Business perceptions of regulative institutions in Central and Eastern Europe

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Abstract:
Purpose – The purpose of this paper is to investigate, theoretically and empirically, how entrepreneurial firms' perceptions of formal institutions differ across Central and Eastern European (CEE) economies.
Design/methodology/approach – The paper uses data from the World Bank Group's World Business Environment Survey (WBES) compare entrepreneurial firms' perceptions of changes in different components of regulative institutions in Latin and orthodox CEE economies. The data used in this paper capture a decade's progress in the development of regulative institutions in these economies.
Findings – It was found that the state's regulatory, participatory, and supportive roles are more favorable to businesses in the Latin countries than in the orthodox countries. The findings provide support for the notion that informal institutions influence the degree of generalizeability and replicability of Western political and economic institutions' success in driving firms' entrepreneurial behavior in emerging economies.
Research limitations/implications – The first limitation is that the data used were collected about a decade ago. Another limitation relates to a lack of coverage of many former Soviet republics and some other CEE countries in the WBES.
Practical implications – The findings point to the need of strategic planning and various degrees of adaptation of business strategies across the CEE economies. Second, businesses may differ in terms of the relative importance of regulatory, participatory, and supportive roles of the government in their operations. Finally, some CEE economies can be influenced more than others by international pressures.
Originality/value – This paper's greatest value stems from the fact that it uses internationally comparable firm-level data to empirically examine entrepreneurial firms' perceptions of regulative institutions in CEE economies.
Keyword(s): Regulation; Entrepreneurialism; Eastern Europe.

Article:

1 Introduction

In a rich body of theory and empirical research, scholars have examined how the institutional environment exerts a powerful influence on entry rates, distribution of various forms of entrepreneurship as well as performance of entrepreneurial firms (Acs, 2007; Baumol, 1990; Djankov *et al.*, 2002; Manolova *et al.*, 2008). To provide benefits to a broader range of people and to enable businesses to compete in the global market, most governments in Central and Eastern European (CEE) economies are interested in promoting productive market entrepreneurship and discouraging unproductive political entrepreneurship (Kreft and Sobel, 2005, p. 604). Note that according to the typology in Kshetri (2009), market entrepreneurship is capitalism dominated (as opposed to socialism dominated) and legal (instead of quasi-legal, extralegal or illegal).

Research has provided evidence that poor regulative institutions such as a lack of protection of property rights, high tax rates, and inefficient tax administration negatively affect the growth of formal firms in an economy and provide incentives for firms to operate informally (Dabla-Norris and Inchauste, 2008; Johnson *et al.*, 2002). Note that formalization of the informal sector is one of the important indicators related to the impact of entrepreneurship (Ahmad and Hoffmann, 2008). A survey of new firms in Poland, Romania, Slovakia, Ukraine, and Russia indicated that weak property rights hindered firms' reinvestment of profits (Johnson *et al.*, 2002).

Appropriate political, legal, economic, and commercial structures are needed for a free market economy (d'Andrea-Tyson *et al.*, 1994; Warner and Daugherty, 2004).

Likewise, informal institutions such as social norms and customs are tightly linked to the development of entrepreneurship. Some examples of anti-entrepreneurship informal institutions include preference for lifelong employment in big firms in Japan (Muller *et al.*, 2004), Chinese societies' negative perception of private entrepreneurs especially in the 1980s (Harwit, 2002) and hostility to entrepreneurship at the societal level in some CEE economies (Kalantaridis, 2000).

Speaking of the problems in transplanting Western institutions in CEE economies, Offe (1996) notes: “the newly founded [formal] institutions fail[ed] to perform in anticipated ways” because of “unreconstructed mental and moral dispositions [informal institutions] inherited from the old regime” (p. 212). Implicit in Offe's (1996) argument is the notion that the development of formal institutions is linked to the contexts provided by informal institutions.

In prior literature, researchers have noted that there is a significant variation across CEE economies in formal institutions to support private enterprises (Johnson *et al.*, 2002). Notably, lacking from this literature, however, is explicit attention to how the development of formal institutions differs across economies in transition with different informal institutions. Important questions remain regarding the different rates of success in transplanting institutions borrowed from the West in these economies.

The purpose of this paper is modest: we investigate theoretically and empirically how entrepreneurial firms' perceptions of formal institutions differ across CEE economies with different informal institutional environment. The central hypothesis is that businesses in economies in the Latin group are likely to perceive the state's role more favorably than those in the orthodox group. The theory we present in this paper extends the theory of institutional changes and fills in some of the gaps that exist both in institutional theory and other entrepreneurship and international business-related studies, especially those studies focusing on the effects of institutions on organizational performance.

Table I. Economies in the Latin group and the orthodox group

WBES country code	Country	Sample size in WBES	Major religions[a]
Latin group			
5	Croatia	127	Roman Catholic (87.8 percent), orthodox (4.4 percent)
6	Czech Republic	137	Roman Catholic (26.8 percent), Protestant (2.1 percent), unspecified (8.8 percent), unaffiliated (59 percent)
7	Estonia	132	Evangelical Lutheran (13.6 percent), orthodox (12.8 percent), other Christian (1.4 percent), unaffiliated (34.1 percent)
9	Hungary	129	Roman Catholic (51.9 percent), Calvinist (15.9 percent), Lutheran (3 percent)
12	Lithuania	112	Roman Catholic (79 percent), Russian orthodox (4.1 percent), Protestant (1.9 percent)
14	Poland	225	Roman Catholic (89.8 percent)
17	Slovakia	129	Roman Catholic (68.9 percent), Protestant (10.8 percent), Greek Catholic (4.1 percent)
Orthodox group			
3	Belarus	125	Eastern orthodox (80 percent)
4	Bulgaria	125	Bulgarian orthodox (82.6 percent), Muslim (12.2 percent)
15	Romania	125	Eastern orthodox (86.8 percent), Protestant (7.5 percent), Roman Catholic (4.7 percent)
16	Russia	525	Russian orthodox (15-20 percent), Muslim (10-15 percent)
19	Ukraine	225	Ukrainian orthodox (83.7 percent), Ukrainian Greek Catholic (8 percent), Roman Catholic (2.2 percent), Protestant (2.2 percent)

Source: [a]Central Intelligence Agency (2009)

In the remainder of the paper, we first provide a brief survey of institutions and entrepreneurship in CEE economies. It is followed by a section on institutions and path dependence, which also develops hypotheses regarding the differential rate of development of formal institutions in Latin and orthodox countries. Then, we describe our data and methodology. Next, analysis and findings are presented. The final section provides discussion and implications.

