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Entrepreneurship in Transition Countries: A Review

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Abstract

The aim of this paper is to provide an overview of the key issues surrounding entrepreneurship development in transition countries focusing on six main themes. Though it can be argued that the transition countries started from more or less the same point when they embarked on their transitional path, in this paper, we indicate a number of the differences in initial conditions which further influenced SME development. By surveying the existing literature on SME development, this paper illustrates that as the transition process progresses, entrepreneurship development in transition countries is a story of increasing divergence. The transitional context provides unique opportunities for entrepreneurship activities to develop. However, at the same time this environment presents unique challenges for entrepreneurial development especially knowledge-based entrepreneurship as the free-market system matures within a context with low levels of SMEs and inherited negative views towards entrepreneurship

Introduction

The late 1980's was characterized by the unprecedented collapse of the Soviet Union and the subsequent demise of the centrally planned economic system in Central and Eastern Europe. This began a process of social, political and economic transformation that continues more than sixteen years later. Initially, many transition countries followed the policies supported by the International Monetary Fund and the World Bank which focused on privatisation, liberalization and stabilization. Small-scale privatisations of shops and restaurants resulted in the creation of a small private businesses sector. However, beyond this limited form of small business development, little attention was paid directly to the formation of the new private sector based on de novo enterprises (i.e. new businesses). In spite of this, the early 1990's were characterised by exponential growth in newly created private enterprises mainly driven

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by the tremendous consumer demand for products and services previously unavailable under the centrally planned system. By the mid to late 1990's, however, the picture started to change, with a general declining trend in new business development experienced in most transition countries (Smallbone and Piasecki 1995; UNDP 1998; Kontorovich 1999; Glas et al. 2000). Increasing regulations, increasing levels of domestic as well as foreign competition, lack of financing and decreasing customer demand are some of the main reasons given for the diminishing levels of private enterprises. Though this decline is to be expected as business entry peaks early in the life of a market (Geroski 1995), of specific concern is the generally low level of total private business activity in many transition countries in the late 1990's as compared to countries in Western Europe.

As Aidis and Sauka further note, SMEs are of special importance to transition countries for a number of reasons (2005). Firstly, they are able to provide economic benefits beyond the boundary of the individual enterprise in terms of experimentation, learning and adaptability. These characteristics are especially important in economies undergoing radical transformation such as has occurred in the formerly centrally planned countries. Secondly, research in transition countries shows, that even if SMEs do not generate net new jobs, they reduce the erosion of human capital by providing alternative employment opportunities for relatively skilled yet unemployed workers (EBRD 1995). Though it is often argued that SME development is especially crucial for the early phases of transition (EBRD 1995; Smallbone and Welter 2001), it is, in fact, just as important for the advanced stages of post-transition. As Michael Porter (1990) has argued, invention and entrepreneurship are at the heart of national advantage and country competitiveness.

The aim of this paper is to provide an overview of the key issues surrounding entrepreneurship development in transition countries. Though it can be argued that the transition countries started from more or less the same point when they embarked on their transitional path, in this paper, we highlight a number of the differences in initial conditions which further influenced SME development. In addition, we emphasize how different political and economic choices have further influenced entrepreneurial development. By surveying the existing literature on SME development, this paper illustrates that entrepreneurship development in transition countries is a story of increasing divergence.

Though entrepreneurship is an intensely researched subject in the social sciences as well as an important issue for policy-related decision-making, it remains an ill-defined concept. In this paper, entrepreneurship is examined as it takes place in small and medium size enterprises (SMEs). Previous research has indicated that the two are found to be closely related. As S. Wennekers and R. Thurik note: 'Small firms are the vehicle in which entrepreneurship thrives' (1999:29).

Similarly, the transition process itself is an ill-defined concept. No single indicator or definition currently exists that accurately describes the end of transition. A number of authors have suggested that the end of transition is achieved by reaching the level of an 'advanced market economy'. Unfortunately there exists no generally acceptable definition for what precisely characterizes an 'advanced market economy'[1]. However, it seems clear that the eight transition countries that are now EU members fulfil the criteria and could be categorised as post-transitional countries. For the remaining transition countries, the criteria are less clear. For simplicity's sake, in this paper, all countries in transition, whether in an early, late or post stage will be referred to as transition countries.

In the following seven sections, this paper analyses the issue of entrepreneurship in transition countries by highlighting six main themes. The first three sections serve as an introduction to entrepreneurship in the transition context. Section 1 presents the specific characteristics of entrepreneurship in transition countries both in terms of regional similarities and differences; Section 2 discusses the specific stages of SME development in the transition context highlighting the experiences in Russia, Lithuania and Poland; and, in Section 3, the potential impact of EU accession for SME development in the eight new EU member 'transition' countries is addressed.

These first three introductory sections are then followed by sections four through six that raise issues important within the field of entrepreneurship analysis and applies them to the context of transition. Section four discusses the concept of declining market

[1] For further discussion, see Brown (1999).

development and declining SME rates as it applies to the transition context. Section 5 raises the relevance of classifying entrepreneurs into necessity and opportunity categories in the context of transition and section 6 discusses the issue of knowledge-based entrepreneurship and its development in the transition countries. This paper ends with concluding remarks in section 7.

Of critical importance in the transition country context is the challenge of obtaining reliable data on entrepreneurship (see appendix 1 for further discussion). In this paper, we utilize the data available from research utilizing both quantitative and qualitative methodologies.

As the following sections of this paper demonstrate, the transitional context provides a unique environment for entrepreneurship activities to develop. However, at the same time this environment presents unique challenges for entrepreneurial development especially knowledge-based entrepreneurship as the free-market system matures within a context that inherited negative views towards entrepreneurship.

1. Entrepreneurial characteristics in transition countries

In this section, based on a literature review, we present the general characteristics of entrepreneurs in the transition countries highlighting the effects of the environment, the role of the state and business owner characteristics on entrepreneurship development. In addition, we also differentiate between entrepreneurs in the Central and Eastern European Countries including the Baltic States (CEEB) and entrepreneurs in the Commonwealth of Independent States (CIS).

General characteristics

Table 1 presents the general characteristics of entrepreneurs in the transition countries. Though a number of the characteristics outlined below may also be applicable to small enterprises in western developed countries, the distinguishing difference is one of degree since some barriers may be similar to those experienced by SMEs in western developed countries however they tend to affect business more severely in the transition context (Smallbone and Welter 2001).

