

# Entrepreneurship in Transition Economies<sup>1</sup>

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## 1. Introduction

The establishment and growth of new enterprises is central to the transition process. This is because the change in economic system from communism to capitalism implies a reallocation of resources in which new firms have to be the main actors (see e.g., Olson 1992). Compared to other situations of major liberalization, existing firms are less well placed to be the engine of structural change because they are themselves institutions of the planning system and must also be subject to major reforms. Thus, while mainstream economists have emphasized the three pillars of the “Washington consensus” - stabilization, liberalization and privatisation (World Bank 1996) - analysts such as Kornai (1990) and McMillan and Woodruff (2002) have instead argued that the creation of new firms *de novo* would be the primary mechanism of the transition.

As a period of major economic and institutional change, transition throws up numerous opportunities for “low-level” entrepreneurs (Kirzner 1983) to transfer resources from low to high productivity uses in the new market economy. Moreover, the incentives for innovation and efficiency were notoriously weak under communism (Hayek 1945) so reformers in the transition economies have been also greatly concerned with Schumpeterian entrepreneurship (Schumpeter 1934). Over-centralisation and inappropriate management incentives were important causes of the stagnation in the last years of communism (see e.g. Ericson 1991) and new technologies have to be adopted to restore growth. As with all innovation, the driving force was expected to be “high-level” entrepreneurship.

However, the transition economies started their reforms with few legal, institutional and policy structures to provide the basis for an entrepreneurial market economy (see e.g. Verheul *et al* (2002), Chilosì 2001). To the contrary, the

institutional environment has created numerous new barriers to entry, some conventional and others unique to transition. These have prevented entrepreneurs from fully exploiting the opportunities opened up by transition. Moreover, the institutional environment is evolving (Murrell 1996 and Spicer, McDermott and Kogut 2000) and the process of reform did not always enhance rapid or fundamental change. Indeed, in many countries the chaos associated with transformational reforms instead led to an entrenchment of the former elite in a new quasi-market environment (Boycko, Shleifer and Vishny 1995). The development of the entrepreneurial sector is sensitive to the institutional environment with a sharp distinction between the more market-oriented economies of Central and Eastern Europe and slower and more erratic pace of change in the former Soviet Union. Successful entrepreneurship depends not only on initial conditions in the transition economies but also on the speed and consistency with which the reform process has been applied.

Despite the unpropitious environment, we observe a remarkable expansion of the private sector in all transition economies. The average share of private sector output in GDP rose from virtually zero in 1989, at least in centrally planned economies like Czechoslovakia or the Soviet Union, to 62% in 2001. The transition economies therefore experienced a similar transformation to China, as Deng Xiaoping's remark about the first eight years of Chinese reform shows, "all sorts of small enterprises boomed in the countryside, as if a strange army appeared suddenly from nowhere" (cited by McMillan and Woodruff 2002). Table 1 shows that the increases occurred in every country, and were paralleled by rises in the share of private sector employment. Growth in the private sector share was caused by privatisation of existing firms as well as the emergence of entirely new enterprises. Privatisation has received enormous attention in the literature (Djankov and Murrell

2002), but new firm growth was probably at least as important; we observe that a significant proportion of private sector development preceded privatisation in most transition economies (see EBRD 1994, World Bank 1996).

In this chapter, we examine the opportunities and constraints for entrepreneurship offered by the evolving institutional environment and the characteristics of the people who stepped up to the challenge. In the next section, we place the concept of entrepreneurship in a transition context, before identifying in the third section the unique features of entrepreneurship in transition economies. Section 4 discusses the evolving business environment while the scale and nature of entrepreneurship in transition economies is reported in the fifth. The personal characteristics and the business strategies of entrepreneurs in the transition economies are discussed in the sixth and seventh sections respectively. Section 8 concludes by outlining directions for future work.

## **2. Entrepreneurship and Economic Transition**

To what extent can definitions of entrepreneurship be transferred from mature market economies to transition economies? Defining entrepreneurship for transition economies is not made easier by the fact that definitions of entrepreneurship vary in the literature, as other chapters in this handbook reveal. In this section, we discuss the distinctive character of entrepreneurship in transition and analyze how this might change as the transition process develops.

### **2.1. Defining Entrepreneurship in a Transition Context**

Existing definitions stress the innovative aspect of an entrepreneur, her decision-making under uncertainty and her role as coordinator of resources (see

Ricketts 2002). These were developed in work on Western economies but entrepreneurs face a different business environment in the transition context. They have to learn a different coping behavior<sup>2</sup>, formed by their experience under communism, and they may have different personal characteristics. Baumol (1990) argues that the definition of the entrepreneur should reflect the local incentive structure. In transition economies, this encompasses the onslaught of rapid changes and the resulting uncertainty, a wide range of opportunities thrown up by the restructuring of formerly planned economies, imbalances between supply and demand, fragile or only partial market institutions and a variety of informal rules and behaviours which are remnants of the communist past. However, while many market institutions were absent, the skill level and educational attainment and in some cases investment into local technology were on par with the developed world.

Thus, the characteristics of entrepreneurs and their economic impact cannot be assumed to be the same as those in Western countries (Smallbone and Welter 2004). For example, entrepreneurs in transition economies can be value-subtracting because of the numerous opportunities in rent-seeking. Dallago (1997) distinguishes between systemic and economic entrepreneurs, with the former introducing changes into the system of institutions and rules. Building on Wennekers and Thurik (1999), Aidis (2003) defines productive entrepreneurship as entailing “innovative activity under uncertainty resulting in an economically productive business”. Thus, entrepreneurship does not necessarily require the establishment of a new enterprise, but includes leaders that took over state owned enterprises and employ new combinations of resources. This definition includes the formation of new businesses as well as spin-offs from former state firms and management employee buyouts (MEBOs) but

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<sup>2</sup> For examples of coping behaviour in regard to resource procurement, initiative incentives and decision-making learned under communism see Ledeneva (1998) and Smallbone and Welter (2001).

excludes managers continuing in their role in old enterprises. We refine this definition by focusing on individuals who:

- a) Perceive and create new economic opportunities through innovative activity
- b) Introduce their ideas in the market in the face of uncertainty and other obstacles
- c) Undertake efforts that result in a viable business that contributes to national economic growth and personal livelihood, and
- d) Engage in this activity at opportunity cost of pursuing other occupations.

## **2.2. Entrepreneurship and Stages in Transition**

The transition process can be divided into several stages that gave rise to different kinds of entrepreneurship. In the first stage, early transition, equilibration of supply and demand, manifested in adjustment of relative prices, opens up opportunities for mainly Kirznian type of entrepreneurs. This is a period of extreme uncertainty, as there is no previous market information. Channels of resource allocation face disruption as planning is abandoned, though nomenclature networks may provide some alleviation.

Macroeconomic stabilization, indicated by reduced inflation and a resumption of economic growth, removes extreme uncertainty and increases the incentives for Schumpeterian entrepreneurship. In this second stage, the price mechanism can be used to convey information about supply and demand and macroeconomic stability reduces business risks. This allows investments into longer-term projects and unmask needs for new projects and technologies.

In the third stage, market institutions become more developed and provide better mechanisms for resource co-ordination, information gathering and contract

enforcement. Property rights enforcement relies less on physical threat or reputation and more on courts so resources are increasingly accessed through financial institutions and market exchange. At this stage, Schumpeterian entrepreneurship becomes more feasible.

