INSTITUTIONS, GOVERNANCE & THE DEVELOPMENT OF ENTREPRENEURSHIP: THE EXPERIENCE OF CENTRAL AND EASTERN EUROPE

David Smallbone

Professor of Small Business and Entrepreneurship
Small Business Research Centre
Kingston University
www.kingston.ac.uk/sbrc

INTRODUCTION

- Paper concerned with issues related to governance and policies relevant to processes of starting and developing businesses.

- Governance is concerned with the rules, procedures & practices affecting how power is exercised, which is central to the democratic process because it affects the legitimacy & effectiveness of institutions.

- Governance refers to the exercise of power in both corporate and state contexts. It includes: “conscious collective action ……deploying, for example, the capacities of businesses, community groups and academic institutions (Hart, 2003)”
ENTREPRENEURSHIP AND GOVERNMENT

- Whilst setting up businesses results from creativity & commitment of individuals, the state is a major enabling/facilitating influence.
- The state can foster entrepreneurship by:
  » removing (unnecessary) obstacles to enterprise creation
  » establishing a facilitating environment for private sector development e.g. tax policies, stable macro economic environment
  » influence on the social value placed on entrepreneurship
  » contributing to the development of appropriate and effective market institutions
  » direct interventions
- A key role is to develop a well co-ordinated relationship between the various ‘actors’ involved in promoting and regulating enterprise creation & development.

TRANSITIONAL ENVIRONMENTS WITH MAJOR INSTITUTIONAL DEFICIENCIES

- In countries where major institutional deficiencies exist, the number of firms remains small and their contribution to economic development limited.
- Key elements include legal + financial infrastructures
- Poorly specified regulations, which leave too much room for discretion; hence inadequate enforcement often involving corruption.
- In such conditions, enterprise development strategies reflect institutional deficiencies e.g. evasion strategies and approaches, which often involve resources being diverted into non-productive activity.
- Survey evidence reveals legacy of non-compliance contributing to diminution of rule of law.
INSTITUTIONS AND SME DEVELOPMENT IN THE EU’S NEW MEMBER STATES

- Entrepreneurship has been a key element in the process of social & economic transformation during the transition period
- The continued development of entrepreneurship is crucial to the process of European integration
- Institutional capacity building is central to this process, because of its potential impact on transaction costs, yet it is one of the most challenging aspects of market reform
- Relevant institutions include public bodies (e.g. tax authorities, licensing offices); private sector institutions (e.g. banks, accountants); development agencies & self governing organisations (e.g. Chambers of Commerce).
- In new member states, the process of accession contributed to the process of institutional development & administrative reform

INSTITUTIONS AND SME DEVELOPMENT IN ACCESSION STATES: the Case of Estonia

- At macro level:
  - responsibility for enterprise support has been centralised under the Ministry of Economic Affairs & Communications
  - strategic policy objectives linked to specific action plans & tied into the budgetary process
- At meso level:
  - banking system has developed a range of financial products for SMEs
  - business support infrastructure is focused on 2 key organisations: Enterprise Estonia & Kredex
- At micro level, institutional development has focused on the reform & development of network of business development centres
PRINCIPLES UNDERPINNING GOOD GOVERNANCE

- **Openness** i.e. institutions operating in an open & accessible manner, with transparent procedures
- **Participation** throughout policy chain, from conception to implementation
- **Accountability**, with clearly defined roles for institutions, with each explaining & taking responsibility for what it does
- **Effectiveness** in delivering what is needed on basis of clear objectives & assessment of future impact
- **Coherence** of policies and actions, as well as between policies

(Commission of the European Communities, 2001)

GOVERNANCE ISSUE I: DIALOGUE WITH ENTREPRENEURS

- The effective institutionalisation of policy with respect to entrepreneurship needs to be based on the partnership principle
- Dialogue & co-operation is needed in policy formulation, implementation and evaluation
- But creating appropriate organisations is not a sufficient condition for the views and interests of entrepreneurs to be adequately represented
- Although Accession involved consultation with entrepreneurs organisations in candidate countries, its effectiveness has sometimes been questioned (e.g. Poland):
  » insufficient familiarity with procedural aspects of preparations
  » insufficient knowledge about integration & negotiation processes
  » lack of lobbying experience
GOVERNANCE ISSUE I: DIALOGUE WITH ENTREPRENEURS (cont)

