailed). Those SMEs with an HR department have a higher innovation rating. In the case of service quality and productivity there were no statistically significant differences.

From Tables 16 and 17, it can be concluded that only in case of innovation there is a statistically significant difference between those SMEs which have a written HR strategy, an unwritten strategy, and those SMEs that do not possess an HR strategy at all. Statistically significant differences can be seen in case of *rating of rate of innovation* ($F(2,352) = 3.588$, $p < 0.029$). The application of Turkey's post hoc test showed that SMEs which possess unwritten HR strategy ($M = 3.24$, $SD = 0.967$) and written strategy ($M = 3.21$, $SD = 1.065$) have a higher rating of rate of innovation than SMEs that do not have an HR strategy ($M = 2.90$, $SD = 0.974$).

Tables 18 and 19 reveal that there is a significant difference between SMEs where HR managers are present on the board in case of *rating of productivity*

Table 14 Group statistics for the exploration of the existence of HR department and performances of SMEs

Group statistics				
	Do you have an HR department?	Mean	Std. deviation	Std. error mean
Rating of service quality	No	3.85	0.665	0.043
	Yes	**3.92**	**0.724**	**0.057**
Rating of level of productivity	No	3.51	0.697	0.047
	Yes	**3.53**	**0.848**	**0.070**
Rating of profitability	No	3.02	0.874	0.059
	Yes	**3.36**	**0.905**	**0.075**
Rating of rate of innovation	No	3.00	1.029	0.070
	Yes	**3.28**	**0.995**	**0.082**

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

Table 15 Independent t-test for the exploration of the existence of HR department and performances of SMEs

		Levene's test for equality of variances		t-test for equality of means		
		F	Sig.	t	df	Sig. (2-tailed)
Rating of service quality	Equal variances assumed	0.007	0.936	−0.970	401	0.333
	Equal variances not assumed			−0.954	322,511	0.341
Rating of level of productivity	Equal variances assumed	4.484	0.035	−0.255	367	0.799
	Equal variances not assumed			−0.245	267,235	0.806
Rating of profitability	Equal variances assumed	5.586	0.019	−3.569	364	0.000
	Equal variances not assumed			**−3.543**	**297,778**	**0.000**
Rating of rate of innovation	**Equal variances assumed**	0.607	0.436	**−2.546**	**363**	**0.011**
	Equal variances not assumed			−2.563	318,093	0.011

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

Table 16 Descriptive statistics for ANOVA test

	Do you have HR strategy	N	Mean	Std. deviation	Std. error
Rating of service quality	No	107	3.77	0.653	0.063
	Yes, unwritten	**152**	**3.92**	**0.724**	**0.059**
	Yes written	**125**	**3.95**	**0.670**	**0.060**
	Total	384	3.89	0.690	0.035
Rating of level of productivity	No	96	3.38	0.684	0.070
	Yes, unwritten	**140**	**3.58**	**0.778**	**0.066**
	Yes written	**117**	**3.56**	**0.770**	**0.071**
	Total	353	3.52	0.754	0.040
Rating of profitability	No	94	3.01	0.836	0.086
	Yes, unwritten	**140**	**3.24**	**0.910**	**0.077**
	Yes written	**118**	**3.21**	**0.914**	**0.084**
	Total	352	3.17	0.895	0.048
Rating of rate of innovation	No	94	2.90	0.974	0.100
	Yes, unwritten	**142**	**3.24**	**0.967**	**0.081**
	Yes written	**119**	**3.21**	**1.065**	**0.098**
	Total	355	3.14	1.010	0.054

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

Table 17 ANOVA test for the exploration of differences in performances of SMEs regarding HR strategy

		Sum of squares	df	Mean square	F	Sig.
Rating of service quality	Between groups	2.261	2	1.131	2.394	0.093
	Within groups	179.924	381	0.472		
	Total	182.185	383			
Rating of level of productivity	Between groups	2.725	2	1.363	2.416	0.091
	Within groups	197.405	350	0.564		
	Total	200.130	352			
Rating of profitability	Between groups	3.197	2	1.598	2.007	0.136
	Within groups	277.914	349	0.796		
	Total	281.111	351			
Rating of rate of innovation	Between groups	7.212	2	3.606	3.588	**0.029**
	Within groups	353.745	352	1.005		
	Total	360.958	354			

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

Table 18 Group statistics for the exploration of the presence of HR manager in top management and performances of SMEs

	Does the person with responsibility for HR issues have a seat on the Board or equivalent?	Mean	Std. deviation	Std. error mean
Rating of service quality	No	3.81	0.742	0.060
	Yes	**3.93**	**0.650**	**0.046**
Rating of level of productivity	No	3.44	0.719	0.062
	Yes	**3.61**	**0.749**	**0.054**
Rating of profitability	No	3.05	0.828	0.071
	Yes	**3.22**	**0.942**	**0.068**
Rating of rate of innovation	No	3.08	1.047	0.089
	Yes	**3.13**	**1.007**	**0.073**

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

(M = 3.61, SD = 0.749) and those SMEs where HR managers are not on the board (M = 3.44, SD = 0.719), t(327) = 2.074, (p < (0.039) two-tailed). SMEs with HR managers in their top management have a higher rate of productivity.

Table 19 Independent t-test for the exploration of the presence of HR manager in top management and performances of SMEs

		Levene's test for equality of variances		t-test for equality of means		
		F	Sig.	t	df	Sig. (2-tailed)
Rating of service quality	Equal variances assumed	7.318	0.007	−1.644	356	0.101
	Equal variances not assumed			−1.614	304,823	0.108
Rating of level of productivity	**Equal variances assumed**	**0.477**	**0.490**	**−2.074**	**327**	**0.039**
	Equal variances not assumed			−2.089	295,750	0.038
Rating of profitability	Equal variances assumed	9.240	0.003	−1.695	323	0.091
	Equal variances not assumed			−1.730	310,178	0.085
Rating of rate of innovation	Equal variances assumed	0.022	0.881	−0.453	326	0.651
	Equal variances not assumed			−0.450	288,588	0.653

Source: Authors' research
Bold values in Table are statistically significant at $p < 0.05$

6 Chapter Summary

In contemporary economy entrepreneurship studies, SMEs are recognized as a driving force, especially in countries with lower levels of development (Ateljević 2013). On the other hand, HRM is seen as a function for creating a sustained competitive advantage. Having these thoughts in mind, authors of this chapter have explored several common ideas about the role of the HRM in the SMEs.

The research conducted allowed the authors to obtain information about the formal existence of HRM in SMEs. In most of the SMEs explored in the CEE region, authors found that there was no HR department. Also, more SMEs have some kind of HR strategy, written or unwritten, which can be described as a wish of SMEs to perform some more detail HRM practices in their own organizations. Also, in the case that SMEs do not have an HR department, the person who is engaged in HR issues is usually the chief executive manager. Besides these findings, the authors explored the presence of an HR manager in the managing board. More SMEs have an HR manager present in their top management board. In regards to responsibilities about staffing, the line-manager makes decisions about training and compensation, not by the HR manager.

As a special part of the research the authors explored HRM activities in SMEs based on the obtained sample. The authors found that SMEs mostly use informal

HR activities in all activities including recruitment, selection, performance management, training and development and compensation.

The first and second part of the analysis was performed in order to test the first hypothesis (H2). SMEs in the CEE region use informal rather than formal activities for staffing, training, performance management and compensation. Furthermore, it is important to emphasize the differences between four countries, Serbia, Slovenia, Hungary and Bulgaria. Slovenian SMEs showed a higher level of HRM development since those organizations have more companies with HR departments. Moreover, the HR manager mostly cooperates with line manager in the decision-making process, and uses some formal methods in the HRM. This is explained by the fact that Slovenia reached the level of development of some other EU countries, and successfully surpassed the transition period. Bulgarian, Serbian and Hungarian SMEs showed somewhat similar, but also diverging HRM development. For example, Hungarian SMEs also practice informal HR activities, but in the case of compensation those organizations use flexible benefits, which are recommended by the theory for SMEs since they usually cannot offer high financial rewards. A country like Serbia, which is in the process of accession to the EU, should monitor and follow good practice and experience of more developed countries regarding SMEs development.

The third part of the analysis was dedicated to the exploration of the differences between SMEs regarding their organizational performance and existence of HRM (H1). After the t-test and ANOVA test the authors found that there were statistically significant differences in terms of organizational performance. Furthermore, SMEs which possess an HR department have a higher level of profitability and innovation, while SMEs with an HR strategy tend to have a higher level of innovation. The presence of an HR manager in the top management board was statistically significant in the case of productivity. Generally, SMEs which possess an HR department, HR strategy and HR manager who is present on the board rated their performance at a higher level.

Based on the research in this chapter, the authors have proposed directions for further research initiatives. Namely, in this chapter there has only been analysis of the differences between groups, whereas deeper statistical analysis related to the measurement of the influence of formal HRM activities on organizational performances was not conducted. The next stage of this research should be a development of a regression model that would measure the influence of mentioned HR variables based on organizational performance (profitability, innovation, productivity and service quality). Furthermore, it would also be interesting to compare results from this stage of development of HRM in SMEs in the CEE region with the new data that will be gathered in new round of Cranet research (in autumn of 2014). This will enable a comparative analysis of HRM practices for two time periods, resulting in a trend analysis of the development of HRM in the CEE SMEs.

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Part III
Particular Fields of Entrepreneurship Development

Venture Capital Funds in Transition Countries: An Empirical Study of Bosnia and Herzegovina

Saša Petković, Jovo Ateljević, and Irena Narić

Abstract Small and medium sized enterprises (SMEs) are the dominant form of business organization in both developed and developing economies [Harvie et al. (Small and medium enterprises' access to finance: evidence from selected Asian economies, 2013; OECD (Financing SMEs and entrepreneurs: An OECD scoreboard final report, 2013)] as they play a major role in economic development [IFC (Scaling-up SME access to financial services in the developing world. World Bank, 2010)]. They account for 95–99 % of enterprises, depending on the country, and are responsible for 60–70 % of net job creation in OECD countries [OECD (Financing SMEs and entrepreneurs. OECD, 2006)]. "Across the EU28 last year, some 21.6 million SMEs in the nonfinancial business sector employed 88.8 million people and generated €3666 trillion in value added. Expressed another way, 99 out of every 100 businesses are SMEs, as are 2 in every 3 employees and 58 cents in every euro of value added. This illustrates how critical SMEs are and reflects the value of the present report" [European Commission (A partial and fragile recovery, 2014, p. 6)].

In Bosnia and Herzegovina (B&H) where this research has been conducted, SMEs represent around 99.5 % of enterprises. However, when analyzing the state of the SME sector, we used a variety of sources, and we concluded that the data on the number and size of companies are different depending on the source. One of the main problems that SMEs are facing in transition countries is access to favorable external sources of financing [OECD (Financing SMEs and entrepreneurs: An OECD scoreboard final report, 2013); IFC (Scaling-up SME access to financial services in the developing world. World Bank, 2010); Balling et al. (Financing SMEs in Europe, SUERF—The European money and finance forum Vienna, 2009); Burk and Lehmann (Financing your small business. Sphinx Publishing, 2006)]. All companies are facing this problem, regardless of whether they are companies that

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_13

already have a well-developed business or those that are start-ups. In particular, this problem relates to SMEs in early stages of development (start-up companies) that do not have sufficient funds for the activities of research, development, and commercialization of innovations. It is also extremely difficult to find sources for funding research, development and innovation projects. Research evidence suggests that VC is one of the most reliable sources of funding for new ventures. However, VC is not suitable for the vast majority of new ventures or SMEs [Smith (Strategic Change 19(7–8):285–292, 2010)]. It is attractive for a specific type of new venture—one that has high growth potential and typically is characterized by a high level of risk.

The significance of VC for the development of the company is also indicated by the fact that in the period between 2000 and 2008 more than one-third of companies around the world used funds from the VC that were not located in the country where those companies were [Schertler and Tykvova (Venture capital and internationalization, 2009)]. However, equity financing was severely affected by the financial crisis. A sharp decline in VC and growth capital occurred between 2008 and 2009. In 2010, equity funding had not recovered to its 2007 level, despite an overall positive economic trend. Countries with high growth rates for VC in 2011 include Denmark (+80 %), Hungary (+62 %), the Netherlands (+56 %) and Canada (+30 %). On the other hand, a strong decrease was observed in Portugal (−80 %), New Zealand (−61 %), Switzerland (−37 %), Sweden (−25 %) and Ireland (−11 %) [OECD (Financing SMEs and entrepreneurs: An OECD scoreboard final report, 2013, p. 28)]. Against this backdrop a question arises as to what are the factors that discourage and slow down the formation of VC in the transition countries, and how to overcome these obstacles?

In the recent economic history, transition countries represent a useful laboratory to assess changes of economic systems from one type to another [Estrin et al. (Effects of privatization and ownership in transition economies, 2009)]. B&H, Macedonia, Serbia and Montenegro are rarely found in samples of cross-country analysis of transition economies. Slovenia was the only ex-Yugoslavian country that was very often included in researches, while in case of Croatia the situation is different. Probably the most used examples of transition economies are those included in Transition Report of European Bank for Research and Development which in 2013 included 34 very different countries and group of countries [EBRD (Transition report 2013, stuck in transition. European Bank for Reconstruction and Development, 2013)]. The aim of this chapter is to analyze the possibilities and limitations of funding promising start up SMEs in B&H, through VC, as well as the interest of SMEs in using VC as source of finance. Our departure point was the following research assumption: *Encouraging the formation of VC funds will contribute to the economic growth and development of B&H through the comprehensive support for the development of innovative SMEs, measured by the increase of the level of employment and the commercialization of innovations*. Quantitative and qualitative research was conducted using a random sample method of 124 companies (122 SMEs) in Republic of Srpska (RS), one of two entities in B&H and 205 VC funds from Europe, with a semi-structured questionnaire and interviews in the period from July to November 2013. The chapter is organized as follows: Sect. 1 provides the conceptual understanding of VC funds, their role in the modern economy and VC Funds access in Western Balkans countries. In the Sect. 2 we elaborate the research methodology in which we combine both qualitative and quantitative approaches. The results and discussion are presented in Sect. 3, followed by the chapter summary in Sect. 4.

1 Literature Review

In developed countries there are numerous sources of financing at the disposal of SMEs, such as bank loans, leasing, factoring, mezzanine financing, and financing from the Stock Exchange, as well as VC (Petković and Berberović 2013; IFC 2010; Balling et al. 2009). On the B&H market, companies usually use bank loans as a source of financing (Petkovic 2010). However, today, at a time when the financial crisis and the crisis in the real sector show no signs of weakening, bank loans become more expensive and unreachable, particularly for SMEs. The European Central Bank (ECB) published a report on the results of a new survey on firms' access to finance (2013). The total sample size for the EU area was 8305 firms, of which 7674 (92 %) have less than 250 employees. EU SMEs reported a marginal deterioration in the availability of bank loans (−11 % of respondents, in net terms, after −10 % in the previous round). The percentage of SMEs reporting access to finance as their main problem remains broadly stable (at 16 %). Countries that expect high economic growth promise a lot more opportunities to VC. These funds invest much more in companies that are engaged in information technology, mechanical engineering and biotechnology than in other industries (Schertler and Tykvova 2009). Metrick and Yasusa (2011) analyzed data about the industry concentration of VC investment for three periods: the pre-boom period of 1980–1994, the boom period of 1995–2000, and the postboom period of 2001–2009. The data shows the dominance of IT (including communications, software, hardware, and semiconductors/electronics) and healthcare (including biotech and medical devices) for VC investment; together, these two sectors comprise about 75 and 80 % of all investments in the preboom and postboom period, respectively. During the boom, media/retail investment had a brief (and expensive) rise, but even then the main effect was the enormous increase in IT relative to the healthcare. Within the broad IT sector, the two most important industries in the boom and postboom periods were communications and software, followed by semiconductors/electronics and hardware. Within the healthcare sector, the story has been a gradual emergence of biotechnology as the dominant industry, receiving almost 60 % of total healthcare investment in recent years. Popov and Roosenboom (2012) examined the impact of VC investment on patented innovation in ten manufacturing industries from 21 European countries over the period 1991–2005. It represents the first study to use both cross-country and cross-industry data to this end. Popov and Roosenboom (2012) find that the effect of VC is significant only in the subsample of high-VC countries, where the ratio VC/R&D has averaged around 3.9 % between 1991 and 2005 and VC has accounted for 10.2 % of industrial innovation during that period. They also find that VC is relatively more successful in fostering innovation in countries with lower barriers to entrepreneurship, with a tax and regulatory environment that welcomes VC investment, and with lower taxes on capital gains.