2 A brief survey of institutions and entrepreneurship in CEE economies

Socio-economic data indicate more variation across CEE economies than many analysts had predicted (Spenner and Jones, 1998). For instance, the number of small and medium-sized enterprises (SMEs) per 1,000 people in the region varies from three in Belarus to 110 in Croatia. Likewise, SMEs account for 10-15 percentage of gross domestic product in Russia compared to 30 percent in Poland (Euro-East, 2000; Goldman, 2006).

To understand the differential rate of development in formal institutions to support entrepreneurship in CEE economies, it may be helpful to compare such institutions in the Latin group and the orthodox group. Following Zweynert and Goldschmidt (2006), these economies are presented in Table I. Some post-socialist (PS) economies have large populations of non-practicing believers and non-believers. Among the believers, however, dominant religions in economies in the orthodox group are various forms of orthodox Christianity. On the other hand, Roman Catholic is the dominant religion in economies in the Latin group.

	Latin group		Orthodox group
Country	No. of SMEs per 1,000 people	Country	No. of SMEs per 1,000 people
Croatia	110[a]	Belarus	3[b]
Czech Republic	86[c]	Bulgaria	31[c]
Estonia	28[c]	Romania	19[c]
Hungary	55[c]	Russia	6[d]
Lithuania	31[c]	Ukraine	6[b]
Poland	37[c]		
Slovakia	8[c]		

Sources: [a]UNDP (2007); [b]Sinelnik (2004); [c]European Commission Enterprise and Industry (2008); [d]Yegorov (2001)

Table II. Number of SMEs per 1,000 people in CEE economies

Researchers have noted that formal institutions in the Latin group are more entrepreneurship friendly compared to those in the orthodox group. Economies in the former group seem to embrace free market capitalism more enthusiastically. With the exception of Slovakia, the number of SMEs per 1,000 people is higher in economies in the Latin group than in the orthodox group (Table II). Table III presents The Economist Intelligence Unit's sovereign risk ratings. It is clear that in the average, the Latin group has a stronger sovereign rating than the orthodox group.

	Latin group			Orthodox group	
Country	Score[a]	Sovereign rating (outlook)	Country	Score[a]	Sovereign rating (outlook)
Croatia	49	BB (negative)	Belarus	NA	NA
Czech Republic	39	BBB (stable)	Bulgaria	43	BB (stable)
Estonia	42	BB (stable)	Romania	50	BB (negative)
Hungary	54	B (stable)	Russia	42	BBB (negative)
Lithuania	46	BB (stable)	Ukraine	59	B (negative)
Poland	47	BB (stable)			
Slovakia	26	A (stable)			
Average	43.28			48.5	

Notes: [a]A lower score represents a strong rating; description of sovereign rating: A capacity and commitment to honour obligations strong; BBB capacity and commitment to honour obligations currently but somewhat susceptible to changes in economic climate; BB capacity and commitment to honour obligations currently but susceptible to changes in economic climate; B capacity and commitment to honour obligations currently but very susceptible to changes in economic climate
Source: EIU (2009)

Table III. Sovereign ratings of economies in the Latin group and the orthodox group (February 2009)

Economies in the Latin group (the Baltic States, Poland, Hungary, the Czech Republic, Slovakia, and Croatia) have been more successful in creating formal institutions to support entrepreneurship than those in the orthodox group (Negoita, 2006; Zweynert and Goldschmidt, 2006; Stoica, 2004). For instance, Hungary is described as a post-1989 success (Negoita, 2006). Likewise, by 1995, Poland had 50 business incubators owned by foundations, associations or local governments.

Table IV presents some examples of barriers to entrepreneurship in economies in the orthodox group. Analysts observed that some economies in the orthodox group also showed a tendency to shift into reverse gear. Romania's development is referred as “stalled” or “de-development” (Negoita, 2006). Stoica (2004) noted that in Romania “the former party bosses are alive and, to the despair of many Romanians, well”. Starting a business in the country is difficult. There are at least 13 institutions involved in the process (Negoita, 2006). State officials in Romania lack accountability; it is impossible to sue them and formal complaints have no effects (OECD, 2002).

Country	Some barriers to entrepreneurship observed in the literature
Belarus	Replacement of Soviet-era managers by ones with a free-market mindset has been slow (Aslund, 1999)
Bulgaria	Bulgarians did not experience the twentieth century capitalist production methods and work habits, risks and rewards (Spenner and Jones, 1998)
	After the fall of the Communist system in the late 1980s, Bulgaria's secret service agents engaged in organized crimes
Romania	Beginning the late 1980s, political elites started converting their positional power for starting businesses (Stoica, 2004)
Russia	Following the mass privatization, former nomenklatura appointees accounted for two-thirds of the top positions in businesses and the government
Ukraine	"Predatory" actions of state officials hinder rural entrepreneurship (Mandel and Humphrey, 2002)
	Powerful oligarchs have a strong influence on government policies (Way, 2005a, b)
	Replacement of many Soviet-era managers by ones with a free-market mindset has been slow (Aslund, 1999)
	It is estimated that the regulatory burden on business takes 14 percent of a manager's time (Fortune, 2003)

Table IV.
Some examples of barriers to entrepreneurship in economies in the orthodox group

Likewise, the "merchant capitalism" thesis suggested that the dominant direction of change in the former Soviet Union would be "backward" or towards a more primitive merchant capitalism rather than a free market-based capitalism (Burawoy and Krotov, 1992). Russian Government arguably acts like a "grabbing hand" and discourages entrepreneurship (Frye and Shleifer, 1997).