Thus changes in environment and opportunities over time in the transition economies are likely to lead to differences in entrepreneurial endeavor, strategies and personal characteristics. One can expect the initial stage to attract a larger number of entrepreneurs but also to witness a larger failure rate. The skill set and physical as well as social capital of initial entrepreneurs may differ from those in later years, as will the types and strategies of businesses created by these entrepreneurs. However, one cannot assume an automatic progression from stage to stage, so the forms of entrepreneurship that emerge in the early stages may become entrenched.

### **3. The Functions of Entrepreneurship in Economic Transition**

In this section, we identify the unique opportunities for entrepreneurship in transition economies. We thus discuss the heritage from planning and describe the reform process and its effect on entrepreneurship, drawing on the literature in comparative economics (see e.g., Gregory and Stuart 1995, Ellman 1994).

#### **3.1. The Heritage from Planning**

The emergence of a market economy from a planned one implies a major reallocation of resources: from industry to services, domestic to global production, intermediate products to final goods. Planned economies were “over-industrialised” – the share on industry in GDP was routinely in the 45-50% range as against less than 30% in developed market economies and output was focused to the manufacture of

intermediary products. Moreover, though most communist countries were small, they were not very open, especially to West European neighbours, as planners had concentrated trade within the communist bloc. Thus reforms opened many profitable opportunities in services, final products and international trade. One might expect this reallocation to be spearheaded by existing firms rather than entrepreneurial ones. However, existing firms were themselves institutions of planning, and therefore part of the problem rather than its solution. It was hoped that the sharper incentives and improved governance would follow privatization, but this was everywhere a major and lengthy project and in the interim, new firms would have to play a disproportionate role.

Former state owned firms were however an important breeding ground for entrepreneurs, as well as a source of fixed assets. Socialist enterprises were highly integrated vertically and these structures were often liquidated when the logic of planning was replaced by market incentives allowing their workers and managers to acquire the assets at low prices (see Johnson and Loveman 1995). New firms, often very small, therefore spun out of the socialist enterprise and filled niches in consultancy, logistics, and business services (see Lizal and Svejnar 2002).

The new market economy also emerged from grey and black-market activities. Planning led to shortages of consumer goods, which created an environment in which arbitragers, black marketers and criminals thrived. At the same time, the rigidity and inflexibility of the planning system, combined with strong incentives for managers to attain plan targets, created a class of “middlemen”, providing inputs critical to the production process. These individuals were often local party members or associated with local government or the secret police, termed the “nomenclatura”. This process of intermediation through informal networks was another important seed bed for the

new entrepreneurial class, especially in the former Soviet Union (see Ledeneva 1998). However, the distinguishing feature of this group was not their ability to spot new economic opportunities but rather their networking skills among the political and economic elites.

### **3.2. Transition Policies and Entrepreneurship**

The transition process itself also influenced the pattern of entrepreneurship. In the early 1990's, the established order broke down and the resulting macro-economic instability as well as some of the methods of privatisation chosen by policy makers in those crucial early years constrained entrepreneurship. Thus, the general business climate in the early years was recessionary and inflationary. Even in the least affected economies, like Poland or Hungary, GDP fell by up to 20%; in much of the former Soviet Union it halved using official statistics (see EBRD 1994). There was also inflation everywhere after prices were liberalised and though, in countries like Poland and Czechoslovakia, it was fairly speedily brought under control, in most countries, it remained persistently high for the early years of transition, greatly increasing the risks faced by entrepreneurs. The chaotic business environment that existed while a legal and institutional framework was being developed also gave many opportunities for nomenclatura-based networking, and led to an increase of corruption, a failure to enforce property rights and the rise of mafias. One can discern a clear distinction between the sustained progress in business environment in Central and Eastern Europe (CEE) – perhaps as a consequence of the European Union Accession process – and the more erratic path followed in the former Soviet Union (FSU) and much of the Balkans.

Privatization policy was also crucial for entrepreneurship. The bulk of new firms in the early years were probably created by the “small privatisation” – the sale of house, flats, shops, garages, restaurants etc. When SOEs were restructured for privatization or liquidated, their assets – plant and machinery but also less expensive and more versatile capital goods such as trucks or office equipment – were sold, often at fire sale prices. This factor was particularly significant in the more advanced transition countries like Poland (see Spicer, McDermott, and Kogut 2000, Belka *et al* 1995).

#### **4. Barriers to Entrepreneurship in Transition**

Institutions affect entrepreneurial endeavours in two ways. Firstly they may hinder the creation of firms, thus lowering total number of entrants into the market. Second they may create obstacles to firm performance, as measured by survival period, growth or profits. Though transition opened many opportunities for entrepreneurship, the heritage from the planned era was in many ways not favourable and many aspect of the reform process acted to make the environment even less conducive to entrepreneurs. In this section, we review the evolution of the institutional, social and cultural environment for entrepreneurs in transition economies, before considering in subsequent sections its impact on the scale and character of entrepreneurship. We commence with financial and institutional barriers, before turning to human capital and cultural factors. In this discussion, we also reflect that some institutions may have stronger impact on firm creation while others may have more effect on firm performance.

##### **4.1 Financial Barriers**

Entrepreneurs require financial resources in order to establish and run their new enterprises, and they must either provide this from their own (or family) saving, or borrow it from financial markets. Neither of these sources was widely available, particularly at the onset of transition. Under communism, individuals were not permitted to accumulate financial assets- almost all wealth was owned by the state- and this must have been a major constraint on the possibilities for entrepreneurship (Pissarides 1999, Chilosi 2001). More generally, the distribution of income and wealth may be an important determinant of the level of entrepreneurial activity. According to Banerji and Long (2001), quoted by Chilosi (2001), “under capital market imperfections due to moral hazard, the very rich and the very poor do not undertake any risk and became passive lenders...only individuals whose wealth lies within the medium range choose to be entrepreneurs” (p.1). This is because poor people would not have access to risk capital and rich people do not wish to undertake extra effort, which implies that entrepreneurs will largely come from the middle-classes, but this is precisely the group that was largely absent at the start of transition.

Financial markets were also seriously deficient and progress in this area (EBRD, 2004) has been slow. The EBRD’s annual indicators report the progress in reform of the securities market and non-bank financial institutions (EBRD, various years). By 1994, only five countries had attained a ranking of 3 for the capital market indices and the situation had not improved markedly by 2000.<sup>3</sup> Ten countries had not altered their category in the last five years and the situation had deteriorated in three – Russia, Slovakia and Slovenia. However, there is differentiation; Poland and

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<sup>3</sup> On a scale of 1-4, 1 represents little progress, 2 indicates a rudimentary exchange and legal framework, 3 means making some progress (securities being issued by private firms, some protection of minority shareholders and the beginnings of a regulatory framework; 4 means that countries have relatively liquid and well functioning securities markets and effective regulations and 4+ implies countries have reached the standard of advanced industrial economies.

Hungary have reached a ranking of 4 and the three Baltic States have also improved somewhat.

Thus financial markets in transition are often very limited and underdeveloped and the market structure is highly concentrated with banks often achieving only low levels of efficiency. The banking sector is also relatively inexperienced in private sector lending, and project finance in particular, and thus lacks organizational capabilities to finance entrepreneurial businesses (Pissarides 1999). The evidence suggests that state owned banks continued to favour state owned firms and, to some extent, large privatised firms by providing soft loans (Lizal and Svejnar 2002). However, they rarely lent to the *de novo* private sector, particularly at the start of the transition process (see Richter and Schaffer 1996, Feakins 2002).<sup>4</sup> This is all a serious problem for the development of entrepreneurship because financial development has been found to exert a disproportionately large effect on the growth of industries that are dependent on small firms (Beck *et al.* 2004).