Environment. The main characteristic all transition countries share is the transition process i.e. the switch from a centrally planned economic system to a more market-oriented system. Though different in terms of degree of change, all transition countries have experienced dramatic changes to socio-economic and political conditions on the macroeconomic level. In addition, on the microeconomic level, all transition countries have had to address the 'reorganization of work' (Johnson and Loveman 1995) which includes the acceptance of private forms of enterprise. Even though in some CEE countries limited forms of private enterprise were allowed even under socialist regimes, most transition countries lack a recent 'productive' entrepreneurial tradition (Smallbone and Piasecki 1995). A 'hostile economic environment' (high inflation rates, persistently high unemployment rates, declining real earnings, etc.) again in various degrees, has characterized the transition process (Smallbone and Piasecki 1995; Smallbone and Welter 2001). The lack of private enterprise tradition in most transition countries resulted in an absence of business infrastructure (Smallbone and Piasecki 1995). Moreover the initial growth of private business activity coupled with the implementation of neo-liberal transition programs resulted in a lack of private business support services (ibid.).

Gros and Suhrchke (2000) conducted a comprehensive analysis of the similarities and differences between transition countries in Eastern Europe and comparable developing countries. Their analysis highlighted that the transition countries had certain common characteristics in the initial stages of reform such as a concentration of firms in the industrial and manufacturing sector, the underdevelopment of financial systems as well as low legal and governance standards.

In addition, a number of studies have indicated that lack of finance is a barrier for businesses in the transition context (Roman 1991; World Bank 1995; Slonimski 1999; Pissarides et al. 2000; Glas et al. 2000; Hashi 2001; Bartlett and Bukvic 2001; Kaganova 2002; Aidis 2003; Bartlett 2001; EBRD 2002; Pissarides 2004). Additional environmental barriers that interfere with day-to-day business operations include low purchasing power (Aidis 2004), lack of qualified workers (Bohata and Mladek 1999), access to equipment and premises (Radaev 2003) and late payment by clients (Bartlett and Bukvic 2001). Finally skill-based barriers such as the lack of business-related skill development stem from the absence of previous private business experience in transition countries (Roberts and Tholen 1998). In many cases, private business owners may not be aware of their skill shortcomings though it can impede with the survival and growth of private businesses in transition countries (Aidis 2004).

Role of the State. Initially many transition countries took a neo-liberal stance (often under the guidance and pressure from the IMF) and exhibited a general hesitance to intervene in market processes (Smallbone and Piasecki 1995). As would be expected, policy mistakes were made especially in areas where there was little previous experience such as with the introduction of a business tax system and business legislation. However, national governments were also reluctant to take responsibility for the effects of bad policies on private business development (ibid.). A later trend has been the tendency for transitional governments to over-regulate and interfere with private business activities reducing the expansion and growth of the private business sector. Over regulation and interference in the private sector further led to increased levels of corruption (Dallago 1997; Frye and Shleifer 1997; Bartlett and Bukvic 2001; Smallbone and Welter 2001). Finally, of significance influence is the negative attitude towards private business owners and entrepreneurs inherited from the values propagated by the centrally planned system that continues to influence government officials in the transition context (Marot 1997; Glas et al. 2000).

The most important state-related barriers seem to be related to either the high level of taxes, the frequent changes to tax policies, the ambiguity of tax policies (World Bank 1995; Bohata and Mladek 1999; Hashi 2001; Bartlett and Bukvic 2001; Aidis 2004; Radaev 2003; EBRD 2002) and/or the general regulatory environment (World Bank 1995; Glas et al. 2000; Hashi 2001; Kaganova 2002). Informal barriers such as the implementation of regulations (Bartlett and Bukvic 2001) especially property rights (Radaev 2003), bureaucracy (Radaev 2003) corruption (Bohata and Mladek 1999) and unfair competition from a large informal economy (Glas et al. 2000; Muent et al. 2001) are also often mentioned as barriers to private business development.

Business Owner Characteristics. As Roberts and Zhou have indicated, for many business owners in transition countries, private business ownership signalled the start of a new career (2000). Business owners under these conditions tend to come from diverse social origins and backgrounds. In addition, given the underdevelopment of the private sector, many business owners in transition countries used quite rudimentary and primitive business methods but still obtained profitable results (ibid.). Furthermore, the lack of developed business infrastructure and support services leads many business owners to depend on business assistance (financial, advice, etc.) through private networks. Most business owners also exhibit scepticism towards the national government in terms of their ability and/or willingness to support (or simply not interfere with) private business development (Smallbone and Piasecki 1995). Though business owners are often critical of the government, they tend to adopt a passive rather than pro-active attitude[2]. In addition, new business legislation and taxes create difficulties for business owners in transition countries who generally lack experience with income and profit tax or private business legislation (Roberts and Zhou 2000). Finally, private business owners in transition countries tend to be more progressive and market oriented than the general population (ibid.). In that sense, they are greater supporters of market oriented changes and reform.

Another rather unique characteristic of entrepreneurship development in transition countries is the transfer of illegal entrepreneurship experience (gained while private enterprise was restricted under the former regime) to legal forms of private enterprise under the current market-oriented regimes. In their study of the factors that influence entrepreneurial success in five transition countries, Earle and Sakova (2000) find that business owners who had operated a side business in the pre-transition year of 1988 increased their probability of having a business with employees in 1993. Based on data of Lithuanian business owners, Aidis and Van Praag (2004) explore the impact of having 'illegal entrepreneurial experience' (i.e. experience with a private enterprise before it was legalized in Soviet Lithuania) on the business performance of their legal enterprises. Their results indicate that though illegal entrepreneurship experience (IEE) does not

[2] This seems to be a legacy of the post-socialist state. See also Kobeissi (2001).

significantly influence business size, turnover or intention to grow, IEE is significantly associated with subjective measures of business motivation. Therefore, IEE could be used as a signal for potential legal entrepreneurship bringing positive qualities such as

Table 1: Entrepreneurship in transition countries: General characteristics

Factor	**General characteristics**
Environment	Macro: Dramatic changes to socio- economic and political conditions
	Micro: The reorganization of work
	Lack of recent 'productive' entrepreneurial tradition
	Hostile economic environment
	Initial explosion of business activity followed by declining SME start up rates
	Absence of business infrastructure and support services
	Lack of external financing
The role of the state	Neo-liberal governmental stance; hesitant to intervene in market processes
	No previous experience with business tax system or legislation
	Negative attitude towards entrepreneurs
	Over-regulation, interference, corruption
Business owner characteristics	New Business, new career
	Diverse social origins
	Primitive business methods
	Dependence on assistance through private networks
	Government scepticism
	Passive, bureaucratic attitude
	No previous experience with business tax system or legislation
	More progressive and market-oriented than the general population
	Illegal entrepreneurship experience

Source: Adapted from Aidis (2004)

persistence and higher levels of motivation to business development. Interestingly enough, the data does not associate a higher level of corruption or tax evasion for entrepreneurs with IEE than with those who have never been involved in illegal entrepreneurship[3]. However, further research in this area is needed to uncover the extent of influence IEE has on legal business development during the transition process.

In table 2, we differentiate between CEEB and CIS countries according to the same three dimensions presented in table 1: environment, role of the state, and business owner characteristics[4].