3 Institutions and path dependence

Formal and informal institutions

Institutions consist of "formal constraints (rules, laws, and constitutions), informal constraints (norms of behavior, conventions, and self-imposed codes of conduct), and their enforcement characteristics" (North, 1996, p. 344). Formal institutions or constraints can be mapped with Scott's (1995) regulative pillar whereas informal institutions or constraints can be mapped with normative and cognitive pillars.

Path dependence

Entrepreneurial activities are embedded in historical circumstances and are supported by a complex web of political and social institutions (Fligstein, 1996). In CEE economies, different social logics, values, and practices influenced the filtration of external ideas through PS values and their integration into the local knowledge base, which influenced the growth of entrepreneurship (Clarka and Geppertb, 2006; Winiecki, 2003). Prior research indicates that formal institutions to support entrepreneurship are associated with and affected by informal institutions (Hayek, 1979). North (1994) observes that informal rules provide legitimacy to formal rules. Likewise, Axelrod (1997) argues that "social norms can become formalized into laws".

The path-dependence approach views the formation of formal institutions as a function of customs, habit, vested interests, and social networks (Spenner and Jones, 1998). It focuses on choices or conditions that influence options and steer history in a particular direction (David and Arthur, 1985; Arthur, 1989; North, 1990). In the CEE context, the central tenet of this theory is that informal rules of the pre-communist past influence the transition (Winiecki, 2004, p. 143).

Prior to discussing the influence of informal institutions on formal institutions, it is necessary to create a theoretical framework about the nature and structure of formal institutions. First, Sobel's (1999) conceptualization of "regulatory" and "participatory" state can be very helpful in understanding regulative institution or the state's role in promoting entrepreneurship. It is argued that participatory and regulatory states reduce risk related to starting a new business (Sobel, 1999). Of equal importance is the supportive role, which entails attacking the barriers related to skills, information, market, and infrastructures by legal and non-legal means.

Regulatory roles of the state

This dimension relates to the state's role in maintaining law and order. A regulatory state is characterized by the strong rule of law, which ensures the enforcement of contracts, minimizes the risk of expropriation and corruption of government, and has a high-bureaucratic quality (Sobel, 1999). Such a state has sound political institutions and a strong court system. In a regulatory state, a strong enforcement of contracts helps produce trust in business transactions (Stiglitz and Squire, 1998).

Participatory roles of the state

The term "participatory state" captures the extent to which policies and institutions represent the wishes of the broad population (Sobel, 1999). In such a state, businesses participate in the national policy-making arena through "dialogue, litigation, and mimesis" (Edelman and Suchman, 1997). Businesses can work closely with state agencies to protect their independence and autonomy (Greenwood and Hinings, 1996). Businesses and their associations carry enormous power to "bridge or link" their members' interests with the power of the state (Hunter, 1993, pp. 123-4).

When business groups are strong, the government will collaborate with them (Scott, 1992). Business groups are also involved in a "highly interactive process of social construction", which influences the practical meaning of a law-in-action (Edelman and Suchman, 1997). India's phenomenal development of entrepreneurship in the offshoring sector can be attributed to the involvement of that country's prominent and powerful software industry and professional association – the National Association of Software and Services Companies – the national policy-making arena (Kshetri and Dholakia, 2009).

Supportive roles of the state

In many emerging economies, new businesses face a host of barriers such as burdens related to tax systems, dysfunctional financial markets, and a lack of know-how (Durnev *et al.*, 2004). A government with high supportive tendencies attacks barriers to entrepreneurship related to skills, information, market, and infrastructures.

Scholars examining the development of information and communications technology (ICT) industry have identified these influences in the forms of new laws, investment incentives, foreign technology transfer, and other supply-push and demand-pull forces (King *et al.*, 1994). For instance, Singapore has developed itself as an ICT hub of Asia by providing attractive infrastructure, skilled workers and a stable labor environment (Kraemer *et al.*, 1992; Wong, 1998). Similarly, a strong university-industry linkage has driven the development of ICT industries in Israel (Porter and Stern, 2001). Likewise, to overcome its lack of high-level international quality certification, the Chinese Government is providing incentives for software firms that attain capability maturity model level 3 or higher (Kshetri, 2005).

The development of formal institutions: institutional changes

"The holistic order" and "the extended order" of the society and the religion's impact on entrepreneurship

A natural question is why the rate of institutional changes varies across economies. Institutionalists and historians have provided a valuable lead into this question. Institutions' propensity to change can arguably be described with two ideal types of social organizations – "the holistic order" and "the extended, functionally differentiated order" (for review of literature, see Zweynert and Goldschmidt, 2006). A holistic society is often characterized by an ideology, mostly in the form of a religion, that "claims validity for all spheres of action and thought" (Zweynert and Goldschmidt, 2006).

At a higher level of analysis, the heterogeneity in institutional reforms in CEE economies can thus be explained in terms of the degree of religious-secular differentiation. An observation is that religion is strong in CEE economies (Tomka, 2009). In 2007, the proportion of people who declared their adherence to a religion and/or a church were: about 95 percent in Bulgaria and Romania, 90 percent Poland, 80 percent in Slovakia, 75 percent in Croatia, 65 percent in Lithuania, 55 percent in Belarus and Hungary, 45 percent in Ukraine, and 18 percent in Czech Republic (Tomka, 2009). Likewise, in Russia, only 16 percent were non-believers and 12 percent believed in God without practicing religion.