Access to finance may be crucial for growth of small businesses, but less for their initial establishment (ISEAED 2001). It appears very high on entrepreneurs' own list of obstacles (Fogel and Zapalska 2001, Pissarides, Singer, and Svejnar 2003) but there is little evidence that finance has been a binding constraint on growth. For instance, Johnson, McMillan and Woodruff (2000) find that whether or not the firm had a bank loan at early stage of their existence has no significant effect on firm growth. They argue, "external finance matters *only after* property rights provide some

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<sup>4</sup> The almost complete absence of privately held savings in the communist era and state ownership of banks led to imprudent lending, followed by a bad loans crisis in several countries. As a result some countries saw privatisation of domestic banks to foreign owners (Berglof and Bolton 2002). While this may have raised efficiency of lending, these banks are still likely to favour large projects, focusing on corporate lending and avoid retail financing, as EBRD experience with foreign banks suggests (Pissarides (1999)).

minimum level of security (and assuming that there is macroeconomic stability)”  
(Johnson, McMillan and Woodruff. 2000).

In assessing the validity of surveys of entrepreneurs, one has to keep in mind that aspiring entrepreneurs who are rejected by banks for good reason – for instance because they lack a clearly defined business plan, or they are considered incapable of implementing their plans – would also complain about not having been funded. Moreover, the contrary evidence between Pissarides, Singer, and Svejnar (2003) on the one hand, and Johnson, McMillan and Woodruff (2000) on the other may arise from the fact that the former have good measures of access to finance and weak ones of other institutions, while the latter have the converse. We still await convincing evidence on the relative importance of access to finance versus general institutions and property rights for entrepreneurship in transition economies.

#### **4.2. Institutional Environment**

The institutional argument concerning obstacles to entrepreneurial establishment and growth has been advanced in recent years by a number of economists including McMillan and Woodruff (1999,2002), De Soto (2000), Frye and Zhuravskaya (2000), Djankov *et al* (2004) and Roland and Verdier (2003). Several institutions are argued to affect entrepreneurial endeavour: quality of commercial code, strength of legal enforcement, administrative barriers, extra-legal payments and lack of market-supporting institutions. The legal and institutional system is certainly immature, having only been introduced in many countries for the first time in the early years of transition. Most of the CEE economies had an outdated commercial code in 1989, but, even here, new laws were needed to define the concept of a private firm, and to create procedures for entry, and bankruptcy. In the FSU and much of the

Balkans, the legal heritage for a market economy was even weaker. In the legal vacuum after the fall of communism, the difficulty of enforcing voluntary contracts was also of great importance, for example customers failing to pay for goods or firms failing to pay wages (see Earle and Sabirianova 1998). In many countries, especially but not exclusively in the FSU, the state also continued to be very active in enterprise affairs, putting out its “grabbing hand” (Shleifer and Vishny 1999) to the detriment of all firms, but especially *de novo* private ones (Belka *et al* 1995). Entrepreneurs are often more affected by corruption and ineffective regulatory frameworks because they lack bargaining power vis-à-vis the public bureaucracy.

In Table 2, we provide an overview of the institutional environment that may affect entrepreneurs and small firms. In addition to five representative transition economies, we also consider China and two West European economies as benchmarks. In the upper part of the table, we report formal indicators based on the World Bank’s interviews with experts in the respective country; in the lower part the EBRD’s indicators based on entrepreneurs’ assessment of major obstacles. Lastly, we report data from a recent FDI survey (Meyer *et al* 2005) and Transparency International’s corruption perception ranking. The different types of indicators tell different stories about the business environment, and thus highlight the importance of methodological aspects of these kinds of studies.

The World Bank data (World Bank 2005, Djankov *et al* 2004) suggest that institutional settings in CEE are largely on par with West European counterparts, although there are major outliers. On the positive side, registering property can be done much faster in Lithuania and Bulgaria than in our benchmark countries. On the other hand, contract enforcement still takes much longer in CEE (except Lithuania) compared to the UK or Germany. Poland, often applauded for its entrepreneur-

friendly environment, appears on this data to be the laggard for three of the seven indicators; Russia, with a reputation for being particularly obstinate to business, never gets the worst score; while the supposedly entrepreneurial Hungarians need to spend 52 days, the highest in our selection of countries, to set up their business. Thus, World Bank data show a pattern of diversity within the region, and overall a not particularly worse performance than in Western Europe.

The picture presented by the EBRD data is very different (EBRD 2004, Pissarides, Singer, and Svejnar 2003). The EBRD asked entrepreneurs which, out of a list of possible obstacles, was inhibiting their business creation and growth in 2002. The findings indicate that entrepreneurs in Russia and Bulgaria experience far more obstacles than Hungary and Poland, with Lithuania taking an intermediate position. On the important issues of taxation and financing,<sup>5</sup> Poland appears to provide least obstacles to entrepreneurs, while Hungary performs best on several indicators including inflation, functioning of the judiciary and infrastructure.

The differences in these evaluations are likely to stem from differences in methodology of these surveys. The World Bank data attempt to provide objective, quantifiable measures of institutional and administrative barriers to entrepreneurship. Validity of these data, however, relies heavily on the source of information on business environments. Countries with policy implementation gaps may have advanced business law on books but reality may be different due to informal institutions. Moreover, high number of procedures to start business may be less of a deterrent for entrepreneurs than uncertainty of the procedure's outcome, not captured by the survey. On the other hand, differences reported in subjective surveys may be either real or perceptual, a problem known in the methodology literature as

‘equivalence’. This creates problems for comparison of ‘real’ levels of institutional development between countries. However, such surveys are still useful in analyzing entrepreneur’s willingness to engage in business activity, as these decisions are likely to be guided by perceptions of the business environment.

Both EBRD and World Bank surveys seem to correspond to the broad consensus that ascribes higher institutional development to Central European countries when compared to former Soviet republics. More interesting may be the relative importance of different obstacles across countries, and this pattern is fairly consistent. In all the transition countries, *taxes*, *financing* and *policy instability* are among the top four items mentioned (except policy instability in Lithuania) while informal institutions, such as crime or the functioning of the judiciary, are mentioned less frequently. In their analysis, Pissarides, Singer, and Svejnar (2003) find that high interest rates and obstacles to raising funding are (on average) the most highly rated items, followed by ‘suppliers unable to deliver’, ‘other operational issues’ and ‘access to land & buildings’. Taxes and price volatility are also important, but classic informal institution issues do not make the top list.

Taxes are a common complaint by entrepreneurs worldwide. However, little distinction is made between the level of taxation and the methods of tax collection and enforcement. In transition economies, the costs created by an inefficient or corrupt system of tax collection may substantially add to the costs of running an entrepreneurial business. Some support for this can be found in Aidis and Mickiewicz (2003<sup>4</sup>). They find that perception of high taxes has a negative effect on the growth expectations of small firms in Lithuania. The measure of taxation is correlated with two omitted variables, “frequent changes to tax policy” and “ambiguity of taxes”

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<sup>4</sup> Contradictory evidence to these data emerges in a different study that also reports entrepreneurs’ own views about the environment. In Fogel and Zapalska (2001), Polish entrepreneurs appear to have more

suggesting that all aspects of the system of corporate taxation, rather than the level alone, may inhibit entrepreneurial growth. A recent study by Meyer *et al* (2005) also points to instability of the rules and regulation, rather than the actual state of these variables, as a major obstacle reported by foreign investors. Even though the regulatory framework is moving towards the regulatory frameworks in other EU countries, the change process as such creates costs and uncertainties that affect businesses.