Environment. The affinity with Europe and the European Union countries has had a strong influence on the more western-oriented development chosen by CEEB countries. For many, the memory of private enterprise as well as the retention of a small and limited private sector even during the socialist period, has resulted in a more rapid development of a private sector. Moreover, in most CEEB countries, the profound changes to the existing socialist political and economic order has led to the replacement of old political elites (Roberts and Tholen 1998).

The situation for business owners in the CIS is quite different. In many CIS countries a dominance of the old Russian language networks continues to link newly independent CIS countries to Russia (Roberts and Tholen 1998). As a result, the Mafia-style capitalism that developed in Russia is having a broader regional influence[5]. Most CIS countries have no memory of private business ownership and Soviet policies resulted in a non-existence of private business culture during communist rule. Even though the collapse of the Soviet Union resulted in the emergence of many new independent countries, most ruling elites remained in power, in many cases simply changing their names (ibid.).

Lack of financing forms a barrier in both CEEB and CIS countries, albeit in different ways. The existing literature indicates that in countries where the process of

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[3] Based on the author's unpublished results.

[4] We recognize that there are differences between countries that we have grouped into two categories. However, for the purposes of this analysis, the two categories (CEEB countries and CIS countries) most clearly delineates the differences between transition countries.

[5] In Russia there is a gradual transition from Mafia-style capitalism to a market-oriented economy with 'Russian characteristics' (Ellman 2000).

transition has been delayed such as in Albania (Hashi 2001), Belarus and the Ukraine (Smallbone et al. 2001), finance is a more significant barrier to SMEs. But in countries such as Poland which is further down the transition path, finance forms less of a barrier since the mid 1990's[6] (Woodward 2001). This trend seems to be mainly due to a more highly developed banking sector that has taken an interest in SMEs. However in the case of the Kyrgyz republic, an example of a slow reformer, finance is also not found to form a serious problem to SMEs (Anderson and Pomfret 2001). This rather surprising result seems influenced by the fact that most SMEs in the Kyrgyz republic are very small (micro firms) operating in the services sector and most of the financing requirements can be met through self-financing and family sources. Financing does however seem to form a main barrier for newly emerging firms in the intermediate stages of transition. In a study of 800 SMEs in South Eastern Europe (Bosnia-Herzogovina, Macedonia and Slovenia), the high cost of credit and loans was found to be the most significant barrier to employment growth in Slovenia and Macedonia but not Bosnia-Herzogovina (2001). However, financing is a complex issue to analyse since there are several interacting dimensions: firm size and sophistication, general macroeconomic development, competition, the existence of informal sources of financing and the development of the banking sector.

Using the Amadeus database, Klapper et al. (2002) further analysed firm financing in 15 transition countries addressing some of the above mentioned dimensions. Most countries exhibit a relatively low level of outside financing with Ukraine having the lowest level. Firms in 6 (Bosnia- Herzegovina, Bulgaria, Russia, Slovenia, Ukraine and Yugoslavia) out of the 15 countries have total liability ratios of less than one which suggests that the firm borrows less than $1 USD for every $2 USD invested in equity. This is quite low compared to the median leverage ratio of $1.73 USD for the Amadeus sample of Western European firms. There is also almost no use of long-term debt which could indicate an underdevelopment of the banking sector, poor collateral law and weak collateral registries. A significantly positive relationship is found between a business environment that promotes access to financing and the size of the SME sector. For

[6] For example, there continues to be low demand for commercial credit for micro-enterprises in Poland (Soblewski and Woodward 2002).

example, Klapper et al. find that a better legal environment i.e. that allows banks to write strong contracts and have such contracts enforced in a court of law, increases the percentage of SMEs. They also find that greater foreign bank assets is related to a higher

Table 2: Differences between entrepreneurship in CEEB and CIS countries

Factor	**CEEB countries**	**CIS countries**
Environment	Affinity with Europe and European Union countries	Dominance of old Soviet Russian language networks
	Western-oriented development	Mafia-style capitalist development
	Memory of private businesses	No memory of private businesses
	During socialist period, small and limited private business culture sustained	During socialist period, private business culture non-existent
	Communism collapsed and resulted in a rotation of political elites	Communism collapsed with only partial rotation of political elites
	Lack of financing	Lack of financing
	Lower levels of corruption	Higher levels of corruption
The role of the state	Invisible hand model	Grabbing hand model
		Inspection culture
		Lack of rule of law – social networks
Business owner characteristics	Specialization of business activities	Business development focused on the 'big strike' or getting rich quickly; coping with unstable market conditions
	Full-time private businesses	Generic business activities
	Diversified business sectors	Business activities primarily engaged in trade
	Business development seen as a gradual step by step process	Part-time businesses in combination with employment in the state sector
	Individuals businesses are the dominant form	Partnerships for business protection and survival predominate
	Businesses function in official economy	Businesses function in both official and informal economies

Source: Adapted from Aidis (2004)

percentage of SMEs and a negative relationship with state-owned bank assets, which may suggest that foreign bank entry encourages domestic banks to lend downstream to smaller customers[7].

Wachtel (1999) identifies that a variety of financing options are needed in transition countries such as micro lending programmes, trade credit, bank lending, venture capital and equity markets. More sophisticated forms of firm financing such as venture capital has been especially slow to develop in transition countries. There are few studies on this topic[8]. Even less is known about informal sources of funding from business angels.

Corruption continues to be a worrisome impediment for private sector development in the transition region. However, it is a much more serious issue in the former CIS countries[9] than in the CEEB countries. As the results from the corruption perceptions index prepared by Transparency International in table 3 shows, compared to most advanced western countries, transition countries generally exhibit higher levels of corruption with clearly the highest corruption levels occurring in the CIS countries.

Table 3: Corruption Perceptions index 2004 (out of 145)

	Rank		Rank
Estonia	31	Russia	90
Slovenia	31	Albania	108
Hungary	42	Moldova	114
Lithuania	44	Uzbekistan	114
Czech R.	51	Kazakhstan	122
Bulgaria	54	Kyrgyzstan	122
Latvia	57	Georgia	133
Slovak R.	57	Tajikistan	133
Poland	67	Turkmenistan	133
Belarus	74	Azerbaijan	140
Armenia	82		
Romania	87		

Key: Lower scores indicate lower levels of corruption.
Compared with Finland which ranks number 1; the UK which ranks 11th and Japan which ranks 24th.
Source: Transparency International (2005)

[7] Other results indicate a positive link between profitability and leverage (short-term debt) which suggests a relationship between profitability and access to working capital financing. Also younger firms are found to have higher leverage and growth while older and larger firms have smaller cash ratios and are more dependent on internal sources of financing (Klapper et al. 2002).

[8] An exception is an article by Karsai et al. (1998) which examines the Hungarian venture capital industry which is one of the best developed in the transition countries. One of their main findings is the need for venture capitalists to obtain control is found to be much stronger in Hungary than in the US.