Historically, the orthodox countries lacked the religious-secular differentiation that existed in Western Europe (Pipes, [1971] 1992). The political changes in Eastern Europe in the early 1990s initially led to attempts to radically change the formal institutions. However, in the orthodox countries, which are closer to the holistic end in the holistic-extended continuum, informal institutions did not change at the same rate as formal institutions (Warner and Daugherty, 2004).

Our point about a religion's effect on formal institutions may warrant elaboration. Observers often note that differences across economies in democratic capitalism and economic development can be partly attributed to differences associated with religions or ethical codes (Berdyaev, [1937] 1990; Buss, 2003; Zweynert and Goldschmidt, 2006). Religions and ethical systems have arguably facilitated economic development in most industrial economies. Judaism, Confucianism the forms of Christianity practiced in these economies have played roles in shaping habits and values that promote economic success including the belief that people can influence their destinies (Harrison, 2006/2007). For instance, people in these economies place emphasis on hard work and education and celebrate achievement. On the contrary, it is argued that Islam and, to some extent, Catholicism and orthodox Christianity promote fatalism and people practicing these religions tend to be more oriented towards the present or the past than the future (Berdyaev, [1937] 1990; Buss, 2003; Harrison, 2006/2007; Zweynert and Goldschmidt, 2006). In societies practicing these religions, hard work and achievement are less recognized; favoritism, nepotism, and personal connections are more readily apparent and family, clan, or class rather than a merit-based system determine awards and incentives (Atiyyah, 1992; Khashan, 1997). Speaking of the Islamic economies in the Middle East, Khashan (1997) observes: “Corruption and nepotism [prevails], and the concept of the state [isn't] fully understood […] as a guardian and representative of individual and community interests”. Observers have noted that these economies place relatively less emphasis on education (Harrison, 2006/2007). In the Islamic countries, the above barriers are particularly stronger for women (Wheeler, 2006).

Speaking of the growing influence of religion in the CEE economies, Tomka (2009, p. 20) observes: “Churches are important contributors to the emergence of civil society in insufficiently structured societies”. Religion's influence on businesses is more readily apparent in countries dominated by orthodox Christianity. It is argued that the orthodox religious tradition in Russia does not allow a person to act as a businessman in one way and as a believer of the religion in another way (Berdyaev, [1937] 1990; Buss, 2003; Zweynert and Goldschmidt, 2006).

It is worth noting that compared to orthodox economies (e.g. Russia and Romania), communists in Latin economies (e.g. Hungary and Poland) encouraged the development of the private sector (Stoica, 2004). In sum, institution formation, deinstitutionalization and reinstitutionalization (Scott, 2001) needed for reforms are likely to face more resistance in holistic societies.

The development of elite entrepreneurship and mutual interests between merchant families and rulers

Stark (1996) makes an intriguing argument as to why institutional changes needed to promote private businesses are difficult in the PS economies: PS transition is not a transition from plan to market but from plan to clan. A central feature of the privatization of state enterprises in these economies is that privileged elites converted “limited de facto use and income rights into more de jure alienable rights” (Feige, 1997). The essence of Stark's (1996) argument is thus simple: elite entrepreneurs take advantage of their positional power to maximize economic rewards. This emphasis on the exploitation of positional power is echoed in the “political capitalism” thesis, which argues that the major winners of the PS transformations are the former nomenklatura (Hankiss, 1990; Staniszkis, 1991).

Scholars also argue that the development of elite entrepreneurship is more apparent in the orthodox group. It is suggested that the “political capitalism” thesis might be more appropriate in describing the PS economies in the orthodox group compared to those in the Latin group (Eyal *et al.*, 1998).

To understand the infancy of capitalism in some CEE economies, it may be helpful to consider shared mutual interests between merchant families and rulers. Big businesses play influential roles in political decision making and remain a strong anti-reform force. For instance, Ukraine's oligarchs had close ties with Leonid Kuchma's Government. In 2004, the businessmen's favor gravitated toward the opposition candidate Viktor Yushchenko, who benefited enormously (Way, 2005a, b). Romania's relatively slower approach to reform in the 1990s can arguably be attributed to the "blocking tactics" from influential Romanians resisting changes (Ibrahim and Galt, 2002).

	Latin group				Orthodox group		
	n	Mean	SD		n	Mean	SD
Croatia	121	4.16	0.910	Belarus	78	3.86	1.289
Czech Republic	92	4.15	0.897	Bulgaria	77	3.90	0.871
Estonia	85	3.31	0.905	Romania	101	3.80	0.929
Hungary	81	3.40	1.137	Russia	416	4.36	0.871
Lithuania	69	4.23	0.763	Ukraine	185	4.21	1.076
Poland	192	4.09	0.776				
Slovakia	100	3.72	0.832				
Latin group	740	3.907	0.937	Orthodox group	857	4.10	0.991

Table V. Regulative roles: perception of the court systems

Development of formal institutions: a comparison of the Latin group and the orthodox group

Regulatory roles of the state: Latin group vs orthodox group

In a holistic society, an action's legitimacy is evaluated on the basis of a "general binding moral prescripts imposed by a superior authority" rather than by an economic logic, a political logic, or a juridical logic (Zweynert and Goldschmidt, 2006). In the orthodox countries, a political logic inherited from the Communist era is difficult to change, which acts as barrier to develop sound political institutions required for the operations of free market entrepreneurship. A similar point can be made about a juridical logic required for the development of a strong court system. In sum, the societies in the orthodox economies may find it difficult to understand an economic logic, a political logic, or a juridical logic. Based on the above discussion, the following hypothesis is presented:

H1. The state's regulatory role is more favorable to private businesses in the Latin group than in the orthodox group.

Participatory roles of the state: Latin group vs orthodox group

Elite entrepreneurs are stronger in the orthodox group than in the Latin group. In the former group, governments tend to direct efforts towards buttering up big businesses. The literature documents evidence of governments' ignoring interests of businesses with a low economic importance and lacking "veto points" (Hicks, 1999). For instance, in China, Russia, and Eastern Europe, the most important barrier to transition to a market economy centered on Communist Party bureaucrats' resistance (Thomas, 1997).