Work on the importance of legal enforcement is less conclusive. Johnson *et al* (2000) find that the entrepreneur's belief in the courts' ability to enforce contracts has a negative effect on employment growth, though this effect is not significant with respect to sales growth. Djankov *et al* (2004) report that in Russia, entrepreneurs seem to have less confidence than non-entrepreneurs in the efficiency of the court system. However, research in this field is plagued by methodological problems in estimating the impact of institutions on firm performance that have not yet been resolved. Thus barriers are hard to measure and entrepreneurs in the same context face the same institutional barriers, yet cross-country or even cross-regional studies capture a lot of contextual variation that cannot usually be attributed to a specific variable. In addition the majority of studies use entrepreneurs own perceptions, as a proxy for institutions and it would be desirable to use variables that come from a different source than the performance measure.

### **4.3 Human Capital and Socio-Economic Factors**

Human capital is also an important ingredient for entrepreneurship, and this is confirmed by Barberis *et al* (1996), who show that new human capital was a crucial ingredient for successful new entry by small firms in Russia. The transition countries

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problems accessing finance than their Hungarian counterparts.

fare relatively well in terms of formal measures of education. However, the social and cultural environment is less conducive. In Table 3 we use the United Nations Human Development Index to address some of these issues for the same countries as Table 2.

The socialist regimes, including China, created extensive education and health services, which contribute to good performance in this index and CEE economies continue to invest a high proportion of GDP in education, even outperforming some West European countries. As a result literacy rates are high in transition economies and educational standards are comparable to Western Europe. Also, transition economies typically have a high proportion of students in ‘hard’ subjects of science, mathematics and engineering. These indicators thus suggest a good human capital basis for entrepreneurship, probably more so than pertains in developing economies.

Turning to indicators of adoption of modern technology, here mobile phone and Internet users, given the heritage from planning, it is unsurprising that the transition economies are lagging behind Western Europe. These indicators also show major variations within the region: Poland, Hungary and Lithuania are catching up, while Bulgaria and Russia are lagging quite far behind. With respect to expenditures in R&D, transition economies show considerably less investment than Western Europe; during the socialist period R&D investments used to be comparatively high but were often inefficient.

An important aspect of the human capital is also the age structure of the population as most entrepreneurs are in the age range of 30 to 45, while young customers are more likely to adopt new products and services. The demographic structure of CEE in many ways resembles that of Western Europe with relatively few young people. This in itself may be seen as an obstacle to entrepreneurship.

There is also evidence that managerial skills are in short supply. Most top directors in transition economies came from an engineering background and lacked managerial skills as well as market experience (see Estrin and Peiperl 1998). The economy had been run bureaucratically. Its concentration of reward on plan attainment suppressed the appetite for risk and instead bred habits of obedience and “playing it safe” (see Ellman 1994). History also acts strongly against an entrepreneurial tradition, particularly in the FSU. Entrepreneurship in the sense of creating new private businesses had been illegal in what was the Soviet Union since 1917, and in CEE after 1945. Moreover, the culture has been strongly opposed to entrepreneurial activity – little distinction was made in the media or public perception between entrepreneurs and criminals.

## **5. The Patterns of Entrepreneurship**

Market liberalisation and the introduction of private property have paved the way for emergence of legal entrepreneurship in Central and Eastern Europe. This section provides empirical evidence on the pattern of firm creation and on strategies adopted by entrepreneurs in response to their environment.

The starting point for the transition economies in the late 1980s was an environment containing very few firms, mostly very large, and with almost no small enterprises outside agriculture or craft. Thus according to Acs and Audretsch (1993), the percentage of workers employed in small enterprises in the late 1980s was only 1.4% in Czechoslovakia, 1.1% in East Germany and 10% in Poland. Indeed the total number of firms was very small in Central European economies, only 19000 in

Hungary and 16000 in Czechoslovakia, compared with 200,000 in neighbouring and comparable Austria.

The early years of transition saw a remarkable rise in the number of firms, a fundamental shift in the size distribution towards smaller enterprises and the creation of a service sector, largely comprised of numerous small enterprises. It seems likely that a significant proportion of this new firm creation represents entrepreneurship of the Kirznian sort. A few figures, tables and charts illustrate the rapid development of a new SME sector. The number of incorporated firms increased enormously.

According to Eurostat, firm numbers had risen more than tenfold in parts of CEE by 1994, with 167,000 firms registered in the Czech Republic, 101,000 in Hungary and 95,000 in Poland<sup>6</sup>. In Table 4, we compare the distribution of firms in the late 1990s in a selection of (advanced) transition economies and some developed Western economies. The turnaround from the figures quoted by Acs and Audretsch is extraordinary. By the late 1990s, the transition countries have approximately the same share of small firms as West Germany or the United States (80-90%), though the share of employment in such enterprises is rather less, except in the Baltic economies. There is a difference between the manufacturing and the service sectors. In the latter, the share of firms, and of employment, in small enterprises is typically larger in transition economies than in the OECD countries, because the service sector had to be created from scratch. In manufacturing however, though there has been a substantial increase since 1990 with the exception of Latvia, the share of small firms in total firm numbers remains somewhat below that observed in developed

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<sup>6</sup> Official statistics have to be treated with caution, especially in periods of rapid change. Entrepreneurs have strong incentives not to report the full extent of their activities to minimize their tax obligations and the potential for extortion by illegal groups) and the incentives magnify if institutions are rapidly changing or non-transparent. On the other hand, many registered new firms have never been operational.

economies, and the difference is even more marked with respect to employment. Thus, the share of small enterprises in manufacturing employment in West Germany is 16.6% compared with only 5.1% in Slovenia and 4.3% in Romania.

The distribution for CEE had moved even closer to the EU average by 2002, according to Eurostat (2002). For the EU as a whole in manufacturing, 8.5% of employment is in micro firms, 32% in small firms and 59.5% in medium sized and large firms. The comparable figures for Hungary at that date were 12.0, 25.1 and 62.9% respectively; for Poland 9.5, 25.9 and 64.6% and for the Czech Republic 11.3, 25.7 and 63.1%. Thus by 2002, we see convergence in CEE to the EU norms in terms of firm size distribution, even in the manufacturing sector.

Russia also experienced an upsurge in firm numbers in the early years of transition, but, according to Kontorovic (1999), the pace has not been sustained post-1994. Figure 1 reproduces a chart from Brown and Brown (1999), which reveals very rapid growth in the share of small firms from only around 25% in 1989 to almost 90% in 1996. Hence the Russian firm size distribution is converging to the American one in less than a decade. However, while the size distribution has taken a more regular shape, the numbers of firms remains quite limited. According to Desai (2005), the number of firms in Russia employing no more than 100 workers had risen by 10% in 2004 to 946,000, to serve a population of 140 million. Businesses of this size only generated around 10% of Russian GDP and provided employment to 19% of the labour force. The seeming discrepancy between Brown and Brown (1999) and Desai (2005) data is explained by the former examining the size distribution of firms in manufacturing and the later looking at the output and employment count in the economy as a whole. These data reinforce the view that while at least in the manufacturing sector size distribution is converging to that of US, the economy as a

whole is still dominated by a few large firm, particularly in the natural resources based industries, while SMEs contribute a modest proportion of national output. Thus 23 firms in Russia control 33% of output and around 16% of employment.