1.1 Defining the Concept of Venture Capital Funds

According to the RS Law on Investment Funds, VCs are defined as open-ended investment funds of venture capital with private offering (RS Official Gazette no. 92/06, 2006). They pay special attention to investments in SMEs which are at the beginning of their development and which are not burdened with a large number of employees. The law in RS does not distinguish between Private Equity and VC. However, it should be noted that the Private Equity Fund is a broader concept of VC. In principle, VC relates to the financing of the company at an early stage of development, while Private Equity Funds includes VC and additional continuation. About 80 % of the organized VC market is controlled by independent VC firms. VC firms are small organizations, averaging about 10 professionals, who serve as the general partner (GP) for VC funds. A VC fund is a limited partnership with a finite lifetime, usually 10 years plus optional extensions of a few years (Metrick and Yasusa 2011, p. 21). VC companies raise money from private investors and expect a high annual return (20–40 %) on their investment and usually invest in companies for a period of 3–7 years (Awe 2006, p. 90)." In the US new ventures face an increasingly diverse set of funding sources. Although they have traditionally relied on independent venture capital (IVC) as a major funding source, a growing number of them have considered corporate venture capital (CVC) in recent years (Dushintsky 2006; Katila et al. 2008, as state in its research Park and Steensma 2012). Thus, VC funds invest in innovative companies that promise a successful business. In a study conducted by Geronikolaou and Papachristou (2008), a correlation between the presence of VC and innovation was proven, where it was found that innovation should create demand for VC funds, but not vice versa—VC funds for innovations. VC funds typically invest in the mid-term and long-term period, provided that the fund has control over deciding the moment of leaving the company. After achieving its objectives, the Fund will seek the best possible way out of the company, i.e., to sell its share of the company thus realizing the return on investment. One of the most commonly cited reasons for the weak presence of VC funds in B&H is limited possibility of achieving the sale of ownership share of the company owned by the fund, and return on investment (Ćudić 2012, p. 19). The expectation of a positive impact of VC on firm performance originates in the idea that venture capitalists are active investors who provide not only finance, but additional services of value to entrepreneurs who "are often technologically competent but commercially inexperienced" (Keuschnigg 2004, p. 285). VC firms often take an active role in helping new ventures succeed by providing managerial advice and referrals to potential customers, alliance partners, management talent, and other investors (Hellmann and Puri 2002; Hsu 2006; Hochberg et al. 2007). Funds are well familiar with the network of suppliers, customers and other businesses in the area in which they invest their capital. Generally, venture capitalists specialize in the skills of screening, contracting and advising (Kaplan and Stromberg 2001). So, they have become important not only because of the capital that they possess but also for providing professional support to companies in which they invest, which makes them very different from traditional bank loans. VC funds pay special attention to investment in SMEs that are at the beginning of their development, and that are not burdened with a large number of employees.

1.2 The Importance and Role of Venture Capital Funds

How important SMEs are for the economies of the member states of the European Union is best demonstrated by the statistics from 2012 in which out of 20.7 million enterprises in the non-financial business sector, 99.8 % are SMEs (European Commission 2013). Financial resources for start-up companies, most often originate from their own resources or the help of friends and relatives. Debates about the nature of relations between banks and SMEs emerged in the academic discussions in recent years. Until recently, it was believed that local and smaller banks are more inclined to the financing of these companies because they are more adapted to the so-called "Partnership lending", the type of funding based on "soft" information received from the loan officer through continuous, personalized, direct contacts with SMEs, their owners and managers, as well as the local community in which they operate (Keeton 1995; Berger et al. 2001; Sengupta 2007). Today, at a time when the financial crisis shows no signs of weakening, the loans become more expensive and unreachable, particularly for SMEs. An OECD report from 2013 reported: "In 2011, SMEs' access to debt and equity finance—and the conditions at which they were granted—varied across countries. SME lending conditions deteriorated in most countries, particularly as a result of higher interest rates and greater demand for collateral. This was also generally accompanied by modest or no growth in credit volumes, with the exception of a few countries (OECD 2013, p. 2)".

Also, according to the European Central Bank report (2013), 6000 SMEs supervised by the European Central Bank reported that the access to bank loans was reduced. When asked the reason for such a conclusion, 54 % of SMEs mentioned the uncertain economic future, and 33 % mentioned increase in non-interest expenses of loan and collateral. One of the forms of SME financing is the VC fund. This method of financing has proven to be very successful in countries with developed market economies. Numerous studies in this field show that this is true. Keuschnigg (2004) in his paper argues that VC funds allow faster growth of new established companies. Evidence that VC funds have a positive impact on macroeconomic indicators was given by Romain et al. (2004), who in their work dealt with the macroeconomic impact of VC funds. Policymakers often perceive VC as being better able to finance innovation than banks (European Commission 2009). According to the European Private Equity and Venture capital Association (EVCA 2012) there are the following types of financing from venture capital funds: Seed, start-up and Later stage venture. About three-quarters of the difference in private sector R&D spending between Europe and the United States is due to difficult access to finance for small innovative companies (European Commission 2008). As Popov and Roosenboom (2012) state, VC is perceived as a solution to these market failures that prevent the provision of risk capital and adequate funding of innovation by SMEs.

1.3 Venture Capital Access in Western Balkans Countries

A transition economy is an economy which is changing from a planned economy, i.e., from socialism to the free market, i.e., capitalism. Gradual changes are made permanently, by adjusting the economic system to changes in economic and social life (Isailović 2009, p. 155). Trade barriers are gradually reduced to elimination, privatization of state enterprises and resources is carried out along with the creation of the financial sector, which should facilitate the movement of private capital. In most socialist countries including the former Yugoslavia, for a long time there existed a system of comprehensive, directive and detailed planning of the development of the economy.

New entrepreneurial society that has yet to be built in these countries should be an association of people with a marked individuality and different needs, and equal rights. Capital markets in Southeast Europe, in recent years, have become increasingly important. However, much work still needs to be done in order to provide more favorable conditions for the normal functioning of the capital market. This applies especially to the countries of the Western Balkans. Croatian Private Equity and Venture Capital Association (CVCA) were founded on the territory of Croatia in 2004, and it started its activities in 2005. Since 2008 it has been an honorary member of the European Venture Capital Association (EVCA), and it has participated in the work of the Association of Central and Eastern Europe. There are several VC funds operating in the Western Balkans. Their investments are presented in Table 1.

Table 1 Venture capital funds operating in the Western Balkans

Name of the fund	Established in	Estimate of the volume of investments (in millions of euros)	Number of investments since inception of the Fund until 2010	Status
Nexus Alpha	Croatia, 2007	11.0	3	The funds are not fully invested. The Fund has provided 35 million euros according to estimates. It is estimated that the Fund has 15 million euros ready to invest.
Questus Private Equity Capital	Croatia, 2003	26.5	7	Funds fully invested; it is estimated that 35 million euros have been provided. The Fund has so far achieved one exit.
RSG Capital	Slovenia, 2008	1.5	1	One investment in Croatia, the possibility to invest in all the Balkan countries. 19 million euros have been provided, and it is estimated are that 15 million are available for investments.
SEAF South Balkan Fund	Serbia, Macedonia, Montenegro, 2005	7.1	7	Seven investments in Serbia, fully invested, the total of 13 million euros have been provided.
SEAF Macedonia	Macedonia, 1998	10.4	14	Fully invested funds are still in the portfolio.
SEAF Macedonia, SIF	Macedonia, 2007	1.0	3	Invested in three Macedonian companies. Funds fully invested. Additional one million euros have been provided for investments in 2011.
SEAF Croatia	Croatia, 1997	6.3	22	Funds fully invested. Three companies are still in the portfolio
Poteza Innovation & Growth Fund	Slovenia, 2007	1.0	1	One investment in Croatia. The Fund no longer exists.

(continued)

Table 1 (continued)

Name of the fund	Established in	Estimate of the volume of investments (in millions of euros)	Number of investments since inception of the Fund until 2010	Status
Horizonte Ventures	Austria, 2001	20.0	8	Eight investments in Bosnia and Herzegovina, Serbia and Croatia. An exit was achieved from most investments.
CC partnership LP	Poland, 1997	23.0	8	Eight investments in Bosnia and Herzegovina, Serbia and Croatia. An exit was achieved from all investments. The Fund no longer exists.
Total		107.8	74	

Source: CVCA—Croatian Private Equity and Venture Capital Association, http://www.cvca.hr, accessed on 18th September 2013

Some of the companies in which investments have been made are: Fratello JSC (BiH), Cement Factory Lukavac JSC (BiH), Tele2 Ltd. (Croatia), Magma Ltd. (Croatia), Imlek JSC (Serbia), Bambi JSC (Serbia), and others. However, it is expected that the real development of these funds in this part of Europe will happen only with the accession of these countries to the European Union. EBRD and EIB have launched an initiative to establish a regional VC fund whose success mostly depends on the creation of favorable legal and tax environment for entrepreneurship development. For the countries of the Western Balkans it is important to develop the VC market, because this method of financing the company contributes to reducing unemployment, increasing the competitiveness of the economy, attracting foreign capital, in short, to the growth and development of the economy. In order to attract foreign and domestic investors, i.e., from VC funds, it is first necessary to create a favorable business environment. In the example of B&H we can understand what it means to have an unfavorable business environment. In transition countries, such as B&H, the capital markets are still underdeveloped and much effort has to be made in order to make the country more attractive to investors. The unstable political situation and unfavorable business and tax environment for SMEs are just some of the reasons why countries in transition are still unattractive to investors.

2 Research Design

To deal with the complex research question we combined both quantitative and qualitative methods. While the quantitative research was conducted with 828 local companies, in the period from mid-July 2013 to mid-November 2013, the qualitative fieldwork was performed in 2014 (from June to September) by contacted 205 venture capital funds across Europe using the European Association of Venture Capital Association (EVCA) database. Despite the low level of responses, 11 useful responses, the answers helped us to better understand the capabilities and limitations of private equity and venture capital market in Bosnia and Herzegovina.

Quantitative research was conducted based on a random sample of 124 companies ($n = 124$). The research involved mostly small enterprises and entrepreneurial shops. The questionnaires were sent by e-mail, and personally delivered to the owners and managers of the companies (companies are chosen completely randomly from APIF business directories). Although we planned to collect responses to the questionnaires until mid-September 2013, due to low response rate, the research was extended to mid-November 2013, when we were able to form a representative sample for this research. We sent the questionnaires to 828 addresses, and we received 124 fully completed questionnaires or 14.97 %.

The research was conducted on a relatively small sample compared to the statistical weight (1.31 %). Data may vary depending on the data source. According to the APIF data, 15,292 legal entities have submitted final accounts for year 2012, and when non-economic entities are set aside, the total number of companies which submitted the required financial statements is 9450. According to the APIF data, there were 9463 companies in 2011, and according to the data from the RS Institute of Statistics, there were 6804 companies, while according to the data of RARS (RS Agency for SMEs Development) there were 14,871 companies. For our statistics we chose the total number of companies that submitted financial statements to the APIF in 2012 (n = 9450).

3 The Research Results

The questionnaire which we used to collect quantitative information consists of 3 parts and 26 questions. The first part relates to general information through which we have collected basic information about the companies that participated in the research. The second part represents information on VC funds, i.e., in this part we have tried to find out how much the companies in the RS are familiar with VC funds and the way to access their resources. Finally, the third part refers to the willingness of companies to be funded by VC funds.

3.1 The Survey Results

3.1.1 The Firms Profile

The "average age" of selected companies was around 15 years, and 50 % of them were established before the year 2000, the oldest being founded in the nineteenth century (1895), while the youngest one was founded in 2013. The most common form of the surveyed firms was a limited liability company (LLC), 77 %, followed by self-employed entrepreneurs and joint-stock companies. In terms of the ownership structure private companies prevail in the sample (88 %). When we talk about the type of activities that companies in our sample are engaged in, statistically, over 55 % of companies are engaged in trade (wholesale and retail) and the food industry, while all other activities (and there are over 15 of them) are less represented in the sample. Only four companies, or 3.22 % were engaged in professional, scientific and innovation activities, while another seven or 5.64 % of the companies were engaged in some kind of high technology, such as communication, renewable energy or computer engineering. The number of employees in the sample ranged from 1 to 700 with an average number of employees was 30.1. The median shows that half of the companies in the sample have 14 or fewer employees, while 50 % have 15 or more (Table 2).

As for the division of the companies by size, the micro and small enterprises are most represented. This data will be presented in Table 3.

The qualification structure of employees in our sample is also better described using the median value (because of the large deviations) and it tells us that the

Table 2 Descriptive measures for the number of employees

N	Sample	124
	Missing data	0
Average		30.07
Median		14.50
Mode		8
Std. deviation		68.6
Minimum		1
Maximum		700

Source: Authors' calculations in the statistical software IBM SPSS Statistics (Version 17.0)

Table 3 The size of the company and the number of employees in companies

Size of the company	Number of companies	% relative to the total sample
Micro	34	27.42
Small	73	58.87
Medium	15	12.10
Large	2	1.61
Total	124	100

Source: Authors

average number of employees with higher education in these companies is 2, with a college degree 1, and employees with a high school degree 10. In all other groups more than a half of companies do not have a single employee with higher qualifications. Specifically, 97.6 % of company employees have no PhDs, while 90 % have no Masters of Economics, and two-thirds of companies had employees with only primary (school) education. Our research included a total of 3729 workers who were employed in all the companies from our sample. The micro enterprises employ a total of 195 workers, or 5.23 %, small enterprises employ 1422 workers or 38.13 %, medium-sized enterprises employ 1162 or 31.16 %, and the two large enterprises employ 950 workers or 25.47 %. According to the collected data, SMEs employ 74.52 % of the workers, which corresponds with the data from the Annual report for small and medium-sized enterprises and skilled craft and entrepreneurship activity in the RS for 2011 (Government of the RS 2012), as well as with the data of the RS Institute of Statistics for 2011. There were an almost identical number of companies which have and those which do not have their own website (62 vs. 61, while one data is missing).

From those companies from the sample that have their own website, less than 39 % (24 of 62) of them were receiving on-line orders, while the majority (54 of 62) regularly updated their website. Looking at this aspect from the viewpoint of the period of establishment, it may be noted that in companies that were established after the year 2000 there is slightly smaller number of those which have their own website, and vice versa. To come to a conclusion whether the observed difference is statistically significant, we used the method of chi-square test. By applying the test we come up with the answer that there is no statistically significant difference

Table 4 Awareness of venture capital funds and the way they operate

		Do you know how these funds operate?		
		Yes	No	In total
Have you heard of venture capital funds?	Yes	11	5	16
	No	2	106	108
In total		13	111	124

Source: Authors

Table 5 Awareness of the funds and existence of the web pages

		Web page		
		Yes	No	In total
Have you heard of venture capital funds?	Yes	12	3	15
	No	50	58	108
In total		62	61	123

Source: Authors

between groups ($p > 0.05$). The structure is almost symmetric, but it cannot be concluded that there is a pattern in this regard.

3.1.2 Awareness of Venture Capital Funds

Most respondents (87.1 %) were unaware of VC funds before this research, which is a disappointing fact. In addition, there is a higher percentage of respondents (almost 90 %) who were not familiar with the way in which these funds operate, and therefore do not know how to access them (95 % of them answered this question negatively). It is also interesting to mention that two of the respondents new how these funds operate (Table 4).

When we look at their lack of information from the point of owning a website, it can be seen that there is a statistically significant correlation. In fact, there were a smaller proportion of those who did not hear of VC funds in the group that has a website. By applying the chi-square test we confirmed this dependence ($p < 0.05$), which can be seen in Tables 5 and 6.

That the respondents in the sample are completely unaware of the existence of VC funds can be sufficiently confirmed by the fact that only one of them knew about the funds that exists in the region, in the European Union and beyond. On the other hand, only two respondents knew some companies that have financed their operations from these funds. Having in mind the previous analysis of the respondents' awareness of VC funds we can with great certainty say that they are rather uninformed on this matter. The following are most commonly used as a source for financing liabilities (short-term and long-term ones):

Table 6 Chi-square test

	Value	Degrees of freedom	p-value
Pearson Chi-Square	5.985[a]	1	0.014
Continuity correction[b]	4.713	1	0.030
Likelihood ratio	6.367	1	0.012

Source: Authors' calculations in the software IBM SPSS Statistics (version 17.0)

- Only a bank loan or a loan in combination with some other sources (104 respondents or approximately 84 %).
- Money from family and friends comes in second place, which, independently or in combination with other sources, appears 34 times in our sample, or 27.4 %.
- The most significant of the other sources is leasing, amounting to 15.3 % of total respondents.

It should also be noted that none of the companies in the sample use the funds that come from VC funds. As the most common reason why they opt for a bank loan the companies mentioned availability and speed (almost all of them chose one of these two available options or they combined them). Affordability, together with the previous two characteristics is the key reason why the funds from family and friends are quite frequent in financing companies. It is an opinion of the respondents that the VC funds in the RS should get help from some of the relevant ministries of the Government of RS (Ministry of Science and Technology and Ministry of Industry, Energy and Mining), while a much smaller number of respondents believe that they should get help from universities. Answers to this question should be taken with a grain of salt, given the fact that they generally do not know anything about these funds.

3.1.3 The Willingness of Companies to Be Financed by the Venture Capital Funds

Companies in our sample relatively take care of the technological progress of their businesses. When we asked whether they regularly introduce new technologies, respondents were divided, i.e., there were approximately the same number of those who said that they had introduced new technologies, as well as those who said that they had not introduced new technologies (Table 7).

When we asked whether they regularly introduce new technologies, 64 companies or 51.61 % of the total sample responded positively, while 58 companies or 46.77 % gave a negative answer. Two companies did not provide an answer to this question. What is very important for our research is the willingness of companies to finance their business from VC funds. Therefore, we asked the question which relates to the willingness of companies to finance their business from these funds. Although the companies we analyzed have a very low level of awareness of VC

Table 7 Introduction of new technologies in the companies

Do you regularly introduce new technologies?	Number	%	Valid %
Yes	64	51.6	52.5
No	58	46.8	47.5
In total	122	98.4	100.0
Missing data	2	1.6	
In total	124	100.0	

Source: Authors

Table 8 The willingness of companies to finance their business from venture capital funds

Would you be willing to finance your business from these funds?	Number	%	Valid %
Yes	97	78.2	78.9
No	26	21.0	21.1
In total	123	99.2	100.0
Missing data	1	0.8	
In total	124	100.0	

Source: Authors

funds, and so far have not applied for these funds, most of the companies in the sample are still ready to finance their business in this way, as it is shown in Table 8.