Big businesses, which have benefited from the status quo, play influential roles in political decision making and remain a strong anti-reform force. As discussed earlier, this capacity is powerfully illustrated in the roadblocks to reforms facing Ukraine (Way, 2005a, b) and Romania (Ibrahim and Galt, 2002).

Political as well as corporate power holders in socialist economies prefer unilateral control of power and decision making and thus oppose empowerment (Lynn *et al.*, 2002). States characterized by a communist ideology and politicized system of decision making tend to fail in implementing a participative management approach. Government officials in such economies are less likely to consider the needs of SMEs in making strategic decisions concerning policies and programs to develop the private sector. In the orthodox group, the state policies are thus less likely to reflect the demands and wishes of the broad population. Regulative institutions in such countries tend to have a low degree of participatory approach. In line with these arguments, the following hypothesis is presented:

H2. The state's participatory role is more favorable to private businesses in the Latin group than in the orthodox group.

Supportive roles of the state: Latin group vs orthodox group

A government whose basis of legitimacy is economic growth as opposed to MarxLeninism is more likely to support market entrepreneurship (Kshetri, 2009). In particular, Marxist ideology is against the development of service activities where small businesses can flourish (Goldman, 2006). The issue here is that many Soviet era managers lack a free market mindset and an understanding of financing and other ingredients needed for the promotion of entrepreneurship.

CEE economies differ widely in terms of institutional inertia to overcome Marxist ideology (Kshetri, 2009). The degree of hostility to entrepreneurship varies across these economies. The orthodox tradition viewed entrepreneurship negatively (Gerschenkron, 1954). Marxism and socialism further reinforced the stereotypes (Kusnezova, 1999; Kalantaridis, 2000). This may explain a lower concentration of SMEs in the orthodox group than in the Latin group (Table II). In sum, CEE economies in the Latin group and the orthodox group vary widely in terms of the state's supporting roles, which can be partly attributed to the inertia effect of Marxism and socialism. It is thus proposed that:

H3. The state's supportive role is more favorable to private businesses in the Latin group than in the orthodox group.

4 Data and methodology

Our data are from The World Bank Group's World Business Environment Survey (WBES, 2000). WBES was administered to enterprises in 80 countries in the late 1999 and the early 2000. The data thus capture a decade's progress in the development of regulative institutions in the CEE economies. It is also important to note that, for some of the items, WBES also measured firms' perception of regulative institutions “now” as well as “Three years ago”. This allowed us to compare entrepreneurial firms' perceptions of changes in different components of regulative institutions during the 1996/1997-1999/2000 period across the CEE economies.

The number of respondent firms in CEE economies varied from 112 in Lithuania to 525 in Russia (Table I). The survey utilized a standard core enterprise questionnaire methodology. Questions in the survey focused on the quality of the investment climate as shaped by domestic economic policy; governance; regulatory, infrastructure, and financial impediments; and assessments of the quality of public services (IFC, 2007).

As noted above, the economies in the Latin group and the orthodox group are taken from Zweynert and Goldschmidt (2006). They are presented in Table I with additional information obtained from the CIA's *World FactBook*. Note that we have analyzed only the CEE economies that were included in the WBES.

Table VI. Regulative roles: perception of the competitors' compliance with laws

Latin group	*n*	Mean	SD	Orthodox group	*n*	Mean	SD
Croatia	87	2.49	0.83	Belarus	74	1.78	0.44
Czech Republic	26	1.85	0.69	Bulgaria	54	2.59	0.85
Estonia	79	1.97	0.67	Romania	178	3.12	1.07
Hungary	48	1.98	0.70	Russia	230	2.02	0.81
Lithuania	38	2.15	0.74	Ukraine	99	2.46	0.84
Poland	102	2.54	0.87				
Slovakia	42	1.95	0.81				
Latin group	422	2.22	0.82	Orthodox group	635	2.06	0.90

5 Analysis and findings

This study mainly focuses on question numbers 7-11 and 35 in WBES. We compared formal institutions related to the state's regulatory, participatory, and supportive roles in the two groups of economies. Most of the hypothesized effects are statistically significant and are in the expected directions.

Regulatory roles

We begin by considering governments' regulatory roles in the two groups. Table V displays the results for the businesses' perception of their states' regulatory roles in terms of the court systems' efficiency in dealing with business disputes. We took question no. 11 in the WBES for this purpose. It read: “In resolving business disputes, do you believe your country's court system to be.” “Fair and Impartial”, “Honest/Uncorrupt”, “Quick”, “Affordable”, “Consistent”, “Decisions Enforced”. In the “Always” (1) to “Never” (6) scale, the Latin group's average of 3.907 was significantly lower than the orthodox group's average of 4.10 ($t=-5.52$, $p<0.0001$). This indicates that businesses in the former group perceive their court systems more favorably compared to the latter group.

As an alternative measure of the state's regulatory role, businesses' perceptions of their competitors' compliance with laws are presented in Table VI. We used question no. 35 in the WBES to measure this, which read: “Please judge on a four point scale how problematic are the following practices of your competitors for your firm?” In the no obstacle (1) to major obstacle (4) scale, the Latin group's average of 2.22 was significantly greater than the orthodox group's average of 2.06 ($t=-2.77$, $p<0.01$) (Table VI). The direction of the relationship was thus opposite to our hypothesis. Note, however, that the item non-response rate was high for this item in the WBES.

Participatory roles

We used item nos 9 and 10 in the WBES to measure the state's participatory roles. Item no. 10 in the WBES read:

When a new law, rule, regulation, or decree is being discussed that could have a substantial impact on your business, how much influence does your firm typically have at the national level of government on the content of that law, rule, regulation or decree?