The growth of a new small firm sector, however remarkable in pace, is not necessarily evidence for an upsurge in entrepreneurship. The increase in firm numbers may also represent the incorporation of enterprises previously operating on grey or black markets, the formation of paper enterprises as an insurance against future unemployment or for shady purposes, or a state imposed break up of former SOEs. Earle and Sabirianova (1998) analyse self-employers in six transition economies, and distinguish between people who work for themselves and those that create jobs for others, a group that they identify with entrepreneurs. They find the self-employment share in total employment in 1993 to be highest in Poland, at 23%, followed by Bulgaria, Czech Republic, Hungary and Slovakia in the range of 8-11%, and finally by Russia with only 4%. Comparable figures for Western economies are in the range of 10-15%. Nonetheless, these proportions had more than doubled in the transition economies since 1978, from around 11% in Poland, 4% Bulgaria and Hungary, and less than 1% in the more centralised planned economies – Russian and Czechoslovakia. “Entrepreneurs” in the Earle-Sabirianova definition remain a relatively small fraction of the self-employed in each country; less than one quarter of the total in Poland and Russia but around half in Hungary and the Czech Republic.<sup>7</sup>

In similar vein, Blanchflower, Oswald, and Stutzer (2001) use “latent entrepreneurship”, which they define as the proportion of people who say that they would *prefer* to be self-employed. They find a great variation in latent

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<sup>7</sup> This measurement of entrepreneurship, however, is also not without fault, as decision to register as self-employed or employing others may be influenced by payroll taxes, which may differ from country to country.

entrepreneurship across countries, with countries like the USA, West Germany and Switzerland having rather high proportions (more than 60%) while those in Denmark and Norway are rather low, less than 30%. Several of the transition economies are at the lower end of the spectrum i.e., Russia at 33.2% and the Czech Republic at 36.8%. However, Slovenia, Bulgaria and Hungary are in the middle between 50% and 60%, while Poland is at the very top of the table with a score of 79.9%. Their study suggests no lack of potential entrepreneurs in many transition economies, though perhaps the low social esteem of entrepreneurs in Russia explains the lower aspirations to self-employment.

Entrepreneurial development has been uneven across CEE. Advanced economies of Central Europe lead over former Soviet republics, whether entrepreneurship levels are measured in number of firms per capita (Glas and Dinovsek 2003), share of total employment or output in SMEs (World Bank 2002) or percentage of the labour force engaged in entrepreneurial activity (Dutz *et al* 2001). However, cross-country comparisons are hindered by inconsistencies of definition and different legal requirements. Small firm definitions range from companies with up to 100 employees in Russia (Goskomstat 2001) to firms with up to 50 employees in Poland (Huebner 1997) or may be based both on employment count and total assets as in Bulgaria (Mateev 2003). However, while these statistics preclude an exact ranking of countries in terms of small firm numbers, the low number of small firms in Russia (adjusted by population) and their contribution to national output is manifest when compared to that in Poland, particularly when one takes into account that the cut off in the Polish definition is much lower.

Furthermore, consistency of findings in showing higher prevalence of entrepreneurs in Central European countries lends credibility to the notion that levels

of entrepreneurship are higher in more advanced transition economies. This is also supported by results of labour surveys conducted in the second half of 1990s. Thus Dutz *et al* (2001) provide further evidence by analysing the proportion of labour force engaged in entrepreneurial activity. Their findings show particularly high proportion of labour force employed in entrepreneurship in Hungary (10.9%) and Poland (8.6%). In Armenia, Croatia, Kyrgyzstan and Russia entrepreneurial employment ranges between 4 and 6 %. In Ukraine only 1% of labour force is employed in entrepreneurship.

## **6. The New Entrepreneurs**

Who are the people that are willing to face the risks, and chase the opportunities of setting up their own business? The entrepreneurship literature has analyzed them in terms of their motives and personal characteristics, distinguishing first and foremost between needs-based and opportunity-driven entrepreneurship. The needs-based or survival motive induces people who set up a business to earn a living or a proper income where other forms of employment (and social welfare) are scarce. Opportunity driven entrepreneurs follow more intrinsic motives such as to be independent, to implement an idea, a technology, or to make a contribution to society, and are more typical for developed countries.

The Global Entrepreneurship Monitor (GEM 2003) suggests that in Eastern Europe few entrepreneurs are driven by needs-based motives. Especially compared to other middle-income economies, where setting up your own business is an important route out of poverty, few people in CEE start their own business under pressures to survive or to earn an acceptable family income. This reflects the still very extensive social security in CEE, which may inhibit new firm creation. In contrast to GEM

(2003), Smallbone and Welter (2001) observe a large proportion of start-ups being motivated by push factors. This may stem from difference in survey samples as well as from the difficulty of giving empirical content to necessity versus opportunity driven entrepreneurship.

Scase (2003) offers a different dichotomy, namely by entrepreneurs' commitment to business growth. He argues that in transition economies a large proportion of business owners are "proprietors" who use profits for private consumption rather than reinvest into business. Thus even though SME numbers may be high, they do not necessarily constitute a growth engine, as their motivation is different from that of their West European counterparts. To our knowledge, there is no conclusive empirical evidence linking motivation and economic impact.

The distinction between self-employed and those who actually grow a business and thus employ other people, used by Earle and Sabianorova (1998), provides a basis for a typology by Ronas-Tas (2002), which we reproduce in Figure 2. From a policy perspective, it is especially the second type of business that holds economic growth potential, while the first may substitute for employment relationships in over-regulated labour markets. Peng (2001) offers a more refined typology of four types of individuals that become entrepreneurs in transition economies, to which we add a fifth:

- **Individuals escaping poverty** may set up as street trader, possibly moving up to become a bazaar trader and then shop owner. These would mostly be needs-driven entrepreneurs, often earning barely enough to survive. They include individuals laid off in the public sector or in state-owned enterprises, and may hold formal education that would qualify them for professions of high qualification that are no longer well paid, such as doctors or scientists.

- **Farmers** may develop their family farm that provides employment for an extended family to expand beyond agriculture. The farm also provides initial resources to set up a business. In the transition economies, farms were usually collectivised during the communist period (except in Poland), and re-privatisation provided business opportunities for new owners, although often inhibited by a lack of economies of scale.
- **Professionals**, e.g. researchers, may create their own business out of their previous organization. Typical examples might include university professors who moonlight as consultants, perhaps eventually quitting their jobs to set up their own businesses.
- **Former cadres** at the early stages of transition used their *de facto* control over resources; including licenses, operating permits, bank credit and business networks. As we have seen, the privatisation process created opportunities for insiders of firms and government authorities to exploit their position for personal benefit, using not only legal means.
- In addition, **returning expatriates** may set up new businesses drawing on experiences gained during their years of expatriation, or building on restituted property regained upon their return. Moreover, countries like Poland permitted large numbers of workers to seek employment abroad during the 1980s and their return brought people with accumulated wealth and experiences from countries like Canada, the US and Australia. It seems likely these returnees played a disproportionate role in the early years of private sector development, and substituted for the absence of an indigenous entrepreneurial tradition under communism. Yet there is little formal evidence on entrepreneurship by returning expatriates.

Other studies have investigated empirically the personal characteristics of individuals becoming entrepreneurs. For instance, Smallbone and Welter (2001) find that entrepreneurs often have comparatively high education levels and previous management experience, though typically from SOEs. According to Szelenyi (1988) entrepreneurs under socialism often came from families with previous entrepreneurial traditions, a finding confirmed by Webster (1992). Smallbone and Welter (2001) argue that family tradition was of particular importance in countries like Poland, which permitted the continuation of small-scale private activities throughout the communist era.

Lussier and Pfeifer (2000) compare Croatian and US entrepreneurs and find that the Croatians are on average younger and have less management experience, and fewer have parents with entrepreneurial experience. They start their business with less capital, less planning and less external management advice. In other words, Croatians appear more spontaneous and less systematically prepared in setting up their own business. Similarly, evidence from Lithuania points to enthusiastic but relatively inexperienced young people coming a long way in building new businesses (Gelbuda 2005). This would suggest some adaptation of entrepreneurial characteristics to the transition environment.