[9] In some CIS countries such as Russia, entrepreneurs have been found to be more corrupt than the population as a whole (Djankov et al. 2005).

The Role of the State. For the most part, CEEB countries ascribe to an 'invisible hand model' of government that limits intervention or interference in private business development. Though in practice a spectrum of experiences have emerged with a tendency for over regulation and governmental interference of the private sector. However, the situation is more extreme for CIS countries. The Soviet state was built on an ideology that stifled independent innovative culture and allowed for a punishment-oriented 'inspection culture' to develop. The disintegration of the Soviet Union has led to a political and economic vacuum in many CIS countries which has facilitated the development of a 'grabbing hand model' of government intervention. This type of governmental structure is characterized by corrupt behaviour occurring in a disorganized way that leads to the personal enrichment of governmental officials to the detriment of the rule of law and private business development (Frye and Shleifer 1997).

Moreover, in cases where the government is less interested in implementing pro-market reforms, the state can itself become the key institution which generates barriers for SME development (Johnson et al. 1997; Bartlett 2001; Smallbone and Welter 2001). A 85-country study by Djankov et al. (2002) which includes transition countries further demonstrates a direct relationship between highly regulated business environments and corruption. Friedman et al. (1999) have also found substantial evidence indicating that entrepreneurs tend to go 'underground' not to avoid taxes but to reduce the burden of bureaucracy and corruption (i.e. dodging the 'grabbing hand').

In a study comparing new firms in Poland, Slovakia, Romania, Russia and Ukraine, Johnson et al. (2000) identify that in addition to macroeconomic stability and adequate financing, insecure property rights inhibit the development of the private sector. This was especially clear for Russia and Ukraine. Furthermore, an additional study of firms in these five countries by Johnson et al. (1999) indicates that relational contracting, i.e. informally enforced through networks, plays a significant role in the transition environment especially in cases where the existing court systems are inadequate. These two studies illustrate the importance of a stable rule of law in terms of enforcement of property rights and a functioning court system for private business development. The lack of a rule of law is a much more critical issue in CIS countries than in CEEB countries.

In the absence of functioning formal structures, informal networks gain importance for business development. To test the importance of social capital, Batjargal (2003) uses a social embeddedness approach, to examine the impact of entrepreneurs' social capital on their firm's performance in Russia. Based on interviews conducted in 1995 and 1999, Batjargal finds that relational embeddedness (the quality of personal relations on economic actions) and resource embeddedness (networks allowing access and use of resources) have direct positive impacts on firm performance whereas structural embeddedness (the structure of the overall network of relations) has no direct impacts on performance (as measured by revenue and profit margin). Similarly, case study information provides further support for the notion that having the right network connections (or employing individuals that do) facilitates business success in Russia (Kets de Vries and Florent-Treacy 2003) whereas not having access to networks may make private businesses more vulnerable to rent-seeking officials (Glasser 2004). The ability to successfully utilize social capital also seems to be different for male and female entrepreneurs. Evidence from survey research in the CIS countries of Ukraine and Moldova suggests that female networks are often not very helpful for business growth (Welter et al. 2004)[10].

Business Owner Characteristics. Private business owners in CEEB countries tend to operate their business activities in a diverse array of business sectors and for the most part, view their businesses as a full-time endeavour (Roberts and Tholen 1998). In this context, business development is seen as a gradual step-by-step process. Individually run businesses versus business partnerships are the dominant form of private business engagement. For the most part, private businesses function (at least partially) in the official economy.

[10] One problem is related to the limited size of the female business community, but more importantly are the characteristics of the networks used. Men can draw on their contacts in high-level administration as well as on their fellow entrepreneurs (who are more numerous and typically more experienced in business), using informal contacts from Soviet times. Thus, the difference between female and male networks is not in gender as such, but more related to the quality of the networks. Spouses or family might be needed to enlarge the network through paving the way into the male network, and business associations may play a particularly important role in giving women entrepreneur's access to other entrepreneurs (Welter et al. 2004).

In contrast, given the unstable economic and political conditions in a number of CIS countries, many business owners focus on short-term get-rich-quick business strategies instead of long-term business growth (Roberts and Tholen 1998). In addition, business owners in CIS countries tend to engage in generic business activities (many activities at once in order to spread risk) and are primarily involved in trade activities (ibid.). Many business owners are also still employed in the state sector and engage in their businesses as a part-time activity (ibid.). Business partnerships are the dominant form of business activity since they seem more effective in protecting business operations (ibid.). Also, many private businesses function in both the official and informal economy (Roberts and Tholen 1998: Kontorovich 1999).

With the weak role of the transitional state and the legacy of black market activities characterising the centrally planned economies, it was no surprise that a large informal sector would emerge during the transition process. Though difficult to measure, estimates of the size of the shadow economy in the transition countries indicate that this sector is larger than the OECD average (which was 18 percent of GNP in 2002) (Schneider 2002). The average size of the shadow economy in transition countries is approximately 38 percent. The shadow economy is largest in CIS countries ranging from over 67 percent in Georgia and over 52 percent in the Ukraine to just over 46 percent in Russia. The percentages are much less in the CEEB countries ranging from just over 30 percent for Lithuania to almost 19 percent in the Slovak republic, with most CEEB countries having a shadow economy which is 20 – 30 percent of GNP (ibid.). As the transition economies advance in enforcement of the 'rule of law' and the elimination of market distortions, it can be expected that the size of the informal economy will shrink. However, in 'delayed' transition countries such as Albania, Belarus and the Ukraine, the informal economy will probably continue to form a substantial amount of the non-registered entrepreneurial activity. As a result, distorting the official data on SME activity. Moreover, hiding business output is significantly associated with high bureaucratic corruption in Poland, Slovakia and Romania (Johnson et al. 2000)

In an attempt to gain a broader understanding of the factors affecting SME development and transition stages, Aidis and Sauka (2005) make use of the results of 35 existing empirical studies on SMEs in transition countries. They first categorize the transition countries in terms of stage of transition based on European Bank of Reconstruction and Development (EBRD) transition indicators into three categories: primary, secondary and advanced stages. The barriers encountered by SME at different stages are then classified into formal, informal, environmental and other categories (based on institutional theory). The authors find that as the transition stage moves into the advanced stage, SME owners become increasingly more concerned with human resource (labour) and skill development (training) then at the initial stages (for table see appendix 2). This may indicate that there is an increased need to develop internal business capabilities to deal with increasing competition as well as business growth such as specific consulting and business training programmes. Three formal constraints: taxes, policy instability and legal regulations form a barrier for business development throughout the transition stages. Access to finance also continues to be a barrier to businesses throughout the three transition stags but it seems that the types of financing needed is affected by transition stage. In the primary or secondary stages the emphasis lies on the need for micro-credit and short and long term bank loans, the more advanced stages necessitate more sophisticated financing such as venture capital and stock listings. As Pissarides (2004) has indicated, it is important for financing opportunities to adapt to the requirements of SME owners as transition progresses, allowing for more complex forms of financing including venture capitalists in more advanced stages. However, there are different viewpoints as to the sequence of funding and institutional building needed for SME development[11].