	Latin group				Orthodox group		
	n	Mean	SD		*n*	Mean	SD
Croatia	127	1.94	0.94	Belarus	121	2.24	0.56
Czech Republic	137	2.15	0.89	Bulgaria	125	1.53	0.79
Estonia	132	2.52	0.96	Romania	125	1.70	0.84
Hungary	129	1.57	0.62	Russia	525	2.08	0.87
Lithuania	110	1.69	0.78	Ukraine	223	2.46	1.22
Poland	225	1.89	9.74				
Slovakia	128	1.72	0.83				
Latin group	988	1.933	0.870	Orthodox group	1,119	2.011	0.916

Table VII. Businesses’ perception of their involvement in the national policy-making arena

This question consisted of four items. In the “very influential” (1) to “never influential” (5) scale, the Latin group's average of 1.933 was significantly lower than the orthodox group's average of 2.011 ($t=-5.52$, $p<0.001$) (Table VII). The *t*-test led to statistically significant ($t=-3.33$, $p<0.001$) result, revealing differences between the two groups in terms businesses' participation in the national policy-making arena (Table VII).

	Latin group				Orthodox group		
	n	Mean	SD		*n*	Mean	SD
Croatia	126	3.17	1.07	Belarus	124	3.68	1.25
Czech Republic	131	3.05	1.04	Bulgaria	124	4.06	1.19
Estonia	118	3.05	1.04	Romania	119	3.66	1.06
Hungary	120	3.09	0.97	Russia	513	4.09	1.04
Lithuania	111	4.34	1.03	Ukraine	223	4.28	1.01
Poland	216	3.35	1.02				
Slovakia	125	3.35	1.23				
Latin group	947	3.45	1.14	Orthodox group	1,103	4.03	1.10

Table VIII. Businesses’ perception of the relation between government and/or bureaucracy (central/national) and private firms (Q9) (“now”)

Question no. 9 asked to rate “overall perception of the relation between government and/or bureaucracy and private firms”. The item: “All in all, for doing business I perceive the state as” was measured in Very Helpful (1) to Very Unhelpful (5) scale for the central/national government as well as for the local/regional government. Moreover, the respondents were asked to rate their perceptions of governments at both levels for “now” and “three years ago”. Table VIII presents businesses' perception of the relation between government and/or bureaucracy (central/national level) and private firms “Now”. The difference between the two groups was −0.581, which was statistically significant ($t=-11.71$, $p<0.0001$). Similarly, Table IX presents businesses' perception of the relation between government and/or bureaucracy (central/national level) and private firms “Three years ago”. The difference between the two groups was −0.373, which was statistically significant ($t=-6.88$, $p<0.0001$).

In the same manner, businesses' perceptions of the relation between government and/or bureaucracy (local/regional level) and private firms are presented in Table X for "Now" and in Table XI for "Three years ago". The differences between the two groups were statistically significant for "now" (of means=−0.444, t=−8.23, p<0.0001) as well as "Three years ago" (difference of means=−0.386, t=−6.76, p<0.0001).

Table IX. Businesses' perception of the relation between government and/or bureaucracy (central/national) and private firms (Q9) ("three years ago")

Latin group	n	Mean	SD	Orthodox group	n	Mean	SD
Croatia	121	3.14	0.94	Belarus	107	3.43	1.27
Czech Republic	116	3.85	1.11	Bulgaria	104	3.87	1.18
Estonia	110	3.30	1.08	Romania	101	3.57	1.03
Hungary	115	2.90	0.85	Russia	513	3.99	1.13
Lithuania	94	4.23	1.08	Ukraine	223	4.29	1.01
Poland	191	3.32	1.07				
Slovakia	118	3.74	1.03				
Latin group	865	3.46	1.10	Orthodox group	1,048	3.84	1.13

For the central/national government, the difference between "now" and "three years ago" of the average of the overall perception of the relation between central/national government and private firms was −0.028 for the Latin group (Table VIII). This difference corresponded to 862 firms. This indicated a more favorable perception of the relation between government and private firms at the time of the survey compared to three years before the survey in this group. The corresponding difference for the orthodox group was 0.195 which indicated a less favorable perception of the relation between government and private firms at the time of the survey compared to three years before the survey in this group. This difference corresponded to 910 firms. The corresponding differences for relation between local/regional government and private firms for the two groups were −0.035 (based on 868 responses) and 0.038 (903 responses), respectively, for the Latin group and the orthodox group (Table IX). We also found that t-tests are statistically significant (t=−5.53, p<0.0001 for the central/national government; t=−2.21 (p<0.05 for the local/regional government), revealing differences between the Latin group and the orthodox group in terms of the perceptions of progress in the three year time period in the relation between the government and private firms.

Supportive roles

Question nos 7 and 8 were used to measure the state's supportive role from the standpoint of private firms. Question no. 7 stated: "Please judge on a four point scale how problematic are these different regulatory areas for the operation and growth of your business". This question consisted of eight items. In the no obstacle (1) to major obstacle (4) scale, the average for the Latin group was 2.071 and compared to the orthodox group's average of 2.103 (Table XII). The difference between the two groups was significant (t=−2.33, p<0.05). Question no. 8 read: "How often does the government intervene in the following types of decisions by your firm?" This question consisted of seven items. To provide an indication of how businesses in the two groups differ in terms of their perception of government intervention, the results from Table XIII suggest that, in the always (1) to Never (6) scale, the average for the Latin group was 5.37 and compared to the orthodox group's average of 5.19. The difference between the two groups was statistically significant (t=2.03, p<0.05).