In Table 8 we see that the 97 companies in the sample, or 78.22 % of companies are willing to finance their business from VC funds, while 26 companies in the sample, or 20.97 % of companies responded that they would not be willing to finance their businesses from these funds. Therefore, we conclude that it would be useful to establish such funds in the RS.

3.2 *The Qualitative Research Findings*

The results based on the information obtained from the venture capital funds show that none of these companies have had investment activities in Bosnia and Herzegovina. The most cited reasons were associated with undeveloped capital markets, lack of attractiveness of the market in terms of size, the language and culture barriers, lack of knowledge about investment opportunities and underdeveloped technology infrastructure. Almost half of the respondents indicated that VCF invest exclusively in the country in which the fund is registered. Limited knowledge and experience of B&H companies in the international market was another major reason for VCF to establish their branches in B&H. One of the respondents cited the following reasons for not investing in B&H: “We are an European fund of fund investors and focus on small and mid-market buyout funds in Europe. For us there are a few reasons why we are not investing directly in B&H, such as following: Internal strategy focusing on the EU, small and mid-market buyout investments; no VC and early stage investments; we have a few investments into pan-CEE funds that technically would be allowed to invest in the Balkans but on a opportunistic basis".

The other respondent stressed that: "the GP landscape is extremely limited with limited experience of players and the market—no track record, first time teams, and unproven set-ups". In many other emerging market countries one of the door openers for institutional investors are the DFI's like EBRD, EIF, IFC... as they ensure that a certain level of corporate governance among GP's.

To attract VCFs to B&H it is necessary to do much more to improve the country market conditions. First of all to ensure economic and political stability in BiH and thus, primarily, to enable the development of entrepreneurial and dynamic private sector able to attract private equity and venture capital. Generally, that these funds invest in companies from abroad need to have a good knowledge of the language and culture of the countries from which the funds are coming, and to gain a lot of trust funds in projects and people.

All the comments received lead to a conclusion that companies from B&H should be much more proactive in international markets through networking, conferences and forums, particularly those dedicated to business start-up, innovation and SMEs capacity building. Respondents also highlighted that the VCFs tend to invest in companies with independent management, strong market position and those that have already demonstrated positive business results and return on invested.

3.3 Discussion

From the literature review we concluded that the VC funds are those that invest in start-up companies, while simultaneously offering numerous benefits to the companies that opt for this type of financing of development projects. In the RS, one of two B&H entities, only the Investment-Development Bank of the Republic of Srpska offers a line of financial support for start-up companies, which can be characterized as relatively modest. Based on the results of quantitative research conducted for the purpose of this chapter, most of the companies in the sample said that they only used a bank loan or a loan in combination with some other sources as an external source of financing (104 respondents, or approximately 84 % of total respondents). Money from family and friends is in second place, which, independently or in combination with other sources, appears 34 times in our sample, or 27.4 %. The most significant of the other sources is leasing, amounting to 15.3 % of total respondents. *It should be noted that none of the respondents in the sample have accessed VC funds*. When asked whether they regularly introduce new technologies into their business, 64 companies or 51.61 % of the total sample responded positively, while 58 companies or 46.77 % gave a negative answer. Assuming that the data we have obtained from the research is realistic, we have a good starting point for the formation of VC funds in the RS. We also asked them if the use of capital from VC funds would be beneficial for their businesses. Respondents could choose between several advantages and the following benefits appeared as most common responses:

– Division of risk and results;
– Commitment to the business development and success of the company;
– It does not burden the cash flow of the company, and
– Return to the fund depends on the growth and success of the company.

Based on this we can conclude that the sources of financing that companies use do not provide them with these benefits. We have also mentioned this in the literature review where we compared bank loans and VC funds. Companies in our research have shown great willingness to use financial means from VC funds to finance their business. Out of 124 companies in the sample, 97 of them are willing to use these funds. Our respondents have become interested in our research, and the majority (73 companies or 58.87 %) responded that they will continue to be interested in financing from VC funds. How would the formation of VC funds, and thus the increase of availability of alternative sources of funding, affect the growth of the GDP of the RS is illustrated by the fact that one million new jobs were opened in the companies financed by VC funds in the European Union between 2000 and 2004. A total of 3 % of employees work in these companies and as much as 10 % in the US, or ten million people.[1] In the RS there is the RS Guarantee Fund, which supports start-up companies. This Fund provides guarantees that serve to the commercial banks as additional security for the loan for companies whose projects are valued as good and promising. However, not even this fund, conditionally speaking, supports high-risk businesses. That is, companies engaged in risky activities pay a high premium for the guarantee of this Fund.[2] It is necessary to bring the fund to a higher level of development, i.e., that it can provide guarantees for high-risk businesses. Based on the aforesaid, we conclude that the formation of VC funds would contribute to the increase of alternative possibilities of financing of innovative SMEs that are at an early stage of development in the RS. Accordingly, we confirm the research hypothesis.

4 Chapter Summary

Entrepreneurs in the early stages of a company's life cycle, in addition to its vision and good business ideas, must have access to a wide range of external sources of funding and the possibility of support from the built institutions of entrepreneurial infrastructure. If the environment provides motivation for creativity and the ability of entrepreneurs, there are much greater chances for his or her success. To keep

[1] http://ec.europa.eu/cip/success-stories/index_en.htm, Accessed on 03 December 2013.

[2] More on: http://garantnifondrs.org/public/?page=23&lang=1&charset=2, Accessed on 03 December 2013.

pace with the competition and compete equally in the volatile market, entrepreneurs must be able to create business capabilities focusing on human capital and new technologies. To implement this project it is necessary to find the best sources of funding. In developed countries, entrepreneurs have access to numerous sources of funding from bank loans, microcredit organizations, angel investors, through credit guarantee funds, to VC funds. Unfortunately, in the RS and B&H there are still no sufficiently built and developed institutions of entrepreneurship infrastructure, the transition is not yet completed, the entrepreneurial spirit of students in schools and the population in general is not encouraged, self-employment is not developed as an option to resolve the existence, nor is it sufficiently promoted. If we add this to the unstable political situation and uncertain future of B&H, a complicated political and legal system and underdevelopment of institutions to support the development of entrepreneurship, no wonder the poor state of the economy.

In our research, we have observed that, in general, most companies use bank loans as external sources of funding (84 % of the companies in the research sample use bank loans). The most common reason why companies opt for a bank loan is the availability and speed of getting loans. However, bank loans are becoming less favorable, especially for start-ups and unclear business history. Even when banks decide to approve loans, their return is very expensive for start-up companies. The costs of processing loans almost do not differ for companies that already operate companies. One of the alternative sources of external financing is financing from VC funds. VC funds, unlike banks, are willing to invest in the companies at the beginning of their business. VC funds, of course, invest in companies of their interest, i.e., to achieve above average returns on investments. Unfortunately, there are no officially registered VC funds in the RS and BiH. According to our research, the formation of VC funds would lead to economic growth and development in the RS, through support to SMEs and increasing employment. Most companies in the sample (97 out of 124 or 78.22 %) which participated in the research expressed their willingness to be financed from the VC funds. The companies from the research sample take account of technological progress of their business. When asked whether they regularly introduce new technologies, 64 companies or 51.61 % of the total sample responded positively, while 58 companies or 46.77 % gave a negative answer. Assuming that the data we obtained from the research is realistic, we have a good starting point for the formation of VC funds in the RS. For the VC funds to operate, it is primarily necessary to adopt regulations governing this area, to create a favorable tax system (introduce cash basis for VAT calculation for SMEs), which tells us that the state should play its role in the development of the risk capital market. The vast majority of respondents in our research believe that in the establishment of VC funds the greatest support should be given by the Government of RS and its ministries, namely the Ministry of Science and Technology and the Ministry of Industry, Energy and Mining. In the analysis of the economic situation in the RS, we have concluded that we have an under-developed legal and tax system, which is not supportive to SMEs, as well as an underdeveloped capital market. In order to attract foreign and domestic investors, and form VC funds, it is necessary first to create a favorable business environment. The National Assembly of the RS should first harmonize laws governing economic life of the RS with the legislation of the European Union that governs these areas.

When we speak about B&H, in general, we see that the situation is far from the best. There is not a single VC fund that would invest in companies in the country and the region. Specifically, in B&H, which is by itself a complex country, even laws in the B&H entities are not harmonized to the fullest extent. In fact laws and legislations concerning the business environment in B&H should be adjusted to those from the EU. International financial institutions such as, EBRD and the IFC support the development of VC through their programs of support to developing countries, so that it could be expected in a long term period that these measures facilitate the development of these funds in our country as well. Based on the research and literature review, in part, we proved our hypothesis, as we concluded that the formation of VC funds would contribute to the economic growth and development of the RS, through supporting the development of innovative SMEs and increasing employment and commercialization of innovations.

Is the B&H ready to change its business climate and thus create better conditions to attract foreign capital? Will the B&H soon provide more support to the SME sector? Would it be possible to create conditions in our country for the establishment of VC funds? Do our companies have enough ideas to interest VC funds? Are our companies ready to introduce innovations that will enable technological advancement of the B&H? The search for answers to these and many other questions we leave to future research opportunities.

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The Boundaries of Coopetition: A Case Study of Polish Companies Operating in the High-Tech Sector

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Abstract Co-opetition is a relatively new but rapidly growing phenomenon in the global economy, and is becoming increasingly important throughout the world as evidenced by the growing number of identified relationships and research activity of numerous academic centres across the world. The importance of the coopetition phenomenon has increased with the development of globalization processes, especially at the level of sectors and particular corporations. The concept was introduced in the late 1980s as a combination of two concepts: cooperation and competition. The complexity of the phenomenon is the simultaneous implementation of two contradictory forms of logic regarding relationships between companies: trust, which is a manifestation of a community of interests, and conflicts of interest. In other words, we can observe the simultaneous occurrence of cooperation and rivalry between competitors.

Literature in the field of co-opetition identifies only the presence of streams of cooperation and competition. It does not indicate, however, in which areas (functions in the value chain) companies decide to cooperate with their rivals. Therefore the aim of this chapter is to identify the boundaries of the streams of cooperation within coopetition. Taking into account an analysis of the literature (especially that of Bengtsson and Kock amongst others) and quantitative research on a sample of 235 companies operating in the high-tech sector in Poland, the areas of competitive cooperation are described herein.

The data was gathered on the basis of questionnaire research. The authors also present the areas dominated by cooperation, taking into account the type of activities in the value chain (primary and secondary) and the multiplicity thereof.

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_14

The results will be the basis for the verification of the views of M. Bengtsson and S. Kock, devoted to the dominance of cooperation in activities supporting the value chains of the parties involved in coopetitive relationships. In the event, the views of these authors were not supported by our quantitative research. The originality of the chapter is also the result of the presentation of unique quantitative research related to the characteristics of the areas of cooperation in coopetitive relationships. Another advantage is the fact that such research is rare not only in Poland, but also on an international scale.

1 Theoretical Background of Coopetition

The increasing complexity and uncertainty of the business environment in the last 30 years has become a prerequisite for the search of new strategic solutions that would allow for the survival and growth of companies. The creation and growth of inter-organizational relationships has become one of the main focus areas in research. Initially, much attention was paid to strategic alliances (Harrigan 1985, 1988; Lorange and Roos 1992; Doz and Hamel 1998; Yoshino and Rangan 1995; Mockler 1999; Dunning 1997; Faulkner 1995; Cygler 2002; Chwistecka-Dudek and Sroka 2000). The turn of the century was characterized by an increase in interest in multilateral relationships (network connections), both in scientific and managerial dimensions (Jarillo 1995; Dyer 1996; Nohria and Ghoshal 1997; Todeva 2006; de Man 2004; Gulati 2007; Håkansson et al. 2009; Capaldo 2007; Child et al. 2005; Kodama 2009; Sroka and Hittmár 2013) and clusters (Porter 1990, 1998; Perry 2005; Piperopoulos 2012; Blien and Maier 2008). In the mainstream literature on cooperation as it is widely understood, an interesting and important topic related to competitive cooperation has arisen—namely coopetition. The concept of coopetition was created in 1989, and Ray Noorda, president and CEO of Novell, Inc. is regarded as the originator of said concept (Gomes-Casseres 1996: 271). Coopetition, as a relatively young research area, draws its roots from achievements in the field of cooperative strategies, both in the single dimension (single strategic alliances) and multilateral (networks, clusters) (Dana et al. 2013; Cygler 2010). The most recent decade is characterized by the dynamic growth of coopetition worldwide, in different types of relationships, amongst them business, political, economic, and social relationships. Generally it is observed that more and more attention is paid to coopetition in research studies conducted by major academic centres around the world.

Coopetition is regarded as the simultaneous presence of cooperation and competition between competitors (Bengtsson and Kock 2000: 413). The phenomenon of coopetition means, in its simplest form, that despite the existence of cooperation between the parties involved, they simultaneously engage in competition with each other (Lado et al. 1997: 111; Hamel et al. 1989; Sroka 2013).

This is due to the presence of paradoxically contradictory logics of actions: cooperation (trust), and competition (conflict). Trust, in addition to a community of interests, sharing of resources, and coordination, is a prerequisite for effective cooperation (Brito and Costa de Silva 2009: 291; Morgan and Hunt 1994). It reduces the tendency of the parties to exhibit opportunistic behaviour, by means of strengthening the sense of community. In contrast, the competitive nature of the relationship results from competition for heterogeneous resources, and offering similar products to the same clients. Companies from the same strategic group frequently find themselves party to coopetition (Lechner et al. 2006: 518). More frequently, however, a competitor is defined broadly rather than within just one sector (Brandenburger and Nalebuff 1996: 18–22), which is an effect of the globalization of economic activity, redefining many sectors, and the frequent change in role performed by the companies, i.e., from suppliers into competitors and vice versa (Hamel and Prahalad 1994: 26).

Coopetitive relations are interpreted using mainly the achievements of three theoretical concepts: game theory, transaction costs theory, and resource-based approach. In the game theory coopetition is perceived as a non-zero game in which players can achieve partially mutual goals. They can gain more cooperating than acting individually (the prisoner dilemma, Andreoni and Miller 1993). The cooperation benefits are additionally strengthen by the *tit for tat* strategy (Axelrod 1984: 31), based in the reciprocity of the players' moves. Moreover, the tendency to cooperate (even with competitors) increases in the long run of the relationship between the parties (Heide and Miner 1992). The longer the cooperation, the greater the benefits. The *shadow of the future* can be extended by increasing the frequency and persistence of interaction and introducing appropriate structure of penalties for opportunistic behaviour (Camara and Casari 2009). Brandenburger and Nalebuff (in their PARTS concept of coopetition, 1996) invented the value network, which consists of five types of players: companies, competitors, suppliers, customers and complementors. Relationships between members of the value network are coopetitive. Companies are interested both in a reduction in the number of competitors and the increase in the number of the other three groups of players. Multiple horizontal and vertical relations between the value network members generate added value (called a cake to share). The added value is greater for all players in the case of acting in the network together than would be generated as a result of independent action of individual players. In turn, according to the transaction costs theory cooperation is an hybrid form of inter-organizational relationships, which are limited two extremes: market transactions and hierarchical structures (Williamson 1987). Transaction costs can be recognized as *ex ante* (as the costs of negotiating process, preparation of documentation) and/or *ex-post* (adaptation costs, the cost of creating and maintaining of the management structure, execution of safeguards, coordination of activities) (Boerner and Macher 2005). The main sources of the transaction costs creation are: asset specificity, uncertainty and complexity of the environment, limited access to information, the continuity of the transaction and bureaucratic costs (Jones and Hill 1988). In addition, the transaction costs of cooperation increase as a result of bounded rationality, opportunistic behaviour and a limited selection of partners (Williamson 1991). Among all hybrid forms of inter-organizational relations, coopetition creates the highest transaction costs. It stems from the competitive nature of the coopetition (Cygler 2009: 67–68). This kind of relations requires a much greater efforts focused on control and protection against loss of assets (especially intangible).

Resource-based approach focuses on the analysis of organizations' specific resources that can become the basis for creating a competitive advantage. Enterprises are able to generate a competitive advantage if they can generate: a comparable value for the customer, at a lower cost of its acquisition (comparing to competitors) or greater value at a comparable cost to acquire it (Hunt and Morgan 1997). Degradation of previously held and used strategic resources, gradually rising costs of acquiring new ones make companies to consider the cooperation with others (including competitors) who have scarce resources (mostly intangible).

Increasingly, the issue of simultaneous cooperation and competition with competitors is discussed in the literature of Strategic Management, which emphasizes the positive impact of the relationship on company performance (Garcia and Velasco 2002), an increase in the value of the organization (Dagnino 2009); knowledge creation and transfer, innovation growth (Ritala et al. 2009), the influence on the competitive behaviour of the parties (He and Madhavan 2006), or creating future strategy and development (Zineldin 2004). It is also worth mentioning that when characterizing coopetition, one frequently indicates the presence of streams of cooperation and competition (Bengtsson et al. 2010). They are autonomous with respect to each other. In the literature on coopetition, little attention has so far been paid to the streams of cooperation and competition. Instead, there is an almost axiomatic foundation of their existence.

