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Barriers to SME growth in transition economies : the case of Albania

BARRIERS TO SME GROWTH IN TRANSITION ECONOMIES:
THE CASE OF ALBANIA

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ABSTRACT

This thesis is a study of entrepreneurship and SME development in a post-communist context. The thesis argues that entrepreneurship and SME development do not have *"system transformation capacities"* unless an institutional structure is in place to orient the entrepreneurial spirit toward productive activities, which lead to the generation of new jobs and economic growth. An institutionalist perspective is adopted to examine features of entrepreneurship development in Albania. Theories of new institutionalist economics and theories of entrepreneurship and business growth have been used to answer the research question about the *extent that institutions influence the prospects for business growth and how the local setting and the intentions and abilities of entrepreneurs moderate this effect.* For the purpose of this study, the growth of the small business sector is seen as a function of three main sets of determinants: opportunities, abilities and intentions of the entrepreneur, with opportunities discussed in terms of the political, social and legal factors that determine the distribution of productive and unproductive entrepreneurship.

The research strategy uses a multi method design involving triangulation to answer the research question. A survey questionnaire collected responses from 110 entrepreneurs in the manufacturing sector in Albania. In addition, qualitative research with public officials and social actors involved in SME development was carried out to gather different perspectives on the process. Both methods were triangulated with information collected from secondary sources including statistics, laws, and strategy and policy documents about Albania.

The research suggests that the patterns of growth of the SME sector in Albania depend upon a combination of political influences, inherited backwardness, progressive attitudes towards entrepreneurship, and economic development. Analysis of the survey data suggests that growth is a resultant of commitment, business skills, social networking capacities and ways to deal with the inefficiencies of the system. Qualitative interviews and documentary analysis reflect on issues of social capital, corruption, short time horizons and the accountability of officials. These empirical insights can be used to inform policy designed to improve the prospects of business growth under the particular institutional framework in Albania. This research concludes that entrepreneurship and SME development is contextual, and therefore future analyses of business growth should be informed by the local context and by the perspectives of the different actors involved in it.

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This thesis is dedicated to:
My father, **Nuzet XHENETI,**
Whose gift of dreams
Lit the way

AUTHOR'S DECLARATION

I declare that the work in this dissertation was carried out in accordance with the regulations of the University of Bristol. The work is original except where indicated by special reference in the text and no part of the dissertation has been submitted for any other degree. Any views expressed in the dissertation are those of the author and in no way represent those of the University of Bristol. The dissertation has not been presented to any other University for examination either in the United Kingdom or overseas.

SIGNED   DATE 21.02.2006

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LIST OF TABLES AND CHARTS

ABBREVIATIONS

ACER	Albanian Centre for Economic Research
BAC	Business Advisory Council
CARDS	Community Assistance for Reconstruction, Development and Stability
CEE	Central Eastern Europe
COM	Commission of European Union
EBRD	European Bank for Reconstruction and Development
EPPA	Enterprise Policy Performance Assessment
EUROSTAT	Institute of European Statistics
EU	European Union
FIAS	Foreign Investment Advisory Service
FDI	Foreign Direct Investment
FTA	Foreign Trade Agreements
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GoA	Government of Albania
GPRS	Growth and Poverty Reduction Strategy
GTZ	German Agency for Technical Cooperation
IMF	International Monetary Fund
INSTAT	Albanian National Institute of Statistics
MoECT	Ministry of Economic Cooperation and Trade
NCB	National Commercial Bank
NIE	New Institutional Economics
NSSED	National Strategy for Social and Economic Development
OECD	Organisation for Economic Cooperation and Development
OIE	Old Institutional Economics
PHARE	Polish Hungarian Assistance for Reconstruction of Economies
RDA	Regional Development Agency
SMEDA	Small and Medium Enterprise Development Agency
SME	Small and Medium Enterprise
SAA	Stabilisation and Association Agreement

SEE   South East Europe

SBCA   Small Business Credit and Assistance

SEED   South East Europe Enterprise Development

SOROS   Open Society Foundation

USAID   US Agency for International Development

WB   World Bank

WIIW   Vienna Institute for International Economic Studies

WTO   World Trade Organisation

INTRODUCTION TO THE THESIS

In this brief introduction I explain the rationale and relevance of my research for post-communist economic transition. I introduce the literature I have used, the key concepts I have developed, my research question and the research methodology. I also set out some of the key findings of my research.