- Effectiveness of entrepreneur’s organisations is affected by fragmentation, representativeness and their lobbying effectiveness

- Small firms can be a ‘difficult to reach group’ for consultation/involvement in formal institutions
  
  - Low priority given by entrepreneurs to activities that are not directly connected with their business
  - Lack of information about possible benefits of participating
  - Doubts about whether any policy influence they may have will be implemented quickly enough to make a difference to their business.

GOVERNANCE ISSUE II: REGULATION

- Administrative and regulatory barriers and compliance costs typically disproportionately affect new and small enterprises

- An issue that may be used as a litmus test of the effectiveness of the wider system of governance

- Regulation covers “the full range of legal instruments and decisions through which governments establish conditions on the behaviour of its (citizens) or enterprises” (OECD, 1994)

- Apart from regulations themselves, the regulatory system includes processes of public consultation, communication & updating

- Principles of good regulation (OECD, 1994):
  - coherence, consistency and balance between competing policies
  - stability and predictability of regulatory requirements
  - ease of management
  - transparency & openness
  - consistency & fairness in implementation
  - adaptation to changing conditions
GOVERNANCE ISSUE II: REGULATION

- Over the last decade, improving the management of regulation has been a EU policy priority, reflected in the drive for ‘better regulation’
- One of the main innovations has been the introduction of Regulatory Impact Assessment i.e. an ex ante assessment of the possible implications of proposed new regulations affecting businesses
- CC BEST initiative in former candidate countries emphasises the importance of administrative simplification:
  - reducing time and cost of registration licensing
  - one stop shops for administrative procedures
- A major challenge has been the need to simplify legislation whilst at the same time adopting the ‘acquis communautaire’
- Other challenges include establishing consultation mechanisms to help government to ‘think small first’ + cost effective ways of informing businesses of changes in legislation + easy exit for entrepreneurs as well as easy entry.

GOVERNANCE ISSUE III: STRENGTHENING THE ROLE OF REGIONAL & LOCAL AUTHORITIES

- In most countries, the development of entrepreneurship varies considerably between regions, which emphasises the importance of promotion and institutional support for entrepreneurship at the local level
- Pre-existing regional/national disparities were widened after enlargement, which underlines the importance of institutional capacity building at the local & regional levels
- This needs to involve:
  - defining the responsibilities of authorities at different levels
  - establishing appropriate lines of demarcation of responsibility
  - avoiding unnecessary layers of bureaucracy
  - engaging in dialogue with entrepreneurs at all levels
CONCLUSIONS

- Although specific policy priorities for entrepreneurship development vary between individual countries, key underlying themes are the importance of institutional development and the development of a market-oriented system of governance.

- In some countries, an appropriate and effective institutionalisation of small business policy is still one of the main preconditions that needs to be fulfilled before productive and sustained private sector development can become embedded.

- In this context, the appropriateness, effectiveness and overall operational quality of the legislative and regulatory framework is a key element.

KEY POLICY PRIORITIES IN NEW MEMBER STATES

- Developing an effective business support infrastructure
- Active promotion of entrepreneurship at the local and regional levels
- Developing market-oriented innovation systems, recognising the need to pay attention to increasing the supply of technical entrepreneurs, as well as to the development of innovation centres and science parks
- Active promotion of entrepreneurship to young people through education system
- Continued capacity building of market-oriented institutions
SOME COMMON ISSUES

- Many of the governance issues facing transition countries are associated with defining and operationalising the role of the state in an emerging market-based democratic system
- No single solution in mature market economies, where there are different views and experiences e.g. business support infrastructure
- Interventions should address market deficiencies, seeking to contribute to building market capacity and not ‘crowd out’ market-based solutions
- Need for publicly funded business support system to be ‘customer-oriented’, whilst contributing welfare gains to the economy as a whole.