2 The Streams of Cooperation and Competition in Coopetition

So far, relatively little attention has been paid to the streams of cooperation and competition in coopetition. Their occurrence is regarded as a *sine qua non* condition of this phenomenon. Even less attention is paid to the problems caused by the limitations of the scope of competitive cooperation. The simultaneity of the occurrence of both streams is frequently assumed (Lado et al. 1997; Gnyawali and Madhavan 2001). In contrast, not enough attention has been devoted by researchers to the aspects of boundaries between cooperation and competition between the parties involved in coopetition. There is a certain tendency for companies to shape the streams of cooperation and competition in coopetition, given the functional scope of the relationship. Parties are more likely to compete in the areas of market activity and customer service. In contrast, if relationships are related to functions in the value chain which are not directly associated with the market, competitors prefer to cooperate with each other (Bengtsson and Kock 1999).

	Primary activities	Primary and support activities	Support activities
Wide scope	**Complex** coopetition including cooperation involving only **primary** activities **4**	**Complex** coopetition including cooperation involving both **primary and support** activities **6**	**Complex** coopetition including cooperation involving only **support** activities **5**
Narrow scope	**Simple** coopetition including cooperation involving only **primary** activities **1**	**Simple** coopetition including cooperation involving both **primary and support** activities **3**	**Simple** coopetition including cooperation involving only **support** activities **2**

Fig. 1 Types of areas of coopetitive relations. *Source:* Own elaboration

In terms of the concept of Porter's value chain (1990: 33–61), the types of coopetition were divided according to the area and scope of cooperation between competitors. Analyses thereof are based on two main factors: area of activities (primary and support activities in the value chain) and scope of cooperation, determined by a number of different areas of activity: narrow (1–2 activities in the value chain) and wide (more than two areas of activity). Given the fact that companies may simultaneously cooperate in the area of both primary and support activities of the value chain, six types of coopetition were specified (Fig. 1).

Type 1: Simple coopetition including primary functions in the value chain R&D alliance between IBM and Apple to develop the new operation systems and Power PC chip may be an example of such coopetition (Dowling et al. 1996). Another example is an agreement for a minicar joint venture in Europe between Toyota and PSA in developing a new minicar. Toyota was deeply interested in the minicar segment because of macro-economic factors, e.g., high fuel prices. In turn, PSA group had two successful models in the minicar segment, i.e., the Peugeot 106 and the Citroen Saxo, and it was Europe's second largest car manufacturer. Moreover, its capabilities were good vehicle design, diesel engines, clever advertising and excellent cost position in manufacturing. As a consequence, the partnership between both companies was formed (Galvagno and Garraffo 2010).

Type 2: Simple coopetition including support activities in the value chain An example may be a coopetition in the frame of "green" alliances concluded between environmental organizations and McDonald's which was aimed at improving the ecological image of the latter (Mendleson and Polonsky 1995).

Type 3: Simple coopetition including both primary and support functions An example of such a situation may be an alliance to develop a new product and its promotion on the market.

Type 4: Complex coopetition including only primary activities in the value chain Such a situation may be observed in Finnish dairy industry between two companies, i.e., Valio and Milka. The cooperation is based on Milka's need for a full product line, as the company does not produce, for example, yogurt and juice. Consequently Milka sells Valio's products and also distributes them in certain geographical areas. This requires that Milka keeps Valio's products in stock in its own facilities in order to Speer up distribution. Today Milka manufactures some cheeses for Valio, while Valio manufactures other types of cheese for Milka (Kock et al. 2006).

Type 5: Complex coopetition including cooperation, in the range of support functions , such as inputs purchasing, financing and/or ICT. Increasingly common example of this type of coopetition is the cooperation of competing scientific institutes applying (e.g., to the EU) for joint funding of research projects (often conducted separately).

Type 6: Complex coopetition including cooperation in the range of primary and support activities A good example may be American Sun which was established in 1982. Over years, Sun built a network of alliances to develop, make, sell as well as promote its chip or system (Gomes-Casseres 1996: 58). Sun's alliance network allowed it to grew to $3.2 billion in sales and $284 million in profits in 10 years (Lorenzoni and Baden-Fuller 1995).

Given the opinions of Bengtsson and Kock, it seems that types 2 and 5 would be most frequently chosen by companies as the best possible, as they include mostly competitive cooperation including support activities in the value chain. The dominant presence of coopetitive relationships should be expected herein. Types 3 and 6 are also present, but much less numerous, in which we observe areas of cooperation including both primary and support activities. Our research will be used for verification of the theses.

3 Methodology

Our research was conducted between September 2012 and January 2013. Due to the minimal availability of existing data on the scope of cooperation within the framework of coopetition of high-tech companies, all data were collected directly by means of questionnaire surveys. The respondents were senior managers or owners of organizations. The choice of the research sample was carried out in several stages. The high-tech sector has been defined according to the OECD classification (OECD 2003). The first stage involved selecting a representative group for the high-tech sector in Poland. Initially, 250 companies were selected

Table 1 Companies in the research sample—by number of employees

Company category	Number of companies within the research sample	Percentage of companies within the research sample	Percentage of population
Small (up to 100) (W1)	130	55.3	94.0
Medium (101–250) (W2)	72	30.6	4.0
Large (over 250) (W3)	33	14.0	2.0
Total	235	100.0	100.0

Source: Own elaboration

Table 2 Sample companies by organizational form

Company category	Number of companies within the research sample	Percentage of companies within the research sample	Percentage of population
Stand-alone company (FO1)	171	72.8	81.1
Corporation (FO2)	49	20.9	13.5
Holding (FO3)	13	5.5	4.7
Other	2	0.9	0.7
Total	235	100.0	100.0

Source: Own elaboration

according to the structure of the high-tech sector. Next, 152 companies were selected from a group of medium-sized and large companies to increase the size of our sample of companies that have entered into coopetitive relationships—thus, said companies were overrepresented in our research sample. The group of 402 companies which met the criteria for representativeness of the high-tech sector in Poland were therefore selected. Subsequently, companies that declared their participation in cooperation with competitors by creating coopetition were selected from this group. Out of 402 companies, the coopetition criterion was met by 235 companies. These companies thus became the target sample of our research, and were classified into seven basic sectors: processing and production (16 companies), pharmaceuticals (79), production of office equipment and computers (4), production of TV, radio and communication devices (31), medical equipment production (54), spaceship production (16), and HT services (35).

As regards the number of employees, the sample was divided into three groups: companies employing up to 100 people; between 100 and 250 people; and more than 250 people (Table 1).

In terms of organizational form, four groups were selected: stand-alone company, corporation, holding, and other (Table 2).

Table 3 Sample companies by stage of a company life cycle

Company category	Number of companies within the research sample	Percentage of companies within the research sample	Percentage of population
I stage (E1)	13	5.5	8.8
II stage (E2)	78	33.2	37.2
III stage (E3)	127	54.0	48.3
IV stage (E4)	17	7.2	5.7
Total	235	100.0	100.0

Source: Own elaboration

The companies were also classified according to the phase of the growth cycle in which they found themselves. The first phase (birth) included companies whose main aim is to stay in business (survival), as well as growth and the acquisition of resources through the innovation of the entrepreneur. The activities of companies in phase I have a short time horizon and are focused on the use of emergent opportunities. These organizations are simple in scope, and managed by just one person. In phase II (growth) were companies which concentrated on increasing efficiency, broadening the scope of the market, stabilizing the organization and gaining a good reputation. As a result of these activities, a perceptible increase in the size of the companies was observed. In phase III were classified companies which are characterized by a commitment to achieve uniqueness, stabilization of organizational solutions, and specialization of activity and resources. Companies in this phase have an established position on the market, substantial resources, experienced management staff, and are able to successfully rationalize costs. Phase IV (decline) includes companies which are threatened by the crisis, resulting from changes in the environment and the excessive formalization of management. A company's ability to generate profit and even survive is threatened. Such companies strive to conduct radical, internal and external changes to increase flexibility (Table 3).

In terms of geographical coverage, the companies were divided into seven categories: (1) local businesses, operating in one province, (2) regional—within several provinces, (3) national (throughout the country), (4) of international scope, but limited only to neighbouring countries, (5) of international scope including European countries, (6) international including selected countries on different continents, and (7) global (Table 4).

Taking into account the above categories, the majority were small and medium-size companies (98 %), and those who have one plant only (81 %), which essentially operate in the home country only (75.8 %). In the population which was

Table 4 Sample companies by market of operation

Market of operation	Number of companies within the research sample	Percentage of companies within the research sample	Percentage of population
Local market (G1)	43	18.3	25.6
Regional market (domestic) (G2)	29	12.3	12.5
Domestic, nationwide market (G3)	93	39.6	37.7
International market—neighbouring countries (G4)	10	4.3	4.8
International market—European countries (G5)	35	14.9	12.4
International market—few countries on different continents (G6)	10	4.3	2.8
Global market—many countries on different continents (G7)	15	6.4	4.2
Total	235	100.0	100.0

Source: Own elaboration

analysed herein, most companies were classified as belonging to phases III and II (85.5 % in total). Just one in every eight companies was classified as being in phases I or IV.

4 Findings and Discussion

Given the areas of cooperation and taking into account Porter's value chain concept (1985: 33–53), nine areas of company activity were analyzed (see Fig. 2).

Figure 2 shows that the companies which were analyzed mostly undertake cooperation with competitors in the area of production. However, it should be noted that they do not tend to completely avoid cooperation with a rival on the market. Such a hypothesis is confirmed by the fact that every second company divulged the existence of such cooperation in the area of sales and distribution, and more than one third of companies in the field of marketing. The importance of competitive cooperation in the field of purchases should also be stressed. This area was in third place in terms of the frequency of competitive cooperation, which demonstrates that companies strive for cost rationalization. Due to the

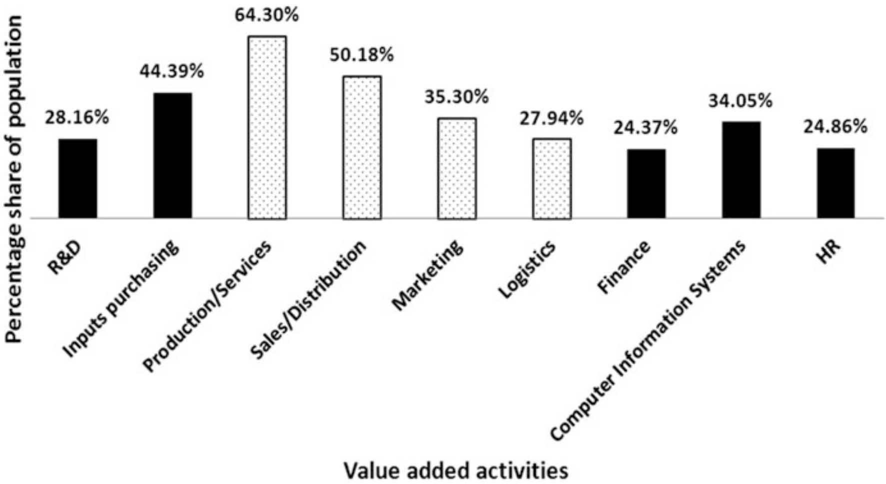

Fig. 2 The areas of cooperation for high-tech companies in Poland in coopetitive relationships. *Source*: Own elaboration

nature of the companies analyzed (high-tech sector), the relatively low frequency of cooperation in R&D may be surprising, especially given that innovation is the basis for building a relatively stable competitive advantage. Our research shows that companies prefer to cooperate in areas in which the effects are almost immediate. As regards the length of competitive cooperation, our analysis of the aforementioned companies indicates that relationships with rivals in the field of supply, production (services) and sales (distribution) tend to be long-term (with an average length of about 5 years). In turn, half the relationships with competitors in the field of R&D do not exceed 3 years. The results demonstrate that the companies prefer to cooperate with their competitors in the field of primary activities (represented by shadowed bars in Fig. 2) than in the field of support activities (black bars).

As regards the typology of coopetitive relationships (see Fig. 1), the characteristics of companies which choose one of the six types of relationship is presented in Table 5 (see Appendix).

Our research has shown that more than half the companies surveyed (54.15 %) cooperate with competitors over a wide area of activities, involving at least three areas of activities in the value chain. Most frequently (52.38 %) this cooperation includes both primary and support activities. Far fewer companies cooperate over a wide range of activities, when including only primary activities in the value chain.

Among the companies which decide to cooperate with competitors over a narrow range (type 1, 2 and 3), half of them choose a somewhat mixed area, including one support and one primary function. Companies which choose narrow cooperation in the field of primary activities of the value chain constitute 15.2 % of the research sample. In contrast, companies that have chosen the second type of coopetition (cooperation involving only single support activities) constitute just over 7 % of the whole sample.

Small companies and stand-alone companies (the highest percentage among all types of coopetition), which are characterized by a low level of expenditure (in relation to turnover) on R&D (second from the end), choose the first type of coopetition (simple, including only primary activities in the value chain). At the same time, these are the companies that are in the second or third phase of growth (81.47 % in total). It is also worth noting that the highest percentage of young companies (phase I) decide on this type of coopetitive relationship (14.04 %). Companies with a minor range of activities—most domestic (87.57 % in total) tend to choose the first type of coopetition.

Companies for whom R&D constitutes the highest percentage of expenditure choose the second type of coopetitive relationship (including cooperation in the form of single, support activities in the value chain). Almost one in every five companies which has chosen this model is a holding company. In contrast, there are relatively few stand-alone companies. In terms of the phase of growth, no young companies (phase I) choose this type of coopetition. More than half of the companies in the third phase of growth—namely maturity—decided to cooperate with a competitor in the field of single support activities in the value chain. It is worth noting that the highest percentage of companies in the 'decline' phase chose this type of coopetition. With regard to the geographical range of the activities, the companies operating at least on the domestic market more often choose competitive cooperation only in the area of support activities (68.99 % in total).

The third type of relationship was selected by approximately one quarter of all companies. Of the three types of coopetition based on a narrower range of cooperation (1–2 activities in the value chain), this type was more frequently indicated than the other two put together. Among types based on a narrow range of cooperation, the third type was also selected by the highest number of multi-plant companies and the smallest percentage of holding companies. In terms of the phase of growth of the companies, 72.19 % of the companies surveyed were in phase II or III. In turn, the largest proportion of companies with a local range selected narrow, mixed coopetition (38.89 %).

Type 4 was chosen by a number of companies only, which constitutes less than 2 % of the entire research sample. This group is characterised by the lowest number of small companies and the highest number of large companies. This type was selected predominantly by companies in the second stage of growth (development), active on both a regional and international scale (lack of both local and global companies).

No companies chose the fifth type of coopetition which is based on multiple relationships only in the area of support activities in the value chain. In turn, half the companies surveyed chose the sixth type of coopetition, in which the areas of cooperation with rivals constituted both primary and support activities in the value chain. The highest number of multi-plant companies, as well as those in the second phase of growth and global players, chose this type of coopetition.

Data from Fig. 2 and Table 5 (Appendix) show that companies decide to cooperate within the framework of coopetition, and such cooperation involves both primary and support activities in the value chain. Given the number of responses, primary activities are more frequently the focus of cooperation than support activities. However, mixed cooperation (involving primary and support operations) was chosen by 75.99 % of the organizations surveyed.

With regard to the phases of company growth, organizations that are in the second or third phase thereof tend to choose coopetition. Companies that are in the fourth phase of growth more frequently choose narrow, rather than broad-spectrum, cooperation.

It may, therefore, be concluded that the scope of cooperation in coopetition of high-tech companies is not limited by the features of this phenomenon, but rather by the characteristics of the companies (including their size, range of operation, phase of growth, organizational form). This means that competitive cooperation may relate both to the market activities and also those not directly related to the market (e.g., logistics, manufacturing and supporting activities), which Bengtsson and Kock opted for.

5 Chapter Summary

The issue of choosing both the scope and character of cooperation in coopetitive relations is increasingly becoming a key success factor for companies in highly turbulent and globalized environment. The phenomenon of coopetition is still relatively little known in both a theoretical and empirical sense, a fact which remains unchanged even given the growing number of papers devoted to this phenomenon, especially in recent years. Individual authors focus their research on different aspects of coopetition. Therefore, the substance of both streams (cooperation and competition) of coopetition and mutual influence on each other should be further explored, as the relations between cooperation and competition in coopetition were observed so far more in terms of intuitive than as a result of scientific research.

The aim of our chapter was is to identify the boundaries of the streams of cooperation within coopetition. We began our research with the presentation of coopetition concept. We then confronted the considerations of theorists dealing with coopetition (mostly Bengtsson and Kock) with the results of quantitative research on a sample of 235 companies operating in the high-tech sector in Poland. Based on the research results, the areas of coopetition were described. According to Bengtsson and Kock, companies should choose mainly Type 2 and 5, because they cover competitive cooperation including support activities in the value chain. They claim that one should expect the predominance of the presence of coopetitive relationships in these types. Our research has, however, shown different results—namely that primary activities were more frequently the focus of cooperation than support activities. For example, no companies indicated the presence of Type 5. It should be noted, however, that mixed cooperation (involving primary as well as support activities) was indicated by 75.99 % of the organizations surveyed.

The results received have several practical implications both for the theorists and practitioners. Firstly, it passed 14 years from the findings of Bengtsson and Kock. Because the results of our research showed a significant discrepancy between the theoretical assumptions and the results obtained, it justifies a need to carry out further research in this area. This is especially important given the fact that in the latest research of Bengtsson and Kock (2014), coopetition is defined more widely, as a "paradoxical relationship between two or more actors, regardless of whether they are in horizontal or vertical relationships, simultaneously involved in cooperative and competitive interactions". Secondly, the need for further research is related not only to the high-tech sectors of the economy, but mostly to the companies operating in other industries. Thirdly, in our opinion, the research conducted is rare not only in Poland, but also on an international scale. The size of the sample research, several-stages selection of the companies and first of all, the results achieved—justify this thesis.