Following the collapse of communism in the whole Eastern Block at the beginning of 90s, special attention was directed toward these countries. The main intention was to bring these countries' inefficient models of social and economic development closer to a Western model. In this context, a special emphasis was placed on entrepreneurship and small and medium enterprise (SME) development as one of the most important prerequisites for faster growth and development in these countries.

Despite the considerable contributions that the SME sector has made in various transition economies in terms of job creation, more flexible production processes and a wider range of products for consumers, there are still many problems related to its *grass rooted development* (Kolodko, 2000) and a need for a better understanding of the impacts of social and formal institutional transformations on entrepreneurship and SME development. One problem has been that transition economies have offered more scope for entrepreneurial trade and services activities rather than the manufacturing activities that could improve competitiveness and support the sustainable development of these countries. Another problem has been that entrepreneurship has not been considered until recently as a *collective effort*. Moreover, the legal and social institutions that would enable entrepreneurial qualities to unfold have not been given sufficient attention.

Thus, the institutionalisation of entrepreneurship and SME development has been spontaneous for many years and not based on well-organised approaches of the state. In addition, certain neglect has been noticed in terms of understanding what the transition process really involves. In this respect, I argue in this thesis that knowledge about forms of entrepreneurship and levels of its development is acquired through an understanding of the social, legal, economic and political institutions that give scope to different entrepreneurial activities, whether productive or unproductive, and their respective contributions to economic and social development.

In Chapter 2, building on the literature available on transition economies, I argue that the post-communist transition is a process of large-scale institutional change and involves the transformation of the whole society rather than just a simple passage from a central by planned economy to a market economy. Moreover, the literature on institutions suggests that institutions are vital in creating certainty and giving structure to economic and other sorts of activities.

Another problem that post-communist economies are facing is known as path dependency. It is argued that people in these countries carry with them in the present the *baggage* of the past which might have different forms of interactions, whether complementary or not, with the newly introduced formal institutions. Much of this research has adopted a legacy or cultural approach that is very deterministic in discussing the difficulties that the culture of communism imposes on people. Part of the problem is related to the lack of research undertaken in post-communist societies on the individual and how the changes can be *lived* or accommodated by her. Further exploration of these issues is of interest in a business context, and from an entrepreneurs' perspective, since entrepreneurial activities were *alien* to the communist system.

The key concept that I utilise in my research is entrepreneurship. I have examined it from the perspective of a variety of authors, as I explain in Chapter 3. I include in the definition of entrepreneurship not only innovative, but also imitative, activities that can make a great contribution in the post-communist context to the accumulation of knowledge, which is then the basis of the process of institutional change and economic development in these countries. Entrepreneurship is connected to the SME sector, which was discriminated against during communism and in transition economies comprises the greatest part of the private sector. Recently, the EU and the leading international organisations have become more concerned with developing policies towards facilitating SME development. I use the growth of business as an indicator of business development, since growth is mainly associated with more jobs, export expansion and capital accumulation.

My main interest is with entrepreneurship and small business development in a post-communist setting that is undergoing major institutional change. The research question I explore in this thesis is: **To what extent do institutions influence the prospects for business growth, and how do the local setting and the intentions and abilities of entrepreneurs moderate this effect?** My research is limited to the case of Albania. As I discuss in Chapter 1, apart from the

many similar features it shares with other post-communist countries in terms of a heritage of central planning, it has many distinctive historical, economic, social and political features. This thesis provides an evaluation of the institutional features that influence entrepreneurship and SME development in Albania. It analyses the special features of the Albanian transition and their impact on business development.

In Chapter 4 I present the methodology I have employed to answer my research question. I triangulate: (i) a survey that captures perspectives of 110 entrepreneurs, (ii) interviews that capture the perspectives of other actors involved in SME issues, and (iii) policy documents and statistics to add to my explanatory construct on SME development in Albania. I have worked with three units of analysis: entrepreneurs, policy makers and support organisations. Based on the conceptual framework I develop in this chapter, I move on to discuss the findings of my research.