Table X. Businesses' perception of the relation between government and/or bureaucracy (local/regional level) and private firms (Q9) ("now")

Latin group	n	Mean	SD	Orthodox group	n	Mean	SD
Croatia	127	2.83	0.92	Belarus	124	3.44	1.31
Czech Republic	130	3.63	1.20	Bulgaria	124	4.02	1.30
Estonia	123	2.98	1.02	Romania	121	3.74	1.09
Hungary	121	2.86	1.01	Russia	515	3.69	1.30
Lithuania	108	4.27	1.02	Ukraine	220	3.66	1.30
Poland	221	3.10	1.02				
Slovakia	123	3.34	1.13				
Latin group	953	3.25	1.08	Orthodox group	1,104	3.70	1.23

6 Discussion and implications

Adequate public policies will obviously play a major role in the implementation of favorable conditions for the growth of entrepreneurial firms. Regulative institutions' roles in promoting entrepreneurship are widely recognized in the literature: "[T]he need to reduce regulatory and administrative burdens affecting entrepreneurial activity; the increasing attention given by governments to entrepreneurship education and training; the need to ease SME access to financing, technology, innovation and international markets; […]. and local policy issues" are emphasized among critical factors that influence SMEs' success (OECD, 2005). Huge amount of work is needed to build such institutions. Regulative institutions to support entrepreneurial firms thus do not develop uniformly across all economies.

The findings suggest that Latin countries and orthodox countries differ in terms of the development of formal institutions to promote private enterprises. A slow rate of the development of formal institutions supporting entrepreneurship has been the most glaring shortcoming of the latter group. The roots of the problem may thus lie partly in the lack of religious-secular difference in the economies.

Our findings provide support for the notion that informal institutions influence the degree of generalizeability and replicability of Western political and economic institutions' success in driving firms' entrepreneurial behavior in emerging economies. We found support for the path-dependence theory indicating that the market is embedded in historical circumstance (Fligstein, 1996). Put differently, much of the success in transplanting Western institutions in emerging economies depends on the precise circumstances provided by informal institutions.

Table XI. Businesses' perception of the relation between government and/or bureaucracy (local/regional level) and private firms (Q9) ("three years ago")

Latin group	*n*	Mean	SD	Orthodox group	*n*	Mean	SD
Croatia	120	3.22	1.13	Belarus	106	3.32	1.30
Czech Republic	116	3.58	1.20	Bulgaria	103	3.95	1.31
Estonia	120	3.23	1.13	Romania	100	3.67	1.09
Hungary	116	2.74	0.99	Russia	419	3.73	1.27
Lithuania	91	4.18	1.07	Ukraine	176	3.54	1.31
Poland	191	3.19	1.01				
Slovakia	114	3.42	1.06				
Latin group	868	3.28	1.12	Orthodox group	904	3.66	1.27

In prior research, scholars suggested that informal institutions affect formal rules (Axelrod, 1997; Hayek, 1979; North, 1994). While there are some country- and societal-level studies, microeconomic evidence on the institutions-entrepreneurial behavior nexus is limited (Johnson *et al.*, 2002). Scholars have called for research examining entrepreneurship related barriers at the micro-level (Kalantaridis, 2000). An important but underexamined issue with respect to both institutional theory and entrepreneurship research concerned empirical documentation regarding informal institutions' influence on the development of formal institutions needed to promote free market entrepreneurship. A related point is that while institutional differences between the orthodox and the Latin groups have been widely noted in the literature (Gerschenkron, 1954; Kusnezova, 1999; Warner and Daugherty, 2004), formal statistical analyses are rare. Empirical research on informal institutions' direct effects on formal institutions is conceptually challenging. We used publicly available micro-level data to examine the differential rate of development of regulative institutions in CEE economies. While there are some studies examining the interrelationships between these institutions (Stoica, 2004), none does so in a way that quite serves the empirical objectives of this study. To our knowledge, these data provide the first comprehensive empirical documentation of the differences. The present study thus fills a gap in the institutional literature by providing clear and convincing evidence that the contexts provided by informal institutions affect the development of formal institutions.

It is also important to note that in the CEE context, most of the prior research focused on larger economies (e.g. Russia) and economies that started the transition earliest (e.g. the Visegrad countries) (Spenner and Jones, 1998). Despite growing interests in other CEE economies, the pace and proliferation of research on smaller and relatively backward economies have been slow (Bristow, 1996; Spenner and Jones, 1998). Our work thus attempts to contribute to entrepreneurship and institutional research on smaller and relatively backward CEE economies.

Limitations and future research

Several limitations of this research and boundary conditions must be recognized in a balanced discussion of its findings. The data used in the paper are gathered from the World Bank's WBES, which was administered to enterprises in the late 1999 and the early 2000. Although the data are dated, it should provide a good insight into what we are looking for. In this regard, new data would be useful to retest the hypotheses presented in this paper as well as test new hypotheses.

Another limitation of this paper relates to a lack of coverage of many former Soviet republics and some other CEE countries in the WBES. For instance, former Soviet republics excluded in the WBES include all economies in Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan), Transcaucasus (Armenia, Azerbaijan, and Georgia), Latvia in the Baltic and Moldova in Eastern Europe. The survey also excluded other important CEE economies such as Serbia, Slovenia, and Bosnia-Herzegovina.

Further, theoretical and empirical research is needed to address these limitations and gain a better understanding of changes in formal and informal institutions and relationships between them. We readily acknowledge that there may be other theoretical explanations for our results. Our analysis, thus warrants further exploration with alternative variables.

Future research based on the present framework can be extended to institutional settings in other economies in transition. For instance, researchers could examine how former Soviet republics and other CEE economies excluded in the WBES differ in terms of businesses' perception of regulative, participative and supportive roles of the state. Development of regulative institutions in other emerging economies such as China and India might also be worthwhile target of study.

Second, as noted above, the data used were collected about a decade ago. In this regard, the issues raised in this paper need further study to shed more light on recent institutional changes in these economies.

Finally, this paper focused only on entrepreneurial firms' perceptions of formal institutions. Future research is needed to extend extant theory by offering a framework that explores in greater detail the differences in informal institutions in CEE and other emerging economies.

Managerial and policy implications
The preceding discussion has important managerial and policy implications.