[11]The finance first approach stresses that the key barrier to SME growth can be overcome by the provision of subsidized or low-cost finance by the creation of credit guarantee agencies, through micro-credit schemes or through the establishment of venture capital funds (Pissarides 1999). This approach tends to be followed by the EBRD. The other view stresses that no amount of low cost credit or easy access to equity finance will overcome the barriers to SME growth if the institutions of the market economy are absent, if there is unfair competition, or if there is a low level of trust and social capital to underpin transactions and minimize the transaction costs of doing business. This view tends to be supported by the EU PHARE programme projects.

2. Stages of SME development in three contexts: Russia, Lithuania and Poland

In this section, the distinct stages of SME development in the transition context are illustrated by presenting a brief overview of the case of two former Soviet countries: Russia and Lithuania and Poland.

In Russia, four clear SME stages of development can be identified (Radaev 2003). The first stage (1986 – 1991) is characterised by SME growth and expansion into almost 'virgin lands' of the emerging market, largely focusing on consumer goods production, housing, construction, communal services and catering. In this period there are still a large number of cooperative based businesses which were set up in 1988 as a result Soviet law which stopped short of legalizing wholly private enterprises and allowed for cooperatives instead. In the second stage (1992 – 1994) privately owned enterprises started to flourish as cooperative enterprise structures declined (many adopted new organizational forms). However, SME growth slowed and then stopped in 1994 due to general macroeconomic deterioration, hard budget restrictions imposed on state owned enterprises, limited access to credit and high levels of taxation which also led to inter-enterprise arrears, production curtailment and reduced investment. In addition, as a result of these changes, many SMEs switched their activities to trade. In the third stage (1995 – 1997) SMEs became the target of complex series of legislative and regulatory measures while at the same time, institutional reform measures were implemented to support SMEs. At this point, the numbers of SMEs stabilized.

Radaev identifies the emergence of two distinct types of SMEs in this period: intermediate SMEs servicing large enterprises and independent small businesses (2003). The former taking advantage of their informal networks that help them develop near monopoly positions. As a result, they tend to enjoy high profits which can be concealed from tax officials. In contrast, the latter group tend to produce goods and services for local needs. They are not very profitable and are vulnerable to market fluctuations and bureaucratic extortion. The fourth and final stage beginning in 1998 is strongly influenced by the Russian rouble crisis (August 1998) which led to a large number of SME bankruptcies especially for those firms involved in trade or using imported goods. But the rouble crisis also resulted in new opportunities for local producers and trading firms dealing with local goods. A less obvious yet possibly more detrimental change has been the lack of state budget funding for SME programmes from 1998 to 1999 and the minimal level of funding made available in 2000.

Since 2000, the situation has further deteriorated. Though on several occasions, President Putin has publicly stated his commitment to reducing administrative barriers for small businesses, a recent survey of small business in Russia indicated that they were more afraid of governmental inspectors and police than the Mafia (Smolchenko 2005:1). In 2003, there were approximately 890,900 registered private enterprises in Russia[12], however it is unclear how many of them are actually operating.

High growth and then decline in the number of registered SMEs has also been observed in Lithuania (Aidis 2004). The numbers of newly registered SMEs mushroomed during the initial transition period in the early 1990's. The most rapid growth took place in the small size category (under 19 employees) which increased 48 percent from 1993 – 1994. However a dramatic decrease of registered SMEs occurred in 1995 and again in 1999 – 2000. The combination of increasing regulations (such as requirements, taxation) coupled with decreasing business opportunities (due to increasing competition) seem to influence the decreasing numbers of private enterprises. An unanticipated negative shock occurred due to the Russian rouble crisis in 1998 which resulted in many SME bankruptcies. In particular, the period from 1999 – 2000 has seen a significant decrease in registered SMEs. At the beginning of 1999 there were 81,600 registered SMEs but by the end of 2000 there were only 52,000 registered SMEs (SMEDA[13] 2004). As in the Russian case, the number of registered SMEs in Lithuania is likely to include a significant percentage of inactive SMEs, thus a change in the register is only a crude indicator of the number of SMEs, which are active (For further discussion see Aidis 2004: 69). The overall picture indicates current low level of SMEs in Lithuania.

Different to both Russia and Lithuania, Poland maintained a large private agricultural sector as well as allowed private activities in the retail sector and in the production of handicrafts. The Fundamental law passed in 1988 allowed for the creation of private commercial firms and resulted in a huge increase in the numbers of private

[12] Source: Rosstat (2004).
[13] Lithuanian Development Agency for Small and Medium-sized Enterprises

firms in Poland. By the end of the 1989 there were approximately 500,000 private firms, much of which were created in the end of 1980's (Surdej 2003). An economic recession in 1990- 1991 led to the decrease in the overall number of Polish private enterprises however the numbers of private enterprises more than doubled in 1992- 1993 and have seemed to have stabilized (until 1995) and increased again in 1997 (see table 4). According to Surdej, a reasonable estimate of functioning private enterprises in Poland is approximately 2 million, at least 99.5 percent of which are SMEs (2003:102). Close to half of all Polish SMEs are engaged in retail trading (ibid.).

Table 4: Size distribution of enterprises in Poland

Enterprise by size	1991	1993	1995	1997
Total	502,275	1,988,079	2,099,577	2,492,489
SMEs (< 251 employees)	494,211	1,980,705	2,093,148	2,486,124

Source: Surdej (2003:102)

3. The Impact of EU Accession

Eight transition countries became members of the EU in May 2004 (Estonia, Latvia, Lithuania, Hungary, Czech R., Slovak R., Poland and Slovenia). A number of authors argue that EU accession will be a win-win situation for both the existing member countries as well as the new accession countries (Mayhew 1999; EIU 2003; Knaack and Jager 2003). To be sure, EU market integration will increase overall business possibilities. However business size does seem to play an important influence. In table 5, we summarize a number of opportunities and threats corresponding to EU membership for SMEs.