However, the personal characteristics of entrepreneurs vary greatly across transition economies. Roberts and Zhou (2000) find that CIS countries, represented by Armenia, Georgia and Ukraine, saw different entrepreneurial strategies than advanced reformers such as Hungary, Poland and Slovakia. First, CIS entrepreneurs are more likely to start in trading and then diversify into a different field. Thus a “generic businessman, always trading, maybe opening a restaurant one year, a taxi business the next, then maybe buying a meat-processing plant...” (Roberts and Zhou 2000 p. 194).

Their Central European counterparts are more likely to create firms that exploit and enhance their specialist skills and thus develop more focused business profiles.

Second, entrepreneurs in CIS countries are more likely to pursue entrepreneurial careers as a part-time occupation while being simultaneously employed elsewhere, often in a SOE. Another distinctive characteristic of entrepreneurship in CIS countries is the prevalence of partnerships as a legal type of businesses, while entrepreneurs in Central Europe are more often sole proprietors. Finally, Central European firms mostly operate in the official economy while CIS entrepreneurs conduct a significant proportion of their business in the second economy.<sup>8</sup>

A World Bank sponsored study is investigating the characteristics of entrepreneurs and the obstacles they face. At the time of writing, the first results from a pilot study using a matched sample of 777 entrepreneurs and non-entrepreneurs in Russia are available. Regression analysis suggests that that family background and exposure to business experience are very important. A cognitive test score and a proxy for 'greed' also have positive effects, as does, perhaps surprisingly, short size. Individuals reporting positive attitudes of society and governments to entrepreneurship are more likely to become entrepreneurs, while perceived corruption has a negative effect (Djankov *et al.* 2004). This ongoing project can be expected to generate major insights on the determinants of entrepreneurship in transition economies, which, as this review demonstrates, are so far not well understood. Future

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<sup>8</sup> Differences in entrepreneurial profiles were also identified within the former Soviet Union (Ardichvili and Gaparishvili 2003). These dissimilarities are a result of historical differences as well as a reflection on quality of existing institutions. In consequence, inferences from one country to the other should be treated with caution.

research may moreover relate characteristics of individuals to their performance as entrepreneurs, possibly using the aforementioned typologies as a starting point.

## **7. Entrepreneurial Strategies**

How do these entrepreneurs in transition economies build their businesses in view of high uncertainty and a not very supportive institutional environment? Generally, they adopt strategies that allow them to circumvent burdensome institutions or create substitutes for missing ones. As McMillan and Woodruff (2002) argue, entrepreneurs in transition economies “succeeded by self-help: they built for themselves substitutes for the missing institutions. Reputational incentives substituted for court enforcement of contracts. Trade credit (loans from firm to firm along the supply chain) substituted for bank credit. Reinvestment of profits substituted for outside equity”. Strategies documented in the literature include engagement in trade and diversification of activities as a means of capital accumulation and hedging against risks (Smallbone and Welter 2001) and using network-based transactions to substitute for missing or costly markets (Stark 1996, Batjargal 2003).

### *Coping with Risk and Capital Scarcity.*

Capital scarcity poses a problem not only for the establishment of businesses but also for their growth. Case studies suggest that engagement in trade often serves as initial capital accumulation that allows entrepreneur to branch off into a different business (Smallbone and Welter 2001). Portfolio entrepreneurship is another way for businesses to hedge against volatility of markets in transition. Welter and Smallbone (2003) find that entrepreneurs engaged in manufacturing and construction are more likely to have several enterprises than those operating in the services sector. They

explain this phenomenon by higher volatility and unpredictability of the manufacturing and construction sectors, particularly in regard to financial flows.

The nature of enterprises also reflects the riskiness of the business environment in transition. Smallbone and Welter (2001) find that 28% of entrepreneurs in Ukraine, Belarus and Moldova- countries considered to lag in business environment- are engaged in other occupations. Multiple ownership may also be a consequence of greater risk. Its occurrence is higher in former Soviet republics, and thus may reflect the need for security and access to resources through networking, which is increased by attracting several owners. While these strategies may help entrepreneurs to cope with their environment, they may also preclude development of business efficiency based on specialization of production and streamlining of organizational structures.

#### *Networking as a Means of Entrepreneurial Growth*

A persistently recurring issue in studies of entrepreneurs in transition economies is the importance of networks, across transition economies from China (Peng and Heath 1996, Batjargal and Liu 2004) and Vietnam (McMillan and Woodruff 1999) to Hungary (Stark 1996, Lyles, Saxton, and Watson 2004) and Russia (Batjargal 2003). The way entrepreneurs use networks varies greatly as the practices are often culturally grounded. For example *guanxi* networks in China ‘function’ in a very different way than ‘*blat*’ networks in Russia (Michailova and Worm 2003). Scholars from a variety of disciplinary perspectives ranging from economics (McMillan and Woodruff 2002), to sociology (Stark 1996, Sedaitis 1998, Batjargal 2003), to business strategy (Peng and Heath 1996, Puffer and McCarthy 2001, Peng 2001, Lyles, Saxton, and Watson 2004) and entrepreneurship (Smallbone and Welter 2001) have recognized the importance of the phenomenon, and have investigated its antecedents and

consequences. Why are networks so important in transition economies and what are the consequences of an entrepreneurial sector that relies to a higher degree on personal relationships?

Many scholars relate the prevalence of networking to the absence of a well functioning formal institutional framework (McMillan and Woodruff 2002; Peng 2001). However there is also a view that sees the pattern of networking such as *blat* in Russia as historical and culturally embedded and thus not only as an outcome of the ways the institutional framework has developed during the period of economic transition (Vlachoutsicos 2000, Buck 2003).

The transaction costs argument runs as follows: underdeveloped formal institutions in transition economies cause extensive market failures due to information asymmetries, lack of contract enforcement, high search and negotiation costs and various other effects (Swaan 1997). In consequence, firms either stay out of these markets or they have to create alternative means to secure themselves. Hence, they build business networks and rely on those relationships to ensure that business partners stick to their side of deals. Moreover, long-term relationships can be built to resemble a repeated game, so the anticipation of benefits from future collaboration outweighs the potential short-term profits of cheating on a partner. These business networks can extend and reinforce the effects of personal reputation. If business partners depend on reputation within a business network, they would be cautious to cheat on anyone in the network as the damaged reputation may outweigh the short-term benefits of cheating – as observed by McMillan and Woodruff (1999) in Vietnam.

Sociologists have analysed entrepreneurs' embeddedness in their local environment (Granovetter 1984) and thus view entrepreneurial action to a large

degree as an outcome of social interactions. Businesses benefit from networking in many ways, including the circulation of ideas, sharing of knowledge and creation of inter-organizational trust. Research on CEE stimulated by sociology thus has emphasized the prevalence of networks as mechanisms of inter-personal and inter-organizational interaction, and thus as a means to access resources, but also as a source of inertia (Stark 1996, Grabher & Stark 1997, Kogut, Spicer & McDermott 2000). This approach has been developed with respect to Russian entrepreneurs by Batjargal (2003). He considers systems of entrepreneurs' social relations as social capital, which has been shown to enhance entrepreneurial performance in other contexts. In Russia, where pure market transactions are subject to high transaction costs, such social capital can be expected to be particularly important. In his empirical study, Batjargal (2003) investigates various dimensions of entrepreneurial networks for the Russian context, and finds that in particular weak ties and resource mobilization (i.e. the ability to access resources through network contacts) enhance revenue growth.