Of course, it is also clear that our study has its limitations, due mainly to the methodology adopted. In fact, it constitutes a case study analysis based on a particular sector of the economy. As such, it allows to formulate policy recommendations regarding the sectors presented (how to cooperate, in which areas, etc.). On the other hand, however, the respondents were senior managers or the owners of the organizations, and the choice of the research sample was carried out in several stages. Therefore, this case study analysis might be utilised to formulate a refutable hypothesis on a sample of companies from different sectors of the economy. Irrespective of factors presented, however, one issue seems to be very important, i.e., the dynamics of coopetition seems to be a promising direction for future research, potentially contributing to a better understanding of the phenomenon.

Acknowledgement This paper was prepared with the financial support of the Ministry of Science and Higher Education in Poland, research grant no. NN 115 006040.

Appendix

Table 5 Selection of coopetition types depending on the features of enterprises (%)

Coopetition type	Distribution of the population	Company size (employees number)			Average R&D expenditures	Organizational form			Stages of a company life cycle				Geographic (market) scope						
		W1	W2	W3		FO1	FO2	FO3	E1	E2	E3	E4	G1	G2	G3	G4	G5	G6	G7
1	15.2	95.31	2.9	1.79	3.19	94.17	5.38	0.45	14.04	27.04	54.43	4.49	32.26	16.74	38.55	5.09	6.89	0.46	0.00
2	7.03	91.06	5.57	3.37	4.76	70.42	10.76	18.82	0.00	29.11	56.23	14.66	18.1	12.91	32.31	9.05	16.17	10.02	1.44
3	23.61	95.19	3.24	1.57	3.24	87.65	12.06	0.3	13.84	31.99	40.2	13.97	38.89	4.14	31.74	3.95	10.02	7.49	2.98
4	1.77	84.55	7.78	7.67	2.71	93.57	6.43	0.00	0.00	0.00	100	0.00	0.00	35.92	3.84	48.63	9.02	2.59	0.00
5	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
6	52.38	93.8	4.32	1.88	3.42	76.38	17.34	6.28	6.5	44.76	47.42	1.31	19.52	14.28	41.95	2.99	14.39	0.36	6.5

Source: Own elaboration

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Entrepreneurial Learning and Communities of Practice: The Case of the Cross-Border Cultural Tourism Development Bulgaria–Romania

Liliya Terzieva

Abstract Entering the twenty-first century is not just a step in time, it is coming into a new era where people are craving for valuable change and are willing to become more active in being part of it through both learning as well as community development [Prahalad and Ramaswamy (The future of competition: Co-creating unique value with customers. Harvard Business School Press, 2004a)]. Communities of connected, informed, empowered, and active consumers are challenging the world. According to Nijs (Imagineering the butterfly effect, transformation by inspiration. 11 International Publishing, 2014), "growing connectivity, interdependency, diversity and interactivity has major influences on the way we can create value in society." Instead of passive users, today's consumers want to be involved in designing processes.

As Hargadon and Bechky argue (Organization Science 17:484–500, 2006), "collective consumer creativity is qualitatively distinct from individual consumer creativity—it occurs when social interactions trigger new interpretations and new discoveries that consumers thinking alone, could not have generated. If we realize that creativity is a systemic—as opposed to individual process, then we are led to broaden our perspective".

Already in 1958 Jacobs approached cities as living beings and ecosystems, unfolding the transformation of the urban environment and the regional development potential, especially for tourism and culture. She suggested that over time, buildings, streets and neighbourhoods function as dynamic organisms, changing in response to how people interact with them. This sentiment is now, more than ever, echoing into the tourism sector evolvement as such and its meaningful interpretation with and for all.

How can we encourage innovation and how can we engage customers and participants in creating the future in order to satisfy the needs of the participants? Why is Co-Creating the future for all of us? How can we design (for) the future in order to ignite interaction? According to Tonder (Journal of Industrial Psychology

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_15

30(3):53–64, 2004) the new society is characterized predominantly by consumption where people create a sense of who they are through what they consume. Simply stated, consumers from a century ago were concerned about the utility value (does it solve my problem?) whereas today's consumers focuses on the intangibles—cultural or symbolic—values (does it promote my identity?). This becomes valid for the tourism sector and especially the cultural one, whereas the entrepreneurial learning has become the collective learning and the exchange and co-creation of value, which leads to the introduction and increase of relevance of communities of practice.

The current chapter aims to study the cross-border cultural tourism development of Bulgaria and Romania as a thriving possibility for entrepreneurial learning and communities of practice. It will unfold the existing potential of these countries and look into the specifics of how the complex nature of contemporary society is affecting the transformational essence of exchange versus value co-creation.

The further objectives of this chapter are to analyze the value and elaborate on a model of entrepreneurial learning and community of practice establishment in the cross-border region of two economies in transition—the Bulgarian and the Romanian. These countries will be analyzed through the lens of cultural tourism by looking at the complexity and the value creation interaction possibilities that are enhanced by the entrepreneurial and community development.

1 Key Concepts

As people move into an S-D logic world (Vargo and Lusch 2004), most organizations are facing a situation that is becoming more and more complex. Managing a business today is fundamentally different from just 50 years ago and the most profound difference is the level of complexity businesses and organizations leaders have to cope with. Within the framework of the last 50 years, consumers have moved from mass consumption to mass collaboration behavior (Nijs 2010). They have gained a voice in an interconnected globe enabled by the rise of technology and globalization. The organizations of tomorrow have to learn to think in an integrated way about engaging consumers wherever they may be. The tourism industry is one of the most affected industries that are currently struggling to adapt to the new demands of their consumers (see initiatives such Airbnb). A swiftly aging population, interconnectivity and systems' integrity (Manning 2012) are just some of the factors, prompting the development of more tailor-made products and services involving the specific experiences directed towards developing innovative entrepreneurial models with the necessary sustainability factor. Therefore, the current chapter addresses these changes by introducing new approaches to the tourism industry in embracing, not just the technical aspect of its business, but also bringing forth the human aspects and communication of the travel and tourism core values to inspire participation from all stakeholders both in terms of entrepreneurial learning as well as in relation to community development.

Change is a constant feature of organizational life and the ability to manage it is seen as a core competence of successful organizations. However, there are significant differences in how it is perceived: is it incremental, punctuated or continuous, can it be driven from the top down or is it an emergent process? (Burnes 2004). These differences are the product of the changing organizational landscape of the last 50 years, where globalization, the rise of technology, economic fluctuations, and other factors have led to a desperate search for increased competitiveness through more and more radical forms of change (Cooper and Jackson 1997; Beer and Nohria 2000; Stacey 2003).

However, increasingly over the last decade, academics and practitioners have come to view organizations through the lens of complexity theory, and this is beginning to have a profound impact on view of how organizations should be structured and changed (McMillan 2008). According to McMillan (2008):

> The complexity theory is the study of complex systems, which are created from many interacting agents that react and respond to each other in a constant interplay. An agent can be an organism, human, or organization that acts on its local knowledge and experience.

Today, however, organizations are still commonly viewed as entities that are driven with a structural form, exhibiting a certain degree of order and determinism. Such a linear top-down approach of analysis does exhibit its own set of limitations when used to explain organizations which are characterized by a complex web of interlinks and interdependencies (Mitleton-Kelly 2003). Complexity theory in this context is a collection of ideas that revolve around a holistic bottom-up approach of understanding systems-like organizations. Complex systems are characterized by the inherent difficulty experienced of an observer in explaining and describing the behavior of the system at a macro level in terms of its constituent parts. Complex systems are typically made up of a large number of constituent entities that interact with each other and also with its environment (Gell-Mann 1995).

The inadequacy of the classical mechanistic approach to analyzing social systems became more and more apparent in the early twenty-first century with the advent of a period of massive dynamics and chaos brought about by the high level of interconnectivity and advances in technology (Stacey 2003). The behavior of organizations with increased levels of interconnections fails to fall in line with classical descriptors and theories. Social systems (organizations) display a myriad of complexity in their form and feature. There is some learning and adaptation at an individual level and system level, order and direction develop, that empowers the group as a whole in better coping with the changes in its environment (Tonder 2004) (Table 1).

The view that an organization qualifies to fit in the definitions of a complex adaptive system (CAS) helps in developing parallels between the principles of a CAS and that of an organization (Gupta and Anish 2011). One qualitative approach to analyze and develop better insights about the deep nature of an organization is to map the fundamental principles of a CAS like the self-organization, emergence,

Table 1 Mapping complexity principles in the organizational context

Complexity principles	Organizational phenomena
Self-organizations and emergence	• Spontaneous coming together of a group to perform a task. The group self directs its course of action without external directives. • The evolution of knowledge and ideas as a result of interactions in a group network.
Chaos	• A person who occupies a position of power and brings about a large scale influence on the organization.
Adaptive behavior	• Experiential learning of groups or organizations embedded in an interacting network.
Co-evolution	• Individuals, groups, and organizations sharing a common eco-system and thus influencing each other spontaneously.
Self similarity	• Different levels of hierarchy exhibiting scaled versions of a common corporate culture.

Source: Mc-Millan (2004)

co-evolution, chaos, self-similarity as well as behaviour exhibited by the organizations.

The concept of an organization as a complex system, capable of naturally evolving strategies, structures and processes and self-adjusting to changes in the environment, implies a new lens for the researcher in understanding the nature of the organization. This framework suggests that complex adaptive systems operate in a special kind of order that they create themselves. Instead of a mission statement, they present a set of values that guides the process of self-organization and emergent properties in an organization.

A community of practice (CoPs) is a group of people who share a common concern, a set of problems, or interest in a topic and who come together to fulfil both individual and group goals (Cambridge et al. 2005). CoPs often focus on sharing best practices and creating new knowledge to advance a domain of professional practice as a result of the engagement of all agents and the effect of involving elements of their systemic but complex nature. Interaction on an ongoing basis is an important part of this. A community's specific purpose and goals inform the appropriate activities and technologies that should support it. Many virtual communities of practice rely on face-to-face meetings as well as web-based collaborative environments to communicate, connect, and conduct community activities, which are noted as a direct result of the Complex adaptive systems' behaviour.

Principles drawn from complexity science are often used as a guiding tool in the process of entrepreneurial transformation and renewal of communities of practice. The focus is on applying the learning by transitioning from classical mechanistic models into fluid and organic entrepreneurial models. Stacey (1996) has developed a theory of entrepreneurial learning using complexity, which is based on a few propositions, and this provides a valuable theoretical framework within which industrial change can be considered. They are:

1. Communities of practice are webs of non-linear feedback loops that connect to other people and organizations by webs of non-linear feedback loops.
2. All entrepreneurial entities are paradoxes. They are attracted to stability by control processes, the human need for security and stability, and adaptation to the environment. They are also drawn to the opposite extreme of instability by the pull of organizational divisions and decentralization, the human need for excitement and innovation, and remoteness from the environment.
3. If an entrepreneurial organization is dragged into stability it will fail because it will ossify and be unable to easily change itself, but if it is pulled into instability it will disintegrate. Success lies in sustaining entrepreneurial learning in the borders between stability and instability. This is the edge of chaos.
4. The dynamics of a successful community of practice are those of irregular cycles and discontinuous trends, which is to be explained with their non-linear nature and behaviour.
5. Due to its internal dynamics, the successful community of practice faces a completely unknown future.
6. Agents within entrepreneurial entities (organizations) are unable to control long-term outcomes.
7. Long-term planning and development should be a spontaneous, self-organizing process out of which new strategic directions may arise. Spontaneous self-organization arises from political activity and collective community of practice learning situations.

2 Problems

Nowadays, businesses and organizations continue to face a growing range of challenges no matter where they operate or what industry they are in, let alone if this is tourism, being referred to as the economic sector mostly impacted by the current changes. To survive and thrive in such fast-changing times, businesses and organizations recognize the necessity to transform their way of thinking and acting. There are new markets replete with unfulfilled needs, new technologies that can be leveraged to meet those needs at an affordable price, and new enterprise logic to link people and technologies in wholly new patterns (Zuboff 2005). As Wolfe and Snyder (2004) point out, numerous recent consumer surveys reported people to be looking less for “things” and more for “experiences” to achieve personal satisfaction in their lives. This means that consumers need more than just a product or service.

Based on the Newtonian Science, organizational success was reached when the system maintained stable by top to down, command and control leadership towards bureaucracies and hierarchies (Tetenbaum 1998). In summary, businesses and organizations in this time were mainly consistent in ensuring regularity, predictability, and efficiency. The shift from classical to an industrial era started in the eighteenth century, when machines were introduced in the production process. In this era, organizations were busy turning raw commodities into goods by adding value to them in a sequential, linear and transitive mode, following the so-called Goods Dominant (G-D) logic (Vargo and Lusch 2004).

In today's world, organizations remain rooted in business logic invented a century ago to mass manufacture goods, and now face a new population of people who demand more. As people face the new century challenges, the differences from the past keep increasing by the context in which organizations operate. Today, organizations have to cope with the six primary characteristics of the twenty-first century: (i) the rise of technology, (ii) globalization, (iii) competition for market share, (iv) the accelerating rates of change, (v) increase in technological speed, and (vi) complex nature (Tetenbaum 1998). The consumption shifted from an era of mass society to a new society of individuals—people who are more educated, informed, experienced, "traveled", and connected than any earlier generations (Zuboff 2005).

Today, products and services are being developed together with the consumers in an interactive value creation process (Lusch et al. 2007; Vargo and Lusch 2008a, b). Both consumers and supply chain partners are viewed as endogenous to value creation and as a source of expertise and knowledge from which the business may generate benefit (Vargo and Lusch 2004; Lusch and Vargo 2009). The new logic that describes this new relationship between organizations and consumers is referred to as Service-Dominant (S-D) logic (Vargo and Lusch 2008a, b).

The transition from G-D logic to S-D logic has altered tourism organizations' business behavior. S-D logic focuses on the use, the consumer, the process, the intangible, the relationship, and doing (Vargo and Lusch 2006; Normann 2001). S-D logic perceives that exchange consists of a sequence of activities (i.e., a flow of service) whereby consumer and producer collaboratively interact with each other, and with others involved in the exchange, thus creating an experience, far richer than the single-direction one. Focusing on the consumer and the relationship, they co-create value, especially when we refer to culture and diversity of countries, people and regions, local and global (Vargo and Lusch 2006; Spohrer and Maglio 2008).

To create a cultural tourism experience, consumers became more willing than ever to participate in the process with all stakeholders. In other words, they want to be active and have their opinions to make an impact on the tourism product generated in order to suit their lifestyles and preferred experiences. Today, things are done with consumers in an interactive value creation process (Lusch et al. 2007; Vargo and Lusch 2008a, b).

In the cross-border regions of Bulgaria and Romania there are already thriving initiatives of developing and sustaining entrepreneurial efforts towards cultural tourism synergies, whereby communities are collectively exploring the possible routes for the establishment of communities of practice.

3 Evidence

The cross border, transnational and interregional programmes for cooperation on a European level aim at giving a specific and purposeful territorial dimension to the Lisbon and Gothenburg strategies via a review of the geographic apportionment of growth, innovations and the processes in the labour market in the eligible cross border and transnational areas and the EU as a whole, and via the provision of integrated and genuine joint actions for sustainable development of the participating countries. Although the priorities of these programmes may correspond to given national and European sectoral policies, unlike the sectoral policies, the territorial cooperation programmes support activities of a completely different type. The selected projects contribute to an integrated territorial development through the wide partnership approach—engaging different sectors and management levels and obligatorily meet two of the following four criteria:

- Joint project development;
- Joint implementation;
- Joint team;
- Joint financing.

On the 18th of December 2007, the European Commission approved a cross-border co-operation programme between Romania and Bulgaria for the period 2007–2013. The programme involves Community support for 15 NUTS three regions, seven in Romania (counties of Mehedinti, Dolj, Olt, Teleorman, Giurgiu, Calarasi and Constanta) and seven in Bulgaria (districts of Vidin, Vratsa, Montana, Pleven, Veliko Tarnovo, Ruse Silistra and Dobrich). In addition to these districts, the Razgrad district in Bulgaria has been included in the eligible programme area in accordance with the flexibility rule contained in Article 21(1) of the European Regional Development Fund (ERDF) Regulation. The total budget of the programme is 262 million euros, with Community assistance through the ERDF amounting to 218 million euros. This represents approximately 2.5 % of the total EU investment earmarked for the European Territorial Co-operation Objective under the Cohesion Policy 2007–2013.

The eligible area is characterized by problems typical of border areas, where marginality and isolation from the economic and decision-making centres are increased by the presence of borders which limit economic, social and cultural exchanges and affect the joint, efficient, and effective management of the territory. The cross-border area is not homogenous and lacks an identity as a region. An analysis of the current socio-economic situation indicates sluggish economic development, growth and job creation, but the potential for beneficial cross-border co-operation exists. From an environmental point of view, the area also possesses rich and varied but highly vulnerable landscapes, ecosystems and morphology.

The overall strategic goal of the programme was therefore to bring together the people, communities and economies of the Romania-Bulgaria border area and support them in the joint development of a co-operative area, drawing on its human, natural and environmental resources and advantages, all using a sustainable approach.