Table 5: EU membership opportunities and threats for SME development

Issue	Opportunities	Threats
Exports	New export opportunities♠	Competition increased in domestic markets♠♣
Economies of scale	Cost reduction and efficient production	Price wars and crowding out of small suppliers♠
Opening borders and market integration	Removal of barriers and restriction in the movement of goods, services, labour and capital♠ Improve cross-border trade♣	Costs: Harmonisation of technical standards and compliance costs♠ Enforcement: Having the laws in place means little if they are not effectively enforced♣ Need new skills in specialized management♠
Further removal of physical barriers for trade and movement i.e. customs procedures	Reduction of transaction costs for businesses♦	SMEs incur highest adjustment costs and will have to accumulate additional investment
Increased mobility for EU citizens	Liberalisation of airlines increases access for tourism♣	Decrease in labour pool due to 'brain drain' to higher wage EU countries♥
Harmonisation of regulations	Improved overall business environment♣	Greater burden: environmental protection; workplace health; May inflate operating costs rather than reduce them♣
Higher living standards	Increased consumption♠	Higher costs of production♣ Labour-cost advantage quickly eroded

Sources: ♠ = Smallbone and Rogut (2003); ♣ = EIU (2003); ♦ = Vilpisauskas (2002); ♥ = Krieger (2004).

In many cases, EU market changes seem to favour large sized enterprises and multinationals more than local SMEs. New export opportunities within the EU can also result in unexpected competitive pressures in domestic markets. Related to this, the advantages of economies of scale can also increase competition and crowd out small suppliers. In addition, opening border and market integration can increase costs for a number of SMEs which will need to comply with new technical standards. Improvement of cross-border trade may further put demands on new skills for management. SMEs who have less human resources to expend on management development could incur further difficulties as they are less likely to acquire these new skills. The further removal of physical barriers will result in the reduction of transaction costs for some businesses but at the same time, will increase the adjustment costs incurred by other businesses. SMEs which currently produce for the local market or import from the CIS are likely to be disproportionately represented in the categories that will face the highest adjustment costs and will need to invest in higher product and process standards.

Though it is tempting to focus solely on the adoption of new laws, a crucial distinction needs to be made between adopting new laws and the reality of actually implementing them with adequate enforcement. EU assessments already indicate that enforcement problems of EU laws exist in the new accession countries[14]. Uneven implementation and enforcement could easily be influenced through networks and corrupt behaviours resulting in unfair policy application. SMEs tend to have less access to this type of influence since they tend to lack in connections, lobbying power and the deep pockets of their larger enterprise counterparts. Therefore, SMEs are more vulnerable in situations were policy enforcement is weak.

It is expected that the harmonisation of regulations will improve the overall business environment but it can also result in additional compliance costs. SMEs tend to have lower absorption capacity, therefore increased regulatory costs result in increased prices for consumers thus reducing overall competitiveness. Some EU regulations will have less impact on SMEs such as environmental protection which will primarily impact large-scale manufacturers especially those producing chemicals, metals, machinery and equipment. However, increased workplace health standards will have a broader impact on all enterprises regardless of size.

Higher living standards resulting from EU market integration should have a further positive economic effect by increasing domestic consumption. But at the same time, it will likely result in higher costs of production which would erode the new member country’s low labour-cost advantage. This may have a special impact on labour intensive industries such as the textile and clothing industry which tend to be SME

[14] See Commission of the European Communities (2003).

dominated. Many SMEs are dependent on clothing industry subcontractors who are likely to move to lower cost third world countries once labour costs begin to rise.

EU integration will also have its advantages. One factor not to be overlooked is the liberalisation of airlines which will result in cheaper pan-European flights to and from new EU member countries. Increased tourism provides an opportunity for SMEs especially those working in the service sector. But increased mobility allowing for the freer movement of labour within the EU countries may have a negative consequence for SMEs. The wage disparities between old and new EU members has resulted in a large percentage of qualified workers leaving new EU member countries to seek employment in other EU states. This trend will reduce the pool of qualified workers available for the SME sector in new EU member states. A shortage of qualified workers for the construction and service sectors is already apparent in Lithuania and is likely to increase (Putelytė 2004).

In general, without government intervention, the winners in EU integration will be large enterprises and the losers will disproportionately be SMEs. However, internal firm-level development also plays a decisive role. As Smallbone and Rogut comment:

… firms that are already proactively managed, and with an existing presence in foreign markets, are in the best position to take advantage of any new foreign market opportunities. In comparison, firms that are focused on regional or domestic markets niches, and in which managers are complacent or dismissive about any market integration effects impacting on their businesses, may be in for a shock (2003: 3).

4. Is a decreasing rate of SMEs part of a natural process?

With few exceptions (most notably Poland), transition countries have been characterized by an initial explosion of SME development followed by diminishing numbers of SMEs. This pattern is consistent with stylised facts on firms entry, where the entry rate peaks early in the life of a market – here following the initial liberalization that took place in the early 1990's, but survival rate of most entrants is low (Geroski 1995). But of specific concern in the transition context is the low concentration of SMEs in transition countries after the 'growth spurt' documented by Eurostat and discussed by Klapper et al. (2002),

In addition to the aggregate number of firms, the size of the firms is also an important consideration in terms of the job creation ability of the private sector. Here, Poland provides a striking example: It has a high level of SMEs: 65 SMEs per 1000 inhabitants in 1999 compared to the EU average of 51 per 1000. However in terms of employment, Polish SMEs employ only slightly more than 65 percent of the workforce as compared to the EU average of 72 percent in 1999 (Surdej 2003). An average EU enterprise employs 6 people (from 11 in Austria to 3 in Greece) while the typical Polish enterprise employs 4.5 employees (European Commission 1997:305). However divergence may be occurring as Klapper et al. indicate, according to the Amadeus survey, where 8 percent and 71 percent of total employment is created by SMEs in Russia and Estonia respectively.

In a country comparative sense, Eurostat data shows that for a number of EU member countries such as Poland, Hungary, Czech R. and Slovenia, the average number of occupied persons per enterprise is similar to the EU member countries in the Mediterranean region such as Greece and Italy though significantly below the EU average. Whereas in terms of firm size, Slovakia, Estonia, Lithuania are more similar to those levels in The Netherlands, UK and Austria. Latvia emerges on the opposite extreme from Poland, as the country with the highest number of occupied persons per enterprise in the EU member country sample (approximately 15 persons per enterprise) (Eurostat 2003).

In order to obtain insights as to the current levels of entrepreneurship activity and their relationship to economic growth, the Global Entrepreneurship Monitor (GEM) was created in 1997. Among other indicators, it provides an annual indicator of the total entrepreneurship activity (TEA) in a given country[15]. This indicator shows the percentage of the adult population that is engaged in starting a new business. In 2004, 34 countries participated in the GEM survey. Unfortunately only three transition countries have participated in the annual GEM studies since 2002 (though some data for Russia is available for 2002 and 2003). Though this data provides a very limited view, it does illustrate the diversity of TEA in the transition region. As table 6 shows, Poland has the highest TEA score at 8.8 (which is consequently the highest TEA score for the 16 EU member countries which participated in the GEM survey[16])[17]. Hungary's TEA is about average for EU countries and Slovenia has a very low score as does Russia. When we compare TEA scores with the unemployment rates of these four countries we see some interesting relationships. Most strikingly is the high unemployment rate for Poland. In fact, the high TEA rate in Poland has been attributed to the fact that many individuals are unable to find employment in the formal labour market and start business to generate an income.