Is the widespread reliance on networks an obstacle or an advantage for entrepreneurs? Taking an institutional economics perspective, networks may first and foremost be a symptom of an inefficient formal institutional framework. However, networking-based business practices can themselves become an institution, as businesses follow certain unwritten rules about how to act within networks, and their strategic actions focus on enhancing or exploiting network relationships. As informal institution, existing business networks, as well as informal rules on how to act within networks, can create barriers to entry and cause inertia in inter-business relationships. They would thus inhibit flexibility and the change of industrial structures.

In view of the importance of both formal and informal institutions for entrepreneurs in transition economies, Nee (1998) raises the question of how these would combine to shape economic performance. He suggests that formal and informal norms would be mutually reinforcing if the formal rules were congruent with the preferences and interests of economic actors. On the other hand, if formal rules are at variance with the preferences and interests of individuals and organizations, then formal and informal rules may be decoupled, with formal rules becoming largely ceremonial, while informal rules guide day-to-day business. Such varying interactions between formal and informal institutions may explain the diversity in the assessment of network-based economic activity. Reading the literature across transition economies, one notices that scholars of Russian business tend to emphasize the negative effects (Ledeneva 1998, Johnson, McMillan, and Woodruff 2000), Puffer and McCarthy 2001), while scholars of China are more cognizant of the positive effects (Peng (2001), Batjargal and Liu 2004). In part, this variation may be grounded in cultural differences in the networking practices, and perceptions about the role of networks (Michailova and Worm 2002). In China, networks may have a higher degree of continuity and network-based practices may provide more coherent overall coordination of economic activity, while Russian networks may have experienced more disruptions during political changes, and therefore provide a less coherent coordination mechanism. In China, networks may have provided an avenue, however imperfect, to alleviate the imperfections of markets supporting institutions. The same may have applied to early stages of transition in CEE, but it is not clear that such a conclusion would also apply to contemporary Russia.

Thus, further research is required to investigate the interaction between formal and informal institutions in guiding entrepreneurs, and the changing role of these

institutions at different stages of the transition process (Peng, 2003). Moreover, little research has been undertaken to establish whether networks have become institutionalized and thus create path dependencies that hinder evolution of more efficient market institutions.

## **6. Conclusions**

In this chapter, we have outlined the main directions of research on entrepreneurship in the transition economies. Transition from one economic system to another has created unique opportunities for entrepreneurs to create new businesses that fill voids in the structure of industry and services. Yet, it also created unusual risks due to both macroeconomic and institutional instability. A broad consensus in the literature suggests that the specific nature of the institutional environment and of institutional change processes shapes the patterns of entrepreneurship. Multiple lines of theorizing outline how institutions might affect small businesses. However, hard evidence on alternative arguments are hard to come by; empirical results vary with the research methods used, with the performance criteria considered, with the specific proxies used to capture the institutional influence, and the study context in terms of time and location.

So which institutions or policies affect entrepreneurial development in transition? No single policy or institution can account for the rising SME contribution to employment and value added. The most crucial ingredients include economic growth and rule of law as these send a message on the success of reforms and quality of entrepreneurship. Other factors, such as political continuity or discontinuity, rapid and gradual change and state officials who are perceived to be supportive or hostile towards new enterprises can all be context for the successful development of a small

firm sector. However, overall success – a critical mass of successful reforms seems to be the answer- which may explain the growing divergence between Central Europe and the former Soviet Union..

Future research may help resolve these issues by working with more rigorous measures of institutions, beyond entrepreneurs' own perceptions, and by systematic comparative studies in multiple countries. Thus, we need more rigorous study of the characteristics of entrepreneurs and of the determinants of growth using a wider variety of potentially relevant explanatory factors. The research agenda also has to move forward. The empirical research questions addressed in the literature so far concern entrepreneurial businesses in their early stages in transition economies. As these firms mature, they face some major challenges not unlike in other emerging markets. Firstly, entrepreneurial firms have to develop into mature business organizations, which require different organizational structures, and different leadership skills. This organizational transition from young entrepreneurial firm to mature business firm merits research attention. Secondly, SMEs from transition economies face major obstacles in accessing global markets, even if they have been successful at home. Many entrepreneurs in CEE appear to have engaged in international business relatively early (Gelbuda 2005), yet failure rates of early internationalizing firms appear to be especially high (Lyles, Saxton, and Watson 2004). On the global stage, firms need other types of resources to obtain competitive advantages, including global brands and access to distribution channels in Europe and North America. Local business networks may be important for growth within a country, but do not help in developing an international strategy. The outward international business by entrepreneurial firms is an important research issue in emerging economies in CEE, and beyond.

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**Table 1: Private sector share in GDP and employment in Eastern Europe, 1989-94**

	In GDP			In Employment		
	1991	1995	2002	1991	1995	2001
<b>Albania</b>	24	60	75	..	74	82
<b>Armenia</b>	..	45	70	29	49	..
<b>Azerbaijan</b>	..	25	60	..	43	..
<b>Belarus</b>	7	15	25	2	7	..
<b>Bosnia and Herzegovina</b>	..	..	45	..	..	..
<b>Bulgaria</b>	17	50	75	10	41	81
<b>Croatia</b>	25	40	60	22	48	..
<b>Czech Republic</b>	17	70	80	19	57	70
<b>Estonia</b>	18	65	80	11	..	..
<b>FYR Macedonia</b>	..	40	60	..	..	..
<b>Georgia</b>	27	30	65	25	..	..
<b>Hungary</b>	33	60	80	...	71	...
<b>Kazakhstan</b>	12	25	65	5	..	75
<b>Kyrgyz Republic</b>	..	40	65	..	69	79
<b>Latvia</b>	..	55	70	12	60	73
<b>Lithuania</b>	15	65	75	16	...	...
<b>Moldova</b>	..	30	50	36	..	..
<b>Poland</b>	45	60	75	51	61	72
<b>Romania</b>	24	45	65	34	51	75
<b>Russia</b>	10	55	70	5	..	..
<b>Serbia and Montenegro</b>	..	..	45	..	..	..
<b>Slovak Republic</b>	..	60	80	13	60	75
<b>Slovenia</b>	16	50	65	18	48	..
<b>Tajikistan</b>	..	25	50	..	53	63
<b>Turkmenistan</b>	..	15	25	..	..	..
<b>Ukraine</b>	8	45	65	..	..	..
<b>Uzbekistan</b>	..	30	45	..	..	..
<b>Means</b>	<b>20</b>	<b>44</b>	<b>62</b>			

Sources: EBRD Transition Report 1999, 2003;

**Table 2: The institutional environment for entrepreneurship**

	Bulgaria	Hungary	Lithuania	Poland	Russia	China	Germany	UK
Starting a business, days <sup>a</sup>	32	52	26	31	36	41	45	18
Starting a business, procedures <sup>a</sup>	11	6	8	10	9	12	9	6
Enforcing a contract, days <sup>a</sup>	440	365	154	1000	330	241	184	288
Enforcing a contract, procedures <sup>a</sup>	34	21	17	41	29	25	26	14
Registering property, days <sup>a</sup>	19	79	3	204	37	32	41	21
Registering property, procedures <sup>a</sup>	9	4	3	7	6	3	4	2
Resolving insolvency <sup>a</sup>	3,3	2	1,2	1,4	1,5	2,4	1,2	1
Taxes <sup>b</sup>	77,9	74,5	82,2	74,4	90,6			
Financing <sup>b</sup>	72,5	60,0	69,8	48,0	78,8			
Policy instability <sup>b</sup>	70,4	57,0	50,0	55,2	84,8			
Inflation <sup>b</sup>	58,6	52,1	56,4	52,9	88,2			
Exchange rate <sup>b</sup>	47,5	16,3	29,0	40,8	72,7			
Functioning of judiciary <sup>b</sup>	41,3	8,3	36,3	39,1	29,8			
Corruption <sup>b</sup>	54,3	28,5	53,0	39,4	50,5			
Street crime <sup>b</sup>	57,8	25,1	53,8	40,3	50,2			
Organized crime <sup>b</sup>	51,2	25,0	48,4	28,5	49,8			
Infrastructure <sup>b</sup>	42,8	15,3	24,5	16,9	32,6			
Frequent legal changes cause costs <sup>c</sup>		3.51	3.67	4.12				
Important to obtain info on changes in the law <sup>c</sup>		4.19	4.08	4.30				
Important to obtain info on changes in regulation <sup>c</sup>		4.15	4.17	4.23				
Corruption Perceptions Index Rank <sup>d</sup>	54	42	44	67	90	71	15	11