Since culture is at the forefront of the European economic and political development by contributing nearly six million jobs and representing at least 3 % of the European GDP, it is as important a source of wealth as any other economic sector. Nevertheless, quite apart from its economic impact, it also contributes to fostering individual and collective identities, social inclusion and creative skills. Culture is also a powerful source of spillover to other industries. It fuels new ICT applications and inspires user-led designs for public and private products or services. Culture also has a significant impact on sectors such as tourism, which integrates content, creative skills and aesthetics throughout its value chains. It is at local and regional levels that culture's broad contribution to tourism is best observed. Cities, regions and their respective identities play a vital role in fostering jobs, businesses and urban beautification through cultural tourism and creative industries (CCIs). Also, cities are historically the place where innovation takes off. They play a key role in stimulating interactions between local stakeholders and contributing to triggering spillover effects from CCIs into traditional economic fields.

Cultural tourism is a commonly used term that reflects the close links that have always existed between culture and tourism in Europe and beyond. It is a term, though, that is open to interpretation because both culture and tourism are very broad concepts in themselves. UNESCO, the OSCE and the European Commission's Enterprise and Industry directorate have all conducted studies on the concept of cultural tourism, its historic background and the impact of culture on tourism and the definition they have arrived at is as follows: "The movement of persons to cultural attractions away from their normal place of residence, with the intention to gather *new information and experiences to satisfy their cultural needs*."

The strategic objective for the development of the cross-border cultural tourism in Bulgaria and Romania can be summarized in the following phrase:

> Transforming the areas in an attractive tourist center by creating favorable conditions for a stable economically successful cultural tourism development *based on the realities of the border region and current trends in demand and supply of cultural tourism products through the joint efforts of the business community, NGOs and local and regional authorities.*

4 Theme in Practice: The Case of Cross-Border Cultural Tourism Development in Bulgaria and Romania

The specific research case of cultural tourism development in the cross-border region of Bulgaria and Romania was chosen due to the complex nature of the above. Namely, the necessity of designing an integral system composed of diverse elements such as: EU subsidies, an objective of social and economic development, cross-border cooperation, tourism and culture, etc. Unfolding the potential of the elements above therefore relates to the essence of the entrepreneurial learnings as business modelling and the communities of practice as socio-cultural community-building. Both of these aspects are relevant for the cross-border context.

The modern model of the contemporary paradigm is the natural way for the development of lively culture, especially at the threshold of two neighbouring countries. It provides more freedom and personal initiative to the artists, and this benefits every citizen. Culture is a reflection of the confidence of the nation in terms of its uniqueness that results from events and important historical and cultural achievements. In this way, culture has a direct or indirect effect on economic development. The events that create national culture are experienced subjectively in space and time and remain in collective memory) and can be converted into an economic program for their future. On this basis, there are some important trends in the development of cross-border cultural tourism in Bulgaria and Romania, such as:

- Cultural heritage has expanded its content, in terms of cultural monuments and other values: traditional agricultural practices, social events, traditions, local cuisine, crafts, intangible values and more, thus forming a cultural environment.
- Cultural heritage has expanded its territorial range to include values of increasingly higher levels: historic cities, cultural landscapes, cultural routes—with local, national, continental, and even transcontinental range;
- Cultural heritage is manifested not only as a spiritual value that should be protected, but also as a unique resource that can and should be used for sustainable development, according to the rules of the economic game and the laws of the market. An essential tool for this is cultural tourism.

In fact, culture can be depicted by two circular representations:

- the inner circle that represents the cultural heart, i.e., more traditional or basic elements of culture, understood as what people do or produced by culture;
- the outer circle represents a way of life or style of living of population of a certain place.

Firstly, the inner circle represents the main elements of cultural tourism, which can be divided into two parts, i.e., artistic heritage tourism (cultural assets, related to products from the past) and tourism of the arts (connected to the present cultural production such as the presentation of visual arts, modern architecture, literature, etc.). While the outer circle represents the secondary elements of cultural tourism that can be divided into two categories: lifestyle: (elements such as beliefs, cuisine, traditions, folklore, etc.) and sector of creativity (fashion design, web and graphic design, film, media and entertainment, etc.). In many countries, the circles tend to gather to form a single cultural offering in which both aspects are complementary. On the basis of the proposed above definition, there are subcategories of the cultural tourism, which are able to contribute to the definition of trends and characteristics of the most important market segments based on motivations and behavior as well as tourist activities exercised as it is in the cross-border region of Bulgaria and Romania:

- Heritage tourism;
- Tourism of art;
- Artistic (creative) tourism;
- Urban cultural tourism;
- Rural cultural tourism;
- Local cultural tourism;
- Modern cultural tourism.

In this light there can be defined the special role for integration relations between cultural heritage and tourism. The historical territory: the part of the earth's surface, regardless of its territorial scope or topographic homogeneity, has overall coherence and cultural and historical identity, including related traces of the past, remarkable of their historical, archaeological, artistic, scientific, social or technical interest Therefore, this concentration of cultural values makes historic sites an integrative field of culture and tourism. A historic area is a complete culture, which encompasses single or collective cultural values, cultural landscapes, historic towns, cultural routes, valuable natural environments and typical landscapes (in the sense of the European Landscape Convention). This cultural background cannot be territorially limited—its territorial range depends on the logic of the cultural and historical processes, the relevant local, national, regional or continental level.

Both the Bulgarian as well as the Romanian cross-border regions are areas of intense historical and cultural backgrounds, encompassing in total more than 1000 diverse cultural and historical resources, sites, events, etc. This enables the complex and integral nature of the possible entrepreneurial initiatives and the formation and establishment of communities of practice. As a result of the 'Cross-Border Cooperation Programme Bulgaria—Romania' more than 100 initiatives in the field of cultural tourism development have been realized, which can be characterized with identifying the following entrepreneurial strengths:

- Co-creation
- Stakeholder networking and interconnectivity
- Joint value creation efforts

5 Outcomes

The research population of this study has been stakeholders of projects implemented in the cross-border area of Bulgaria and Romania in the field of cultural tourism. The research encompassed stakeholders (both internal and external) having implemented the projects and organizations, which affect or have been affected by the project implementation. The internal ones include employees inside the organizations, which implemented the projects, from the top level of the management up to the subordinates in each department, while the external ones refer to tourists, local population, representatives of NGOs, municipalities, local councils, etc.

The methodology used for this research consists of desk research, semi-structured interviews and collaborative sessions for the data collection. In addition, the data collected has been analyzed by method of thematic analysis as part of the data analysis. For this study, the researcher has conducted semi-structured interviews where the order of questions varied, depending on the conversation flow. The objective of semi-structured interviews was to engage the interviewee into the conversation without limiting them but staying within the context of the interview objective. The interview used both the traditional interview techniques in combination with the appreciative inquiry approach. Appreciative Inquiry is defined as collaborative search to identify and understand the strengths, opportunities and people's aspirations for the future of an organization (Cambridge et al. 2005). The main concept of appreciative inquiry is to include the whole system in an organization to work together in the transformation process. The application of the appreciative inquiry technique in the interview helped the researcher in obtaining information from another perspective and the possibility to look ahead for the possible solution in the existing situation.

Looking at the background of the interviewee set the interview topic. The interview topic had been formulated after reviewing some data retrieved from desk research and hence the interview questions were composed based on the main interview topic.

The topic and sample questions are shown in Table 2 below:

After the data collected through the field and desk research, the data was analyzed using the method of the thematic analysis. From the process of analyzing the data, certain findings were identified and this led to the development of the concept. A collaborative session based on the World Café model was conducted to obtain feedback from the organizations (within and outside the project implementation) together with the external stakeholders (tourists, local populations, NGO representatives, etc.) about the findings that have been identified at that point and to discuss the potential of the ideas for the final outcome.

The Final analysis identified four main themes: *the meanings of cultural tourism and cross-border regions, the perception towards projects implemented; the expectations towards the projects' sustainability and the future image of a cross-border region, characterized by cultural tourism development from the standpoint of community and entrepreneurship*. The final results indicate that the projects have been implemented with the notion and perception of integrity not only within the tourism sector itself but also in relation to the other stakeholders that had been directly or indirectly involved/impacted. This condition has opened opportunities for developing a concept of entrepreneurial learning and communities of practice in the future. In the process of designing the above concept, the stakeholders need to be aware of the necessity of being adaptive, flexible and dynamic in terms of implementing the strategies, in order to cope with the changes that might emerge in the future.

The interviewees have referred to culture as not simply a sector but also a resource like the environment. As such, it can be carefully 'mined' to attain different policy objectives such as to:

Table 2 Interview topic and questions

No	Interview topic	Interview questions
1.	About the project	• Where does the project put the main focus and why? • How would you describe your management position in the project implementation in terms of entrepreneurial attitude and possibilities of enabling community of practice?
2.	Meaning of community of practice	• What is the meaning of community of practice for you? • How do you associate the community of practice with you/your work?
3.	Future image of the cultural tourism cross-border development	• How would you see the development of the cross-border cultural tourism in the future? • What is the smallest change needed by the cross-border region to enable the delivery of its key message to the visitors in the future?
4.	External perceptions towards the project	• How do you see the project sustainability in terms of entrepreneurial activities as a follow-up? • What is your first consideration before visiting a cross-border region for tourism? • What will challenge you in visiting a cross-border region for tourism and why?
5.	External expectations towards the project	• If there is a cross-border region that provides cultural tourism from the standpoint of community and entrepreneurship, how would you like it? • What do people usually look for when they visit a cross-border region for tourism?

- improve skills, employment and social cohesion in an entrepreneurial manner,
- enhance the territorial image and attractiveness by means of community building,
- develop the economy and new forms of entrepreneurship and innovation,
- protect and promote heritage as a source of common identity and community or practice.

Cultural tourism on the other hand, especially in a cross-border region, implies this implicit polarization of cultures, which enhances the possibilities for "third" or "hybrid" cultural interests for the visitors. In the analysis, the cultural tourism projects have been categorized as those that stressed the link to tourism or the importance of tourism for the project in their project description. Altogether, 26 % of all cross-border projects had cultural tourism as their main focus. Since cultural tourism is an important and growing sector of both countries' economies, it is not surprising that 88 % of the analyzed cross-border cooperation projects and 50 % of the analyzed transnationally funded projects are in this field. Around 145 million EUR of the European funds budget was allocated to this type of project (28 % of the total ERDF budget of the analyzed ones) and spent on cultural tourism.

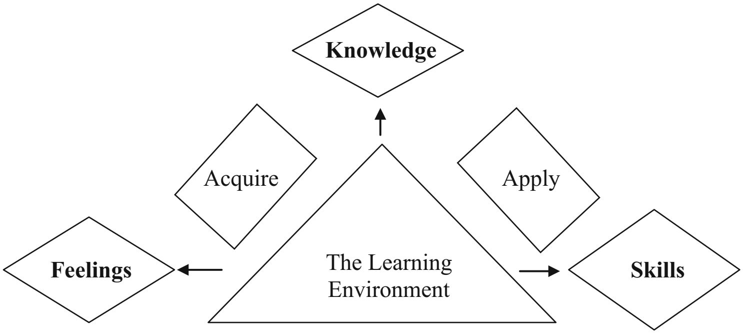

Fig. 1 Experiential learning via a direct educational encounter Borzak (1981)

The main activity of the cultural tourism projects is the development and implementation of community of practice activities. In order to make cross-border regions and cities more attractive and competitive in the European and world-wide tourism markets, those projects tend to develop joint tourism concepts, entrepreneurial strategies, offers and information campaigns. By exchanging knowledge and sharing good practices in areas such as effective tourism management, infrastructures and services, projects endeavour to gain greater visibility of the project area and its community development potential. Many of the analyzed projects combine entrepreneurial activities in tourism with the preservation of cultural goods such as buildings, monuments, archaeological sites or cultural landscapes.

The emerged entrepreneurial learning model based on the implementation of cultural tourism projects is characterized in two dichotomous but significantly related contexts. The first context is the type of learning undertaken by the directly involved stakeholders, who are given a chance to acquire and apply knowledge, skills and feelings in an immediate and relevant setting (in this case the specific project). It involves a direct experiential encounter with the learning event rather than simply a thought process associated with learning (Borzak 1981) (see Fig. 1).

This direct experiential encounter with a learning event requires active engagement of the stakeholders as opposed to passive engagement commonly associated with programme-directed instruction that generally results in minimal stakeholder interaction in the entrepreneurial learning process.

The second context addresses the external stakeholders' reflection on direct participation and direct encounters within the events of everyday life—the dynamics of the region in the cross-border territory. It presents itself in a less structured format and in some respect aligns with the term—continuous entrepreneurial learning. It represents the idea of learning new things based on the innate variations of life-experiences in the context of projects.

Highlighting cultural heritage and transforming cultural goods into appealing tourist attractions also has a favourable effect on the regional economy in terms of entrepreneurial learning, this has been shared by 87 % of the respondents. Examples include developing cultural landscapes for tourism, using historic events or figures to develop tourism products or attractions, developing and promoting a route or theme through different countries, such as historic cycling routes. Folklore, local traditions, and crafts are also important components of the cultural tourism projects as cross-points for community of practice development. As such, the projects help preserve local and often unique traditions by organizing training programmes, exhibitions and events such as crafts workshops or folklore festivals. Many of the analyzed projects have expansion as one of their main objectives and aim to diversify what the region has to offer by turning unique elements of the local culture into marketable products (such as wine, food, or handicrafts) or appealing tourist attractions.

6 Chapter Summary

European cultural policies are increasingly recognizing the multidimensional role of culture, especially in relation to bordering, interaction and enhanced community recognition. The Agenda for Culture calls on culture to ensure intercultural dialogue, to stimulate creativity (including at the local level to increase beautification initiatives) and to position Europe in the international realms vis-à-vis third countries. Because of the role of culture in mainstreaming innovation and cohesion policies such an entrepreneurial potential and economic growth are being enhanced. Innovation policies propose a broad concept of innovation based on cultural and creative inputs in tourism. Regional policies emphasize the role of culture in making regions attractive, both for tourists as well as highly skilled professionals. They should also consider cultural tourism to be in a strategic position of enabling a link to creativity and innovation at regional and local levels by means of entrepreneurship and community-building. The most recent European policies in the field of culture, innovation and cohesion show a paradigm shift where the linkages among the different dimensions of culture and their contribution to various aspects of economic and social life are increasingly recognized and encouraged.

The above is in full compliance with the consumer and the economic logic of today as today's consumers are vastly different from those of the past. The rise of technology, globalization and the complex nature of today's society and economy have led to changes in tourism preferences and consumption habits. A positive outcome of this has been the rapid advance in travel technology, processing and information techniques and tools that help to ensure the diverse value creation possibility of the tourist product. Ultimately, the value identified as such by the consumer, depends on the efforts of everyone involved in the "supply chain" from destination to information, from idea to experience, from inspiration to innovation.

The cross-border region of Bulgaria and Romania has become a good practice model for successfully working through initiatives of developing and sustaining entrepreneurial efforts towards cultural tourism synergies, whereby the collective entrepreneurial community explores the possible routes for establishment of communities of practice.

As Nijs (2014) states:

> In good conventional marketing tradition, they try to sell 'the entity/the destination/the product' to 'consumers' by pointing out the unique selling proposition of the entity, the destination. That this way of working with a tagline in a connected society could (and should) be used as a dialogical instrument for reframing value creation to enable collective creative participation, to generate better business and, at the same time, more satisfied guests/participants, is still an opportunity waiting to be discovered for many destinations in the tourism industry.

The challenge of further research may lie in studying the long-term sustainability of what has emerged as an outcome of the projects implemented in terms of entrepreneurial learning models and communities of practice. This would be related to the continuity of the initiatives generated and their further reframing and/or redesigning versus the complex nature of tourism, culture and cross-border cohesion in general.

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Present State and Perspectives of Entrepreneurial Financing in Bosnia and Herzegovina

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Abstract Financing start-up firms and small-and-medium enterprises (SMEs) is a challenging task. The main reason for the inability of entrepreneurial firms to finance their business lays in the fact that conventional financing sources (such as commercial bank credits, bond issuing) are not always available for entrepreneurs because there is no available credit history, which are necessary for financial institutions to finance their clients' business operations.

Entrepreneurship development and increase of its overall impact on employment through entrepreneurial activities can be observed from the data of "The Executive Report" of Global Entrepreneurial Monitor (GEM) from 2007. The data shows that in some countries 25 % of the population is employed by starting their own firms (e.g., Peru and Thailand). Due to the fact that entrepreneurial activities are becoming an important driver of economic development in both developed and developing countries, new financial institutions and innovative financing instruments are being created to address the growing need for financing entrepreneurial activities.

This chapter focuses on the examination of different types of financial resources available to financing entrepreneurial firms in the countries with a developed tradition of entrepreneurial thinking and in the countries where entrepreneurial activities are becoming a new trend in economic development. At the same time, we are focusing the research of the impact of the recent financial crisis on the availability of the above-mentioned resources to entrepreneurs. The main incentive for conducting this research is the fact that the financial sector of Bosnia and Herzegovina (BiH) is considered as bank-centric with banks holding more than 80 % of assets within the financial sector. Other financial institutions, microfinance institutions, investment funds, and insurance companies hold less than 4 % each, of the total assets. This means that entrepreneurs are largely dependent on the financial products (credits and loans) from the banking sector. Having in mind that banks perceive entrepreneurial firms as the most risky clients due to the lack of credit history, it raises the issue of how to overcome the gap between banks and

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J. Ateljević, J. Trivić (eds.), *Economic Development and Entrepreneurship in Transition Economies*, DOI 10.1007/978-3-319-28856-7_16

entrepreneurial firms and what might be the role of the state (and government) in bringing these two sides closer.