Implication 1: differences in the cost of doing business and the need of strategic planning and adaptation
The above discussion points to the need of strategic planning and various degrees of adaptation of business strategies across the CEE economies. This is because formal institutions supporting entrepreneurship differ widely across these economies. For instance, in general the cost of doing business is likely to be higher in economies in the orthodox group than those in the Latin group. This is because the former group has failed to develop institutions in areas such as contract enforcement. It would be erroneous, however, to assume that economies in a group (e.g. orthodox group) are homogeneous in terms of regulative, participative, and supportive roles of the government. This means that there is no one-size-fits-all approach to operate in all economies in the orthodox group.

Implication 2: relative importance of regulatory, participatory, and supportive roles
Businesses may also differ in terms of the relative importance of regulatory, participatory, and supportive roles of the government in their operations. Established multinational corporations in established industries such as manufacturing, retailing, and automobile may place particular emphasis on regulatory components such as enforcement of contracts, the rule of law, the risk of expropriation, corruption of government, and bureaucratic quality. Specific laws tend to be relatively well developed in these sectors. For emerging industries (e.g. offshore outsourcing), the participative component – businesses' participation in the national policy-making arena – may be especially important. For small local firms, on the other hand, the government's supporting roles (e.g. projects related to the development of the physical infrastructures such as broadband technology, gas, water, sewage, roads, industrial zones, and setting up business incubators) may be more important.

Implication 3: inter-group differences differ markedly across the three components

While the businesses in the Latin group consistently rated their governments more favorably than those in the orthodox group, the inter-group differences differ markedly across the variables studied. Differences in the two groups are more readily apparent in businesses' perceptions of the governments' participatory roles compared to regulative and supportive roles. As noted above, since the participative component is likely to be especially important for firms in emerging industries, such firms may have higher incentives to operate in the Latin countries compared to firms in more established industries.

Implication 4: intra-group heterogeneity and the importance to move beneath the group level aggregate data

The aggregate data used in *t*-tests do not capture businesses' perceptions of governments in the individual countries. As there is substantial intra-group heterogeneity in each variable, it is important to move beneath the group level aggregate data to examine businesses' perceptions of regulatory, participatory, and supportive roles in individual countries. Averages of all corresponding observations for each country are given in Tables V-XIII. With respect to some dimension, it is quite possible that a country in the orthodox group may perform better than a country in the Latin group despite the opposite effect at the group level. For instance, it is clear from Table VII that Bulgarian businesses rated their national government better (mean=1.53) than Estonian businesses (mean=2.52) in terms of participatory roles.

	Latin group				Orthodox group		
	n	Mean	SD		n	Mean	SD
Croatia	110	2.17	0.60	Belarus	85	2.24	0.50
Czech Republic	98	2.26	0.61	Bulgaria	77	1.95	0.57
Estonia	110	1.75	0.45	Romania	69	2.18	0.57
Hungary	91	1.99	0.53	Russia	313	2.06	0.56
Lithuania	68	2.22	0.52	Ukraine	163	2.34	0.59
Poland	162	2.13	0.58				
Slovakia	94	2.02	0.68				
Latin group	733	2.071	0.593	Orthodox group	707	2.146	0.581

Table XII. Businesses' perception of regulatory areas for the operation and growth

Implication 5: contexts and mechanisms related to barriers to the development of regulative institutions

The economies in each group may also differ in terms of the contexts, mechanisms, and processes related to barriers to the development of entrepreneurship-friendly regulative institutions. Economies in the orthodox group, for instance, may differ in terms of the extent of elite entrepreneurship, the rate of replacement of Soviet-era managers by ones with free mindset and former political elites' engagement in organized crimes. Each of these factors may have differential impact across entrepreneurial firms. The aggregate-level data presented in the paper do not reflect such differences.

	Latin group				Orthodox group		
	n	Mean	SD		n	Mean	SD
Croatia	96	5.51	0.97	Belarus	54	4.41	1.23
Czech Republic	76	5.43	1.10	Bulgaria	97	5.51	0.97
Estonia	118	5.50	0.72	Romania	67	5.35	0.95
Hungary	67	4.73	1.16	Russia	351	5.38	0.76
Lithuania	59	5.51	0.84	Ukraine	123	5.07	1.08
Poland	118	5.58	0.70				
Slovakia	52	4.95	1.17				
Latin group	586	5.37	0.937	Orthodox group	692	5.19	0.947

Notes: The averages are based on six items; responses related to wages were not included in the WBES data

Table XIII. Businesses' perception of government intervention in their decisions

Implication 6: international pressures to change institutions

Some of the economies in the orthodox group (Bulgaria, Romania, and Ukraine) are the World Trade Organization (WTO) members. Moreover, Bulgaria, and Romania have also joined the European Union (EU). It can be suggested, therefore, that compared to non-EU economies and WTO non-members, EU, and WTO members are likely to face a higher pressure to bring institutional changes to support entrepreneurial firms. Strategic planning and adaptation of business strategies thus need to consider other factors such as membership to supra-national and international organizations.

Implication 7: applying the path-dependence approach at the industry level

While we applied the path-dependence approach at the societal level, it can also be applied at the industry level. That is, “small events and chance circumstances” can determine the particular path selected and subsequently followed by an industry (North, 1990, p. 94). As predicted by Bhagwati's, theory of kaleidoscopic comparative advantage (Bhagwati, 1998), some economies in the orthodox group may perform well in some industry sectors despite their overall backwardness. To illustrate this argument, we consider the Romanian ICT industry. We discussed earlier various barriers to entrepreneurship in Romania. Thanks primarily to the Romanian Ministry of Science and Technology's long-range plan of science and technology, the country's ICT industry has developed rapidly. Many software companies from the USA and Europe including Microsoft have significant presence in Romania. As of 2005, Romania had 45,000 software developers and 8,000 graduates enter the software industry annually (McGee, 2005).

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