Table 6: Total Entrepreneurship Activity (2001 – 2004)

	2001	2002	2003	2004
Hungary	11.4	6.6	-	4.3
Poland	10.0	4.4	-	8.8
Russia	-	2.5	2.5	-
Slovenia	-	4.6	4.1	2.6
EU average	-	-	-	5.4
All country average (34 countries)	9.9	8.1	8.7	8.4

Source: Global Entrepreneurship Monitor (2004)

Table 7: Unemployment rate (2001 – 2003)

	2001	2002	2003
Hungary	5.6	5.6	5.8
Poland	18.5	19.8	19.2
Russia	8.9	8.6	8.5
Slovenia	5.8	6.1	6.5
EU25 average	8.5	8.8	9.0
EU15 average	7.4	7.7	8.1

Based on percentage of civilian labour force. (Source UNECE 2005; Russia data – EBRD 2004)
Note: These figures do not show hidden unemployment levels which are considered to be high in Russia

5. Necessity vs. Opportunity entrepreneurs in the transition context

[15] The TEA is based on a random sampling of the total adult population based on telephone interviews. The TEA score indicates the percentage of the adult population who is engaged in starting a new or nascent business (less than 3 months old).

[16] 13 old EU member countries participated as well as 3 new EU member countries: Poland, Slovenia and Hungary.

[17] However, when we compare necessity versus opportunity entrepreneurs, Poland records a high level of necessity entrepreneurs (close to 3) than other European countries.

The Global Entrepreneurship Monitor's research has not only attempted to categorise countries in terms of high and low levels of entrepreneurship activities but further distinguishes between 'necessity' and 'opportunity' entrepreneurs. Necessity entrepreneurs predominate in the developing country context where lack of other alternatives pushes individuals to engage in entrepreneurial activity. In contrast, opportunity entrepreneurs are individuals who feel pulled into entrepreneurship due to the desire to apply a marketable idea or to apply their skills to starting a business venture.

Some authors suggest that a majority of SME owners in transition countries are better described as 'proprietors' i.e. necessity based entrepreneurs rather than 'opportunity based entrepreneurs' (such as Scase 2000, 2003; McIntyre 2003; Glinika 2003). According to these authors, entrepreneurship is characterized by the reinvestment of business profits for the purpose of business growth and ultimately further capital accumulation, while proprietorship is characterized by the consumption of surpluses generated (Scase 2003). This implies that a large proportion of SME owners in transition countries would fall into the 'proprietorship' category, at least when their businesses are started.

Glinkina adds that since the primary function of a proprietor is survival or supporting consumption, it is unlikely to serve as the initiator of dynamic growth in transition countries (through cumulative personal accumulation and capital investment). It calls into question the widespread opinion that small business is indisputably a driving force of economic progress (2003:63).

Earle and Sakova (2000) have empirically investigated this claim on survey data collected in 1988 - 1993 in Bulgaria, Czech R., Hungary, Poland, Russia and Slovakia. Their results based on earnings differentials between SMEs with employees (employers) and SMEs without employees (self employed or own-account workers) indicate that own-account workers have a much smaller predicted earnings differential to employees than SME with employees. According to Earle and Sakova, these results provide some evidence that employers form a 'successful' group of entrepreneurs while the situation for own-account workers is more ambiguous. In their interpretation, own-account workers tend to be composed 'at least partially' by workers who would prefer, on the basis of wage, to be employees (ibid: 24). So they may in fact be a form of 'hidden unemployment' rather than entrepreneurs in the transitional context. The GEM study TEA results for Poland seem to indicate that in this context, necessity may influence the high numbers of new start-ups.

However authors such as Welter et al. (2004) and Aidis et al. (2004) urge a more dynamic view be taken which recognizes the learning capacity of individuals over time (particularly where considerable human capital is involved), as well as possible changes in external circumstances. Both can lead to changes in the aspirations of individuals and their ability to spot and exploit new business opportunities. As a consequence, even if specific entrepreneurial actions or events, such as creating a venture, are primarily driven by necessity or opportunity, it is inappropriate to place entrepreneurs, into such categories, because of the need to incorporate a dynamic element. Similarly, Chilosi (2001) claims that the 'utter newness' of private enterprise in the transition countries demands 'entrepreneurial' abilities beyond what would be expected in the more stable market conditions of advanced western economies.

6. Knowledge Based Entrepreneurship

Knowledge based entrepreneurship (KBE) focuses on the development of innovation in sectors that necessitate high levels of human capital, technology and research. It would seem that the high levels of human capital as well as technological expertise that was present in the transition countries would stimulate the development of high levels of KBE. However the opposite has been the case. The transition countries are mainly characterized by SMEs in retail trade and low-tech services. Two main influences seem to play a crucial role in this development. The first is related to the lack of specific human capital skills needed for a market economy such as marketing and business management. As a result, individuals that may have the know-how but are unable to bring it successfully to market. However, on the other hand this perspective does not explain the high levels of highly educated entrepreneurs engaging in business activities unrelated to their skills such as the classic example of a physicist starting a business selling underwear in Russia. In this striking yet common example business skills are not the problem, but matching technical skills with market opportunities are. This example is illustrative of the situation most transition countries found themselves in where market demand centred on providing goods for customers. In addition, business support, especially in the early transition period was virtually non-existent in the form of information, infrastructure or funding. All three of these issues are necessary for developing KBE. Here again much variation exists between countries with the greatest progress occurring in the new EU member countries. As transition market economies mature, national governments become aware of the need to foster KBE, specific programmes have been implemented such as science parks and business incubators. A number of the new EU member countries have been at the forefront in developing KBE such as pharmaceuticals in Hungary, IT companies in Estonia and the Czech republic. Much potential is present in the transition countries to increase their levels of KBE. It may happen organically, but could be more effectively channelled through governmental support. In this sense, we can expect KBE to develop more rapidly in the new EU member countries due to EU harmonization policies as well as their own determination to improve their economy's efficiency and productivity.

7. Concluding Remarks

Entrepreneurship development in transition countries shares some general commonalities. As the transition countries switched from a centrally planned economic system to a more market oriented one, private enterprise grew tremendously due primarily to the unmet consumer needs within these countries. This occurred in spite of the fact that in most cases, governmental policies did not actively promote SME development. Subsequently, in many transition countries, the total number of enterprises has declined after the initial spurt and stabilized at a rather low level compared to other Western European countries. This is a cause for concern since SMEs are seen as the vehicle for entrepreneurship and further economic growth in terms of innovation and job creation.

SME development in the transition countries did not occur on a clean slate and was influenced by the attitudes, practices and norms inherited from the previous regime. Though for the most part, this inheritance has not contributed to a conducive environment for legal SME development, not all countries began with the same baggage. A clear distinction can be made between the CEEB and CIS countries in terms of three main dimensions: the environment, the role of the state and business owner characteristics.