The main goal of the research is to identify the degree of development in different types of financial sources available to entrepreneurs in developing countries, with an emphasis on the present state and perspectives of entrepreneurial financing in Bosnia and Herzegovina. In order to conduct the relevant research, we proposed the scientific hypothesis that financial resources available through different types of financial institutions in BiH are not adequately structured to the needs of entrepreneurs starting new businesses.

Methodologically, this research was conducted in two stages. In the first phase, desk research was conducted in order to identify and enlighten the theoretical aspects of entrepreneurial financing. In the second phase, a specific questionnaire was sent to financial institutions in BiH in order to investigate the degree of development of available financial products for entrepreneurs. It further served as the basis for providing recommendations for more usable financial products for financing new businesses.

This chapter is divided into three parts. In the first part, the theoretical background on financing entrepreneurial activity is presented. Using a growth cycle theory, different types and sources of financing available in different stages of entrepreneurial firm life cycle are discussed. In the second part of this chapter, previous research on entrepreneurial financing is discussed. The third part discusses present state and perspectives of entrepreneurial financing in BiH. First, an overview of the BiH financial system is presented, followed by a discussion of empirical finds on BiH financial institutions' lending practices to entrepreneurs. The main focus is on the banking and microcredit sector, government grants and subventions, and venture capital financing perspectives.

1 Theoretical Background on Financing Entrepreneurial Activity: Growth Cycle Paradigm Versus Pecking Order Theory

Facing a problem of high unemployment rates, in most developing countries and countries in transition self-employment through seeking business opportunities and starting new businesses is becoming a major source of creating new work places. According to *The Executive Report* from the Global Entrepreneurial Monitor 2007 (GEM), entrepreneurial activities have profound impact on employment. In some developing countries, a quarter of the population is employed through business start-ups.

By signing the European Charter for Small Enterprises, Bosnia and Herzegovina (BiH) made a commitment to promote and develop an entrepreneurial climate, which is the most important strategic goal for reducing high unemployment.

According to the Agency for Statistics of BiH, in January 2014 there were 557,474 registered unemployed persons. Based on the findings of GEM reports for BiH (Umihanić et al. 2010, 2013), financial and productivity problems are the most common reasons for business discontinuance in BiH in general.

In this chapter, rather than focusing on entrepreneurial firms' perceptions regarding financing, we analyze the factors perceived by financial institutions and government as drivers and obstacles to financing entrepreneurs. Since financing is a key precondition for developing new businesses, the first step in assessing the entrepreneurial climate and its development perspectives is to assess development of financial infrastructure supporting new businesses, measured by the number and types of different financial institutions supporting entrepreneurs.

Furthermore, in order to discuss financing challenges of entrepreneurial firms, it is necessary to make a distinction between entrepreneurial firms (entrepreneurial enterprise) and small-and-midsized enterprises (SMEs). The main difference taken into consideration in this paper is the age of enterprises. We consider that the entrepreneurial firm is a firm in the early stage of entrepreneurial activity. In accordance to the GEM methodology, the early stage of entrepreneurial activity is defined as a period of the first 3.5 years or 42 months of operating a business. This time frame is considered to be the turning point for establishing successful business or discontinuance of entrepreneurial activity. Entrepreneurial firms can be classified to the category of SMEs by defining parameters of SMEs, such as the number of employees and total revenues.

The age difference between entrepreneurial firms and SMEs is a key parameter for distinguishing types of external financial sources available to these enterprises. Even though SMEs have limited options for financing their needs, entrepreneurial firms face a greater problem, which is related to the lack of information regarding the business. This problem is more pronounced when it comes to traditional financial sources (bank loans, initial public offerings—IPOs, and securities emissions).

As it was observed by Denis (2004: 310) entrepreneurial financing situations are characterized by two fundamental problems. First, there are large information asymmetries between entrepreneurs and investors. For example, it is difficult for outside investors to ascertain the quality and potential value of technological innovations. By contrast, entrepreneurs who are often the innovators themselves understand the quality of the innovation. Secondly, there is a potentially serious moral hazard problem. Once entrepreneurs have raised funds from outside investors, they have the incentive to misallocate these funds by spending on items that benefit themselves disproportionately. For example, an entrepreneur/scientist might choose to invest funds in research activities that bring notoriety to the scientist, but for which there is little return for the investor.

Entrepreneurial financing problems caught the attention of the academic circles in the early 1990s, with a boom of entrepreneurial ideas in the high tech, information, and bio-technology areas in the USA. Financing entrepreneurship activity (as well as SMEs) differs from corporate financing, due to their unique characteristics such as size, age, ownership structure, risks related to new technologies development, and, mostly, due to the informational opacity. Unlike large firms, small firms do not enter into contracts that are publicly visible or widely reported in the press; contracts with their labor force, their suppliers, and their customers are generally kept private (Berger and Udell 1998: 616). These characteristics, in large, determine the availability of different types of financial resources.

According to the relevant academic literature, two main streams of theories on entrepreneurship (small business development) can be observed. The first theory is based on the financial growth cycle paradigm disused by Berger and Udell (1998). The second theory discussed in the academic literature is the pecking order theory developed by Myers (1984).

The Financial Growth Cycle paradigm proposes that entrepreneurial firms need different types of financial sources in different phases of a life cycle. The second theory, the pecking order theory, originally devised to examine the financing of large corporations, suggests that the capital structure decisions of a firm are a function of the firm's age. As postulated by this theory, internal sources of funding are prioritized, while use of external sources is delayed until the internal sources are exhausted. As such, when seeking funds, a firm prefers internal equity to external debt, short-term debt to long-term debt, and external debt to external equity (Abdulsaleh and Worthington 2013).

The theory of financial growth is generally accepted in academic research papers and text books, and provides a general idea of which types of financing are available (and appropriate) throughout the life cycle of entrepreneurial firm. Figure 1 shows a general scheme of financing entrepreneurial firms throughout an entrepreneurial firm life cycle focusing on the early stage of entrepreneurial activity.

The developing (seed) phase of entrepreneurial activity is the most risky one, where many businesses do not survive to the next phase, and therefore financial sources are limited. Cash flow in the developing phase is negative due to the existence of different costs associated with product development, legal and tax consultant services, business plan creation, and lack of revenues. Entrepreneurs depend on their own capital and capital which can be borrowed from family and friends, as well as on their ability for bootstrapping. In some cases, providers of external sources are business angels and venture capital funds, which are more commonly connected to the start-up phase.[1] It is important to underline that the role of venture capital funds is not just in providing financing for the new business, but providing managerial assistance as well.

In the start-up and survival stages, which are stages of introduction of the product to the market, the most important providers of financial sources are venture

[1] Business angel or angel investor is usually a former entrepreneur or professional who provides starting or growth capital to promising ventures, and helps also with advice and contacts. Unlike venture capitalists, angel investors usually operate alone (or in very small groups) and play only an indirect role as advisors in the operations of the investee firm. On the other hand, venture capital fund or venture capital firm is a government, semi-government, or private firm that provides start-up or growth equity capital and/or loan capital to promising ventures for returns that are higher than market interest rates (www.businessdictionary.com).

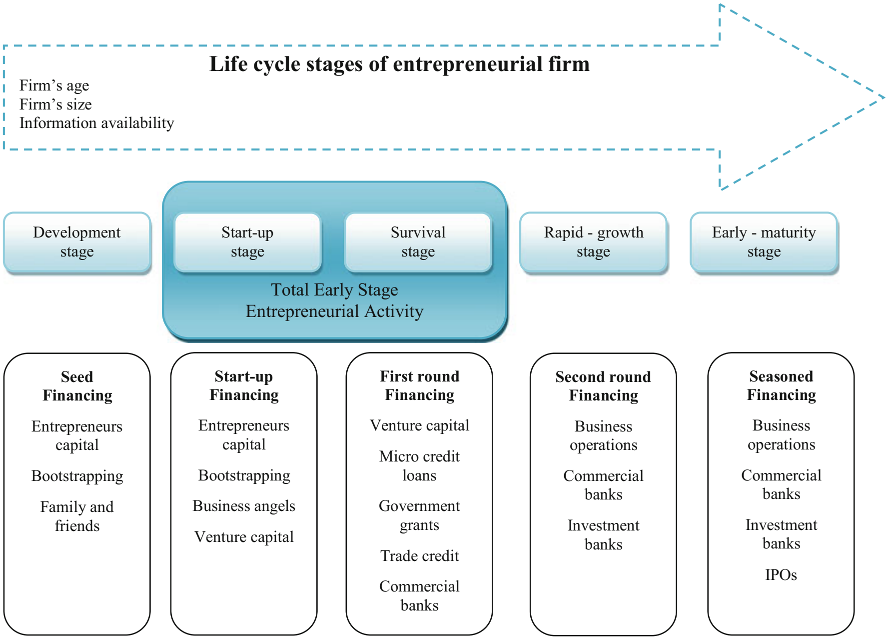

Fig. 1 Types and sources of financing through the life cycle stage of entrepreneurial firm. *Source*: Adapted from Berger and Udell (1998, p. 623), Leach and Melicher (2012, p. 24) and Xavier et al. (2013, p. 13)

capital funds, government grants, as well as a commercial or micro finance institutions loans, depending on the development phase of a national financial system. In the later phase (rapid growth stage) cash flow of the business is positive with a potential of rapid growth, which is a precondition for debt financing. Therefore, in this phase more conventional (traditional) financial sources are becoming available, such as investment loans or financing through securities issuing.

According to Barringer and Ireland (2010), types of financial sources for entrepreneurial firms can be also connected to the riskiness of entrepreneurial activities. In this context, three types of entrepreneurial activity based on the risk associated with the activity can be identified: highly risky activity with uncertain return, low risk activity with less uncertain return, and activity with high return. The most adequate financial sources for highly risky activity with uncertain return (characterized by low cash flow, high debt rate, low to moderate growth, and inexperienced management) are personal capital and capital borrowed from family and friends combined with bootstrapping methods. For low risk activity with a less uncertain return, which is characterized by strong cash flow, low debt rate, revised financial statements and proper management, debt financing is the most appropriate source of financing. IPO and security issuing are methods appropriate for financing activity with a high return, characterized by a unique business idea, high growth market niche, and well-established management.

2 Previous Research

As indicated in the previous part, one of the first research in financing small business (and therefore, entrepreneurial firms) can be found in early papers of Berger and Udell (1998), Helwege and Liang (1996), Kimhi (1997), following Cassar 2004; Hartarska and Nadolnyak (2007), La Rocca et al. (2011), Wu et al. (2008), etc. The early research made by Berger and Udell (1998) provides an insight to a number of facets of small firm finance, the investors and intermediaries that provide it, and the private equity and debt markets in which they function. They argued that the degree of informational opacity is a key feature that drives the financial growth cycle and distinguishes small business finance from large business finance. Information opacity (lack of information on the specifics of business operations, lack of (audited) financial statements and repayment and profitability history, inadequate collateral, etc.) is a key obstacle of entrepreneurial firms to obtain external financial sources for financing their business projects.

Cassar (2004) investigated the relationship between the size of the start-up company and a company's asset structure in the structure of financing. This research shows a strong correlation between size and tangible assets in terms of the possibility to use debt financing. The larger the start-up the greater the proportion of debt, long-term debt, external financing, and bank financing. Firms with a relative lack of tangible assets appear to be financed through less formal means, where nonbank financing, such as loans from individuals unrelated to business, plays a more important role in the capital structure of start-ups (Cassar 2004: 277).

The most important factor governing the ability of start-ups to raise sufficient capital for their projects is the depth of the local capital markets, according to Kerr and Nanda (2009). They found that more developed financial markets, measured by the number of different financial institutions, provide numerous financing opportunities for companies. Furthermore, developed financial markets are characterized by the existence of different types of financial instruments, which help financial institutions reduce risks associated with lending to non-financial firms. On the other hand, emerging financial markets are characterized by a lower number of financial institutions and financial instruments available to financing the non-financial sector. Since entrepreneurial activity is risky in the early stages, entrepreneurs starting their business in economies with developing markets are facing greater constrains related to external sources of financing.

As it is shown in the reviewed literature, financing entrepreneurial activity is a more challenging task in developing countries with an underdeveloped financial system. Financial systems in developing countries are more oriented towards well established companies with credit history (bank oriented financial system) and often do not provide more sophisticated forms of financial support to entrepreneurial companies, such as venture capital, factoring, forfeiting, or leasing.

As the research of the Financial Inclusion Experts Group shows, access to finance is, and remains a key constraint to SMEs as well as entrepreneurial development in emerging economies. Comprehensive data on the SME finance gap is still to be more consistently collected and monitored over time. However various data sources and studies indicate that small firms rely on internal financing much more than large firms do, and that the likelihood of a small firm having access to a bank loan in low-income countries is about a third of what it is for a medium-sized firm, and less than half of what it is for a larger firm. Furthermore, other sources of SME finance, such as leasing and factoring, are also less developed in emerging countries (IFC 2010).

Several attempts to analyze access to financing by entrepreneurs in BiH can be found in the papers by Hartarska and Nadolnyak (2007), Welle-Strand et al. (2010), which are oriented towards examining the role of the microfinance sector in financing entrepreneurs, SMEs, and the poor. Hartarska et al. applies the financing constraint approach to the study whether microfinance institutions improved access to credit for microenterprises in BiH. According to this approach, microenterprises with improved access to credit rely less on internal funds for their investments.

Furthermore, the Global Entrepreneurship Monitor,[2] which has monitored entrepreneurial activity for BiH since 2008, provides a more systematic approach to covering the issue of entrepreneurial financing, but focusing on entrepreneurs and experts' perceptions of the quality and accessibility of financial sources within the BiH financial system. Experts from BiH, surveyed in the 2012 GEM Report, perceive financing as an unfavorable condition for entrepreneurship development with less equity funding available to new and growing firms compared to the previous years (Umihanić et al. 2013: 10). Moreover, GEM reports show that there are no sufficient government incentives to new and growing businesses, as evidenced by the fact that continuous growth of budget revenues in the last years was not in the function of business.

Now we turn our attention to the analysis of the present state and problems of financing entrepreneurial activities in the BiH bank-centric financial system by focusing on the demand of financial products/services offered by different types of financial institutions.

[2] For more detailed information on GEM reports see http://www.cerpod-tuzla.org/index.php/bs/gem/gem-izvjestaji and http://www.gemconsortium.org/

3 Entrepreneurial Financing in Bosnia and Herzegovina

3.1 Overview of the Financial Sector in Bosnia and Herzegovina with the Focus on Financial Institutions Supporting Financial Needs of Entrepreneurs

In order to examine and analyze the types of financial products/services offered by the financial institutions to entrepreneurs in BiH, an overview of the financial industry and key financial institutions is provided here. The financial sector of BiH is dominated by commercial banks. On the other hand, nonbank financial sector is relatively underdeveloped with the following financial institutions operating within the sector: microcredit organizations, leasing companies, investment funds, and insurance companies. The BiH financial system is bank-centric, where a dominant role is played by the commercial banks. As Fig. 2 shows, commercial banks account for 84 % of the total financial assets within the BiH financial system, while the remaining financial institutions account for 5 % or less of the total assets.

Data on the BiH financial system show that total asset value of the financial institutions in BiH supporting entrepreneurs increased during the last several years (as shown in Table 1).

According to the data provided by the banking agencies of the Federation of BiH and of Republic of Srpska, stability and security of the overall banking sector is adequate. In 2012, the capital adequacy rate of the banking sector, as the most important measure of banking sector performances, was 16.4 %, which is substantially above the regulatory minimum of 12 %. Regardless of the financial crisis, the financial system of BiH remains strong in terms of its ability to provide financial support to the non-financial sector (companies and households).

On the other hand, statistical data shows that credit activity of banks decreased during 2012, where 51.6 % of the total credits (approximately 16 billion BAM) was granted to nonfinancial companies (public and private), 42.6 % to households, and 5.2 % to the government. In the same period, microcredit financial institutions in the Federation of BiH (FBiH) granted only 2 % of the total credits (400 million BAM) to companies and 98 % to households. According to the Annual Report for 2012 of the Central Bank of BiH, there were 28 licensed banks in BiH, of which 18 operated in FBiH and 10 in Republic of Srpska (RS). There were 19 microcredit financial institutions (13 in FBiH and 6 in RS), where 15 of them are organized as microcredit foundations and 4 as microcredit organizations.[3] Leasing companies

[3] One of the main differences between microcredit foundations and microcredit institutions is related to the maximum sum of granted credit. Microcredit foundations can grant a credit up to BAM 10,000 (some 5000 euros), while microcredit organizations can grant a credit up to BAM 50,000 (some 25,000 euros).

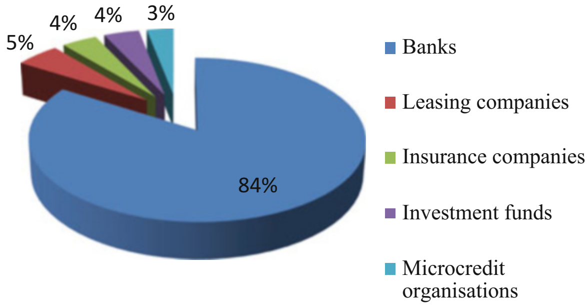

Fig. 2 Structure of financial institutions of the BiH financial sector in 2012. *Source*: www.cbbih.ba

Table 1 Total asset value of financial institutions in BiH

	2012		2011		2010	
	Value in (mil BAM)	%	Value in (mil BAM)	%	Value in (mil BAM)	%
Banks	21,187	86.3	20,923	86.0	20,416	85.6
Leasing companies	716	2.9	767	3.2	744	3.1
Microcredit organizations	681	2.8	752	3.1	853	3.6

Source: www.cbbih.ba

are less developed financial institutions with only nine being licensed for providing leasing contracts (seven in FBiH and two in RS).