Sources and notes: <sup>a</sup> = World Bank (2004); <sup>b</sup> = EBRD (...): Enterprise Survey in Transition 2002 (% of respondents indicating moderate or major obstacle to the business environment in 2002); <sup>c</sup> = Meyer *et al.* (2005): five point scale from 1= do not agree at all, to 5 = fully agree; <sup>d</sup> = Transparency International (2004).

**Table 3: Business Environment in Transition Economies**

	Bulgaria	Hungary	Lithuania	Poland	Russia	China	Germany	UK
GDP per capita (US\$), 2002	1.944	6.481	3.977	4.894	2.405	989	24.051	26.444
Human Development Index, 2002	0,796	0,848	0,842	0,850	0,795	0,745	0,925	0,936
Public expenditure on education (as % of GDP), 1999-2001	..	5,8	..	5,4	3,1	2,3	4,6	4,6
Tertiary students in science, math & engineering (% of all tertiary students), 1994-97	25	32	38	..	49	53	31	29
Mobile phone subscribers (per 1,000 people), 2002	333	676	475	363	120	161	727	841
Internet users (per 1,000 people), 2002	80,0	157,6	144,4	230	40,9	46,0	411,9	423,1
Research and development expenditures (as % of GDP), 1996-2002	0,5	0,9	0,6	0,7	1,2	1,1	2,5	1,9
Population age composition: ages 0-14, 2002:	14,8	16,5	18,2	18,2	16,9	24,2	15,1	18,4

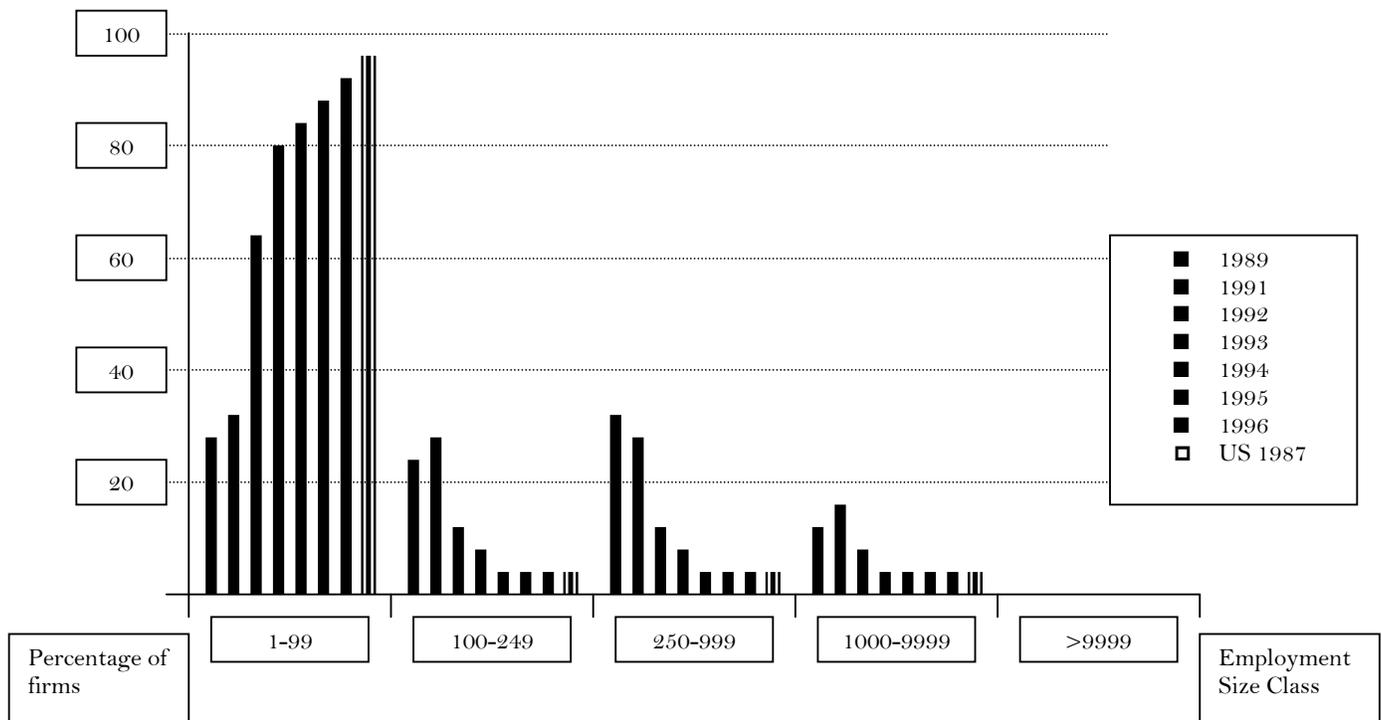
Source: United Nations: Human Development Report 2003.

**Table 4: Firms with less than 20 employees as a percentage of total, 1990s**

	Firms			Employment		
	Total Economy	Manufacturing	Services	Total Economy	Manufacturing	Services
West Germany	89.6	85.3	..	25.8	16.6	..
UK	..	81.3	..	..	12.4	..
US	88.0	72.6	88.7	18.6	6.7	19.9
Slovenia	87.7	71.6	93.1	13.4	5.1	26.0
Hungary	84.4	71.1	90.8	16.0	8.8	23.6
Estonia	80.6	64.6	87.1	22.8	11.5	34.2
Latvia	87.7	87.8	87.6	24.7	26.9	24.2
Romania	90.9	77.1	95.6	12.9	4.2	31.6

Source: Bartelsmann, Haltiwanger and Scarpetta (2004)

Figure 1:  
Size Distribution of firms in Manufacturing Sectors: Russia and the United States



**Figure 2: A Typology of entrepreneurs in transition economies**

	<b>The Caterpillar</b>	<b>The Worm</b>
Main actor	Entrepreneur	Self-employed
Main unit	Enterprise with its own space	Household
Main goal	Accumulation	Survival / consumption
Main resource	Smart combination of factors of production	Labour
Genesis	Pull	Push
Strategy	Innovative, initiative (prospector)	Defensive, reactive, imitative
Commitment	High, full-time	Low or intermittent, part-time
Contracts	Formal, legal	Informal
Employment	Employs others	Employ only self, family, good friends
Legal form	Incorporated, limited liability	Sole proprietorship, unlimited liability
Market	Anywhere, potentially even abroad	Local
Biz Relationships	Supplier, subcontractor to big biz	No substantive relations
Source of profits	Market opportunities	Self-exploitation
Business cycle	Expansion in up cycle	Expansion in down cycle
Taxes	Major source of tax revenue	Often tax evading
Policy intervention	Access to credit	Training
Growth	Likely to grow when successful	Keeps its size small even if successful

Source: Ronas-Tas (2002)