In addition, SME development is currently being influenced by the subsequent changes and development paths these countries have chosen to implement. For the eight new EU member 'transition' countries, this necessitates the adoption of the new norms, values and EU policies towards SMEs. For many of the former CIS countries, little further progress has been made to implement SME development initiatives. Therefore, the further choices made by transition countries with regards to SME development have shaped the environment for legal entrepreneurial development.

However, as this paper indicates, the story of divergence is not limited to the regional divisions CEEB and CIS. Much variation occurs even within these main categories. Other factors seem to play a role influenced by an interplay of cultural perceptions of entrepreneurship, the state of the economy and implementation of policies. These three factors combined most likely explain the high general levels of entrepreneurial activity in Poland, the moderate levels in Hungary and the low levels in Slovenia.

The development of knowledge based entrepreneurship presents another challenge for transition countries. Given the characteristics of the switch to the market system in a period of extreme shortages of basic consumer products and services, it is not surprising that most entrepreneurial activity has taken place in low tech sectors such as retail trade and basic services. However in post-transition countries such as the eight new EU member states, the development of knowledge-based entrepreneurship is of critical importance for economic growth and productivity.

In addition, the general low and stable levels of entrepreneurship in transition countries indicate that the conditions have not yet been created to maintain a vibrant entrepreneurial climate. In this sense, even in the most advanced transition countries, the inheritance from the centrally planned system has not yet successfully been shed.

Appendix 1: A note regarding the challenges of researching entrepreneurship in transition countries

In most cases, only poor or unreliable data is available on SMEs in transition countries. Obtaining data on the total number of enterprises is especially difficult. Often, many enterprises registered in the early 1990's never became active or were not removed from the register after they failed and stopped functioning. In other cases these firms were created solely to collect state subsidies for business start-ups or were used for unofficial financial operations. According to Glinkina 30 percent of SMEs are dormant in Poland (Glinkina 2003:51). In Lithuania, the Lithuanian Department of Statistics data is notorious for providing inaccurate data on the number of active businesses in Lithuania. In the late 1990's it was thought by statisticians working at the LDS that up to 60 percent of the businesses contained in the official registry were inactive (Aidis 2003:68). This situation has since improved in Lithuania in 2000 when new legislation was introduced to facilitate the process of de-registering inactive firms from the official register.

As McIntyre (2003) points out, there can often be an exaggeration of 'foundings' (firms often never function) while firm deaths are usually not reported, meaning that year-to-year changes may not be accurate. McIntyre further stipulates that 'since everyone is happy to report SME success, there is a polite and sustained conspiracy to ignore these unfortunate facts'(2003:15).

Given the unreliability of existing data collected by the national statistical offices, individual as well as cross country surveys have been conducted. Some authors have also utilized parts of existing data sets such as Household surveys in Russia, Bulgaria, Czech R., Hungary, Poland and Slovakia (Earle and Sakova 2000) or large data sets such as the Business Environment and Enterprise Performance Surveys (BEEPs) collected on the Business Environment by the World Bank and the European Bank for Reconstruction and Development (EBRD), or the AMADEUS data set compiled by the Bureau van Dijk. The other option is to collect individual surveys (mainly through mail surveys) either for a single country or for cross-country comparisons (e.g. Smallbone, et al 2001; Aidis 2004; Hashi 2001; Fogel 2001; Anderson and Pomfret 2001; Muent et al. 2001; Dmitrov and Todorov 1995; Frye and Shleifer 1997; Johnson and Loveman 1995; Bartlett 2001).

The advantages of quantitative surveys are their ability to provide a representative sample of the SMEs being studied. However, this is difficult in the transition context when the exact number of SMEs is disputed. There seems to be the additional problem of survey breadth. The AMADEUS survey provides a large sample of SMEs for European countries as well as for a number of transition countries. However it does not include firms that have less than ten employees (micro firms). Which may seem irrelevant except when one takes into account the fact that more than 92percent of all registered SMEs in 2003 in the EU15 had less than ten employees (Eurostat 2003). An even higher percentage ratio of micro firms is likely in the transition countries given the fact that SMEs tend to be smaller with fewer employees (Klapper et al. 2002).

Qualitative methods have also been used to collect data on SMEs in transition countries mainly through interviews and case studies (e.g. Bohata and Mladek 1999; Hashi 2001; Smallbone et al 2001b; Pissarides et al. 2003; Robson 2003; Batjargal 2003; Aidis 2004). In general, flexibility and depth of understanding are viewed as the main strengths of interview methodology. However, the generalizability and reliability of interview methods are often difficult to apply.

A further difficulty arises with regards to defining SMEs in the transition context. Definitions of SMEs vary considerable from country to country. The eight new EU member countries have accepted the EU's standard SME definition (micro < 10; small < 50; medium < 250 employees), while non-EU member countries such as Albania limit the upper size of SMEs to less than 80 employees. In Russia, SME size requirements vary according to industry so that for the construction and transport sector it is 100 employees while for wholesale and retail trade it is only 30 employees (Radaev 2003).

Finally, it can be argued that the methodology utilized by worldwide studies such as the World Business Environment Survey (WBES) collected on the World Bank that include transition countries are not enough to capture the specificities of the transition country context. is not sufficient in order to uncover the unique aspects of transition. Because the questions asked are not enough to understand the essence of the situation where the difference lies in the degree and not the general category. For example the 85 country study by Djankov et al. (2002) measures the 'costs' it takes to register a business in terms of number of procedures, official time and official cost and compares that across countries. But it does not accurately measure the informal barriers to business development such as corruption. In some countries such as Russia, these informal barriers are the main obstacles to new firm entry (Aidis and Adachi 2005).

Appendix 2: SME Barriers at different transition stages

	STAGE 1	STAGE 2	Stages 2 & 3	STAGE 3
FORMAL: Taxes, Policy instability/uncertainty, Legal regulations				
	• Customs and trade regulations	• Frequent changes to laws and government • Business registration business	• Gov't non-transparency • Commercial law • Social security payments	• Too many licenses • Accounting standards • Information • Need for specific consulting advice (marketing, financial, psychological) • Lack of state support
INFORMAL:				
		• Gov't Attitude • Organised crime and mafia • Anti – corruption measures • Business security • Lack of positive attitude	• Corruption • Bureaucracy • Payment behaviour of clients	• Too many tax inspections • Implementation of regulations • Motivation / quality ethics of the workforce
	• Macroeconomic stability • Inflation	• Physical infrastructure • Low product demand • High input prices • Suppliers • High interest rates	• Infrastructure • Unfair competition • Premises rental costs • Wage costs • Business training	• Shortage of qualified workers • Strong competition • Lack of investment/finance
OTHER				
				• Business growth into new markets

Source: Aidis and Sauka (2004)

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