Furthermore, capital markets in BiH are not used to their full potential. Organized capital markets exist within two securities exchanges (Sarajevo Stock Exchange and Banja Luka Stock Exchange), but the annual turnover at these exchanges is rather symbolic. The structure of the securities exchanges turnover shows a lack of foreign investors and a dominance of government debt securities. Private companies do not use securities exchanges to raise capital funds through stock or bonds issuing or initial public offerings. Therefore, since microcredit organizations and banks provide a major source of financing to entrepreneurs, these financial institutions are further analyzed.

3.2 Research Data

The assessment of the present state and conclusions on future perspectives of entrepreneurial financing in BiH is based on a survey conducted among banks and microcredit organizations as they are the major supplier of external financial resources to entrepreneurs. For the purposes of the survey a specific structured questionnaire was designed and sent to the above mentioned financial institutions in FBiH.

The questionnaire included 12 questions and addressed three main issues as follows: (1) the extent of financial institutions' involvement with entrepreneurs, (2) learning about motives of financial institutions' financing to entrepreneurs, and (3) determining obstacles of future involvement in financing entrepreneurs. Furthermore, key personnel of financial institutions were interviewed in order to provide better insight into financial institutions' operations.

The response rate was rather low, due to the fact that banks and microcredit organizations are known as non-transparent financial institutions. The response rate among banks was 50 % (9 out of 18 banks operating in FBiH in 2012, according to Banking Agency of Federation of Bosnia and Herzegovina (2013a), returned the questionnaire). The response rate among microcredit institutions was 23 % (in absolute terms 3 out of 13 microcredit financial institutions operating in FBiH in 2012, Banking Agency of Federation of Bosnia and Herzegovina (2013b) returned the questionnaire), but the microcredit institutions that returned the questionnaire account for more than 50 % of the total assets of the overall microcredit sector in FBiH.[4]

Furthermore, using available secondary data, we addressed the issue of government involvement in financing entrepreneurs through grants and subventions. Since venture capital market practically does not exist, we assessed the current state and future perspectives of venture capital financing in BiH by analyzing perceptions of entrepreneurs (who are starting or have established their own business) towards using venture capital.

3.3 Present State and Future Perspectives of Banks and Microcredit Organizations' Involvement in Entrepreneurial Sector

The survey data shows that commercial banks and microcredit organizations are increasing their involvement in financing entrepreneurial activities and entrepreneurial firms, where the involvement of commercial banks is in most cases linked to the survival stage of total entrepreneurial activities. Moreover, several leading banks in BiH have established separate departments to deal exclusively with entrepreneurs, which is a strong indicator of increased awareness among banks about the profitability of this segment of clients.

Financial institutions' exposure to entrepreneurs, measured as a ratio of entrepreneurs' loans to the total outstanding private sector loans, is higher among microcredit organizations (ranging up to 25 %), than among commercial banks,

[4] As the response rate was rather low for microcredit financial institutions (MFIs), more detailed information on the present state and perspectives of their future involvement in entrepreneurial sector were obtained through the interviews with representatives of MFIs who returned the questionnaires. In that respect, results presented in the following parts of the chapter are rather descriptive than quantitatively presented.

where this ratio ranges from 0.9 to 13 % for the banks surveyed. A low percentage of commercial banks' involvement in the entrepreneurial sector is expected, due to high credit risk associated with the lack of credit history of entrepreneurial firms. On the other hand, the survey shows an unexpectedly low involvement of microcredit financial institutions in financing entrepreneurs. In informal communication with the key personnel of microcredit financial institutions, it was determined that the majority of entrepreneurs do not have adequate education about available financial products/services offered by the microcredit sector and therefore, they do not use this type of the financial support to its full potential. Furthermore, entrepreneurs find microcredit products (loans) rather expensive since interest rates are approximately 3–4 times higher than the ones calculated on commercial banks' loans.[5]

In terms of the financial product types that banks and microcredit institutions use to engage with entrepreneurs, bank lending products (loans) are mainly short-term, while microcredit institutions offer mid-term and long-term loans. The most important lending products among banks are short-term loans (revolving credits) and overdrafts. These loans are used for financing current asset purchases or maintaining liquidity. Besides short-term loans, banks offer a number of different financial services to entrepreneurial firms, such as checking and savings accounts, services related to payment system, e-banking, etc. (see Fig. 3).

Microcredit institutions, on the other hand, offer long-term loans up to 5 years to prospective entrepreneurs, which are used for long term investments, such as buying equipment for production and other non-current asset. When it comes to collateral requirements for granting a loan, the surveyed banks and microcredit institutions reported using movable property, backer or bills of exchange as instruments for hedging credit risk (collateral) with entrepreneurs. Several banks indicated that they accept guarantees from other business entities for reducing credit risk, since entrepreneurial firms usually do not own significant material goods.

In order to understand motives for financial institutions' involvement in the entrepreneurial sector, banks and microcredit institutions were asked to determine the significance of different factors, using the following scale: "not significant", "significant" and "highly significant". The financial institutions were offered to assess the following factors: (1) entrepreneurs are perceived as a profitable client segment, (2) high competition among financial institutions for large corporate clients (regardless of the ownership structure), (3) high risk exposures to other client segments (households, SMEs and large corporate clients), (4) possibility to

[5] According to the statistical data on the banking sector and microcredit system published by the Banking Agency of FBiH, the average effective interest rate on commercial bank loans was 7.35 % and on microcredit loans it was 25.29 % in 2013. Furthermore, the effective interest rate on short-term loans of commercial banks was 6.8 %, while that of microcredit organizations was 26.89 %. The effective interest rate on long-term loans of commercial banks was 7.95 %, while that of microcredit organizations was 24.82 %. (Information on the banking sector of FBiH as of Dec 31, 2013, p. 48 and Information on the microcredit system of FBiH as of Dec 31, 2013, p. 22.)

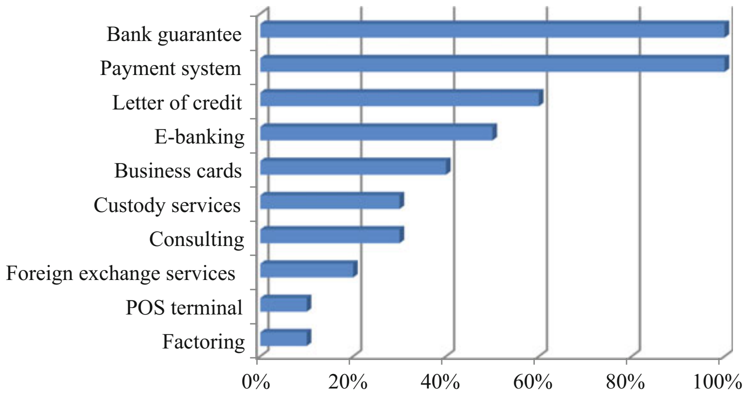

Fig. 3 Other banking services offered to entrepreneurial firms. *Source*: Authors' research

obtain information about prospective clients from the existing ones, and (5) Other factors (specify).

Microcredit institutions highlighted the following three factors as highly significant: profitability of entrepreneurial client segment, possibility to obtain information about prospective clients from the existing ones, and motivation to promote new job openings, and production increase. All the surveyed banks indicated that profitability of entrepreneurial clients segment and high competition among financial institutions for large corporate clients (regardless of the ownership structure) are significant factors for their involvement in entrepreneurial firms, while only one bank indicated the possibility to obtain information about prospective clients from the existing ones as a highly significant factor.

Regarding perspectives of future involvement in entrepreneurial clients segment, all of the surveyed banks and microcredit organizations reported that they intend to increase their involvement in this segment of clients. Moreover, we assessed the degree to which this involvement is affected by certain obstacles. Financial institutions were offered to assess the following obstacles to future increase of involvement in entrepreneurial firms as follows: (1) entrepreneurial specific factors, (2) competition in entrepreneurial client segment, (3) macroeconomic factors, (4) regulations, (5) legal and contractual environment, (6) lending technology, (7) lack of adequate demand (8) bank specific factors, and (9) other factors (specify).

All the surveyed banks and microcredit institutions indicated entrepreneurial specific factors and regulation as the most significant obstacle to further involvement in the entrepreneurial sector. Macroeconomic factors, lack of demand, and bank specific factors were perceived as not significant. None of the surveyed financial institutions indicated highly significant obstacles for their future involvement with entrepreneurial clients, which may lead to the conclusion that a better regulation within the entrepreneurial sector and better understanding of particular entrepreneurial entity (or an entrepreneurial idea) will help to increase the involvement of financial institutions with entrepreneurs in the future.

Since improper regulation is regarded as the most significant obstacle to stronger relation between entrepreneurs and the financial sector, the surveyed financial institutions were asked to indicate concrete measures and possible areas in which government actions could help enhance institutions' incentives to increase their involvement with entrepreneurs. Their responses can be summarized in the following actions:

– creating a positive business environment,
– tax system reform focusing on tax exemptions or deductions for entrepreneurial firms,
– greater government subventions and grants for entrepreneurial projects,
– interest rate subventions for employment and production, and
– reform of the legal and judicial sectors.

Concrete measures at the level of financial institutions and government are moving towards a joint approach of financial institutions and different levels of government (state, entity and cantonal) in supporting entrepreneurial activities.

3.4 Government Grants and Subventions to Entrepreneurs

When it comes to government support to the entrepreneurial sector, government financial support to entrepreneurs in BiH is implemented through grants and subventions at several government levels (entity, canton and local level). According to the available statistical data, the amount of grants and subventions at the federal level was less than 0.5 % of the total annual budget of FBiH for the last several years. Table 2 shows a more detailed breakdown of subventions and grants disseminated through the Federal Ministry of Development, Entrepreneurship and Crafts.

According to the data of the Federal Ministry of Development, Entrepreneurship and Crafts, most subventions and grants are granted for different purposes, such as:

– building entrepreneurship infrastructure,
– support for entrepreneurship associations,
– subventions of interest on loans,
– women entrepreneurship,
– youth entrepreneurship, etc.

Financial sources are granted through public announcements on an annual basis and in accordance with the national program of measures for development of small businesses. Due to inadequate regulations, financial sources available to different private sectors (and therefore, entrepreneurial firms) are ten times smaller than those available for public enterprises. Statistics show that, just before the economic crisis in 2008, financial sources provided for the public sector amounted to 100 million BAM (around 50 million euros, while for small and midsized companies this amount was 10 million BAM (around 5 million euros. This treatment of public

Table 2 Financial support to entrepreneurship and agricultural and rural development from the Budget of FBiH

Year	2009		2010		2011	
Total budget of FBiH	1,988,877,738		1,734,227,815		1,645,041,660	
Sector	Entrepreneurship			Agriculture and rural development		
% provided from Budget in BAM	up to 2			from 2 to 6		
Allocated sources from Budget in BAM	2009	2010	2011	2009	2010	2011
	4,100,000	8,005,000	6,308,330	49,198,591	56,237,203	51,931,974
Percentage of subventions and grants from Budget	0.21	0.46	0.38	2.47	3.24	3.16
Percentage of employed in the sector in the total amount of employed persons in BiH	56			20		
Percentage of GDP of FBiH	50			5		

Source: Audit office for the institutions of FBiH (2013)

enterprises put non profitable and poorly managed companies in a better market position than the private sector (Martinović et al. 2012: 342).

3.5 *Venture Capital and Venture Capital Funds in BiH*

Venture capital is a major and the most important source of external financing in the total early entrepreneurial activity. Therefore, entrepreneurial activity is dependent on venture capital market development. The venture capital market in Europe started developing in the early 1990s and showed steady growth up to the financial crisis in 2008. The financial crisis in 2008 followed by the European sovereign debt crisis had a profound impact on the investments in venture capital funds, which can be observed from Fig. 4.

Figure 4 shows a steep decline of venture capital fundraising activity in European venture capital market in 2009 and 2010 with short-term recovery in 2011, following another decline in 2012.

In Western Balkan countries, venture capital funds are relatively new financial institutions. The first association (South Eastern Europe Private Equity Association—SEEPEA), promoting industry of venture capital in South Eastern Europe was established in 2005. There have been some positive developments it the

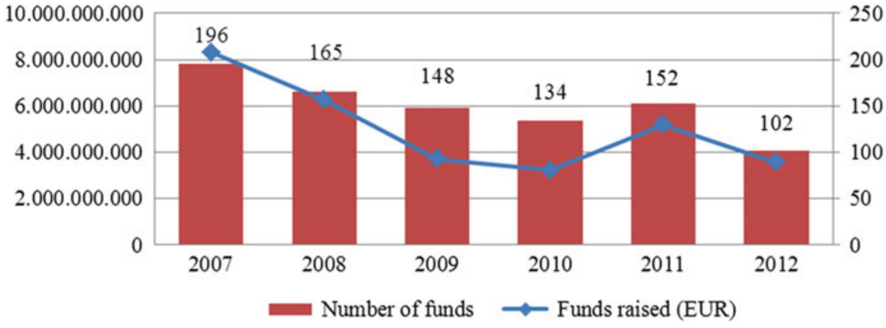

Fig. 4 Fundraising activity in Europe. *Source*: EVCA

Western Balkan region indicating the overall increase in the venture capital activity. This type of financing is becoming more common across this region, including BiH (Kozarević et al. 2013: 442). Croatia and Serbia have established an institutional framework for venture capital. Furthermore, in the above-mentioned countries, associations for promoting venture capital, as well as business angles networks have been established. On the other hand, the venture capital market in BiH can be characterized as nonexistent. One business angle network was established in 2013, but the network does not pursue significant activities. According to the Venture Capital and Private Equity Country Attractiveness Index, BiH was on the second place among Western Balkan countries and 73rd on the global rankings.

As for perspectives of venture capital market development in BiH, it is important to support and stimulate an entrepreneurial culture. In other words, it is necessary to develop a functioning market where innovative businesses can grow. In order to implement this complex task it is important to have in mind that the venture capital market needs three types of subjects: innovative entrepreneurs, investors (with liquid funds and aspiration to long-term investing) and specialized financial intermediaries (Softić 2013: 85–86). BiH Herzegovina lacks specialized financial intermediaries, while there is a growing entrepreneurial culture and investors with sufficient funds to invest in entrepreneurial ideas.

Furthermore, it is important to point out that the results of an empirical study conducted in BiH clearly indicate that the local companies have a very limited understanding and knowledge about financing options through venture capital funds. This highlights the need for proper education and informing in this area. While there is a strong aversion to equity sharing (ownership dilution), entrepreneurs are aware of the benefits associated with the financing through venture capital funds. Therefore, better education and stronger knowledge of venture capital funds would help reduce the predominantly negative perception about this type of fund raising in this particular region (Kozarević et al. 2013: 442).

4 Concluding Remarks and Further Research

The overall conclusion of the research can be summarized in the fact that financial infrastructure supporting entrepreneurship in the total early stage of entrepreneurial activity in BiH is underdeveloped. The most important structural part of this infrastructure namely venture capital market is still practically nonexistent. The following reasons might explain undeveloped venture capital market: poor entrepreneurial culture and infrastructure in BiH and lack of adequate practical government support for promoting entrepreneurship (legal documents in form of action plans do exist, but implementation of the defined measures fails).

The financial sector of BiH is bank oriented. The banking sector, together with the microcredit system, is the primary source of financing for entrepreneurs. However, financial products/services offered by these financial institutions are expensive for young and growing businesses often suffering from low and irregular cash-flow. Moreover, commercial banks offer mostly short-term loans, which are not adequate for financing long-term projects and development plans of entrepreneurial firms. It is positive that commercial banks and microcredit finance institutions accept guarantees from other business entities as the collateral on loans for entrepreneurs, which is of great help to entrepreneurial firms when seeking for long-term financial solutions.

Government support exists in the form of grants and subventions to different interest groups supporting entrepreneurship. Still, the percentage of the budget disseminated for entrepreneurship is low. Based on the information from the financial institutions in BiH, the following measures need to be implemented by the government bodies in order to further develop financial infrastructure for entrepreneurs: creating a positive business environment, tax system reform focusing on tax exemptions or deductions for entrepreneurial firms, greater government subventions and grants for entrepreneurs projects, interest rate subventions for employment and production, and reform of the legal and judicial sector.

Furthermore, research shows that the majority of entrepreneurs are not educated about the available financial products offered by the microcredit sector and therefore do not use this type of financial support. Similar conclusions can be made for venture capital financing, where entrepreneurs have strong aversion to venture capital and ownership dilatation associated with venture capital. Banking financial products, on the other hand, are becoming more available to entrepreneurs. Banks perceive the entrepreneurial segment as profitable due to the lack of profitable opportunities related to large clients (large companies) and the SME sector. The banking sectors' greater involvement in the entrepreneurial sector is evident through the changing organization of banks, where major banks in BiH are creating separate departments, which exclusively support entrepreneurial clients and offer specific products created to aid entrepreneurial firms.

In that respect, further research should address a more in-depth analysis of entrepreneurs' perception of financial sources available for businesses operations. This research has provided two main contributions. One is to help in better understanding of entrepreneurs' needs for external financial sources, as well as for other financial services. The other benefit is to help financial institutions create better-tailored financial products for entrepreneurs, which will increase financial institutions' presence in the entrepreneurial sector.

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