In Chapters 5 and 6, I discuss the entrepreneurs' perspectives identified through the survey. Chapter 5 is concerned with enterprise behaviours as a result of the formal and social institutions. I discuss: (i) the reasons to be in business, and the demand for external finance as indicators of business growth aspirations; (ii) attitudes toward new knowledge and how other actors in SME development facilitate the learning process; (iii) forms of business relationships and the balance of formal and social institutions used by enterprises. The analysis of the data suggests that Albanian manufacturers pursue business opportunities in the market and have an inclination toward the accumulation of capital, new skills, and knowledge. They face many difficulties in accessing new technologies and information about products and markets. These difficulties are multiplied by a system of formal institutions, which have little legitimacy. Businesses have adopted various strategies to cope with the deficiencies of the formal institutional system such as reliance upon personal contacts, or corruption and other forms of cheating the formal institutions.

In Chapter 6, based on my conceptual framework, I look at the simultaneous effect of a variety of determinants of business growth. Using principal component analysis, I identify four different institutional determinants of growth together with other variables, such as the intentions and abilities of entrepreneurs. These institutional variables are entered into a regression model designed to explain business growth. My analysis supports the hypothesis that business growth is a function of determinants that vary with the context where the business is operating in terms of time and space as well as with entrepreneur's intentions and abilities. The regression analysis demonstrates that regulation and information barriers hinder business

growth. In addition, corruption-related barriers surprisingly appear to have a positive effect on growth, even though businesses cite corruption as a severe barrier to their business operations. Interestingly, the embrace of business values that were non-existent during communism has had a positive effect on growth. Other variables that influence growth include the motivation for entering business, the nature of business networks, as well as the size and age of the businesses.

In Chapters 7 and 8, I analyse government policy on SMEs. Using latent content analysis I look at the underlying meanings of sentences in key documents, and I present an analysis of my interviews with other social actors involved in SME development in Albania. I find that there is a well-established policy framework on a national level, with all the relevant laws and regulations in place. I also find some ambiguity in the strategy documents and in the policy initiatives with regard to the distinction between policies on entrepreneurship and small businesses. I identify a lack of cooperation and an insufficient appreciation of the SME sector as important features of the institutional framework, which have a negative impact on business growth. I find that policies emphasize the state of the SME sector rather than considering the needs of SME, which vary with the type of industry or sector of activity. I find that the relationship of the business community with the state is influenced by inherited patterns of behaviour, but it is difficult to determine whether these patterns of behaviour are based on familiarity and legitimacy, or are simply short-term responses to the existing rules of the game. One conclusion that emerges from the research is that a fundamental and wide-ranging learning process is taking place. I propose that this process could be further accelerated through the promotion of 'role-model' entrepreneurs.

I conclude this thesis with a reflection on theories of institutions, entrepreneurship and business growth, on the basis of which I offer some tentative policy recommendations. Reflecting on possibilities for future research, I suggest that theories about business growth and the design of policies to facilitate such growth should pay more attention to the local context and to the perspectives of businesses and other actors than has hitherto been the case in most of the previous literature.

CHAPTER 1
ALBANIA-AN INTRODUCTION

For Albania, joyous days are at hand.
The darkness is receding. Happy is he who will live
To see her reign!

Knowledge and progress,
Goodness and humanity will arise,
Never to stray.

(Naim Frasheri, 1890)

Introduction

Whilst one of the most ancient people in South Eastern Europe, Albania has also been for a long time among the least known countries, due to historical and political circumstances. Albania is a post-communist country whose transition to democracy and sustainable development has been complex. Albania's main aspiration is to join European Union (EU) so as to become part of the European family where it has always belonged in geographical terms but less so in political or cultural terms.

In this chapter, my aim is to outline some of the most distinctive features of Albania's history, polity, economy and culture that I utilise for the discussion of entrepreneurship and SME development in subsequent chapters. I start this chapter with a very short historical introduction dating back to the proclamation of independence after 500 years of Ottoman rule. I move my discussion in Section 2 to the characteristics of communist Albania and the overemphasis on manufacturing and the break of relations with other communist countries. In Section 3, I discuss some of the main features of Albania's fragile democracy following the collapse of communism. Thereafter in Section 4, I discuss the economic features of the Albanian transition and how they have influenced enterprise growth and development. I conclude this short background chapter by emphasising Albania's experience in creating a strong and durable state, her legacy of a mainly agrarian economy and also her highly isolated status and lack of exposure to the world during the communist years. These factors go a long way in explaining many of the characteristics of Albania's long and shallow transition.

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1.1   Historical features of Albania

Albania is situated in the Balkan Peninsula and has an area of 29 thousand km^2 and a population of 3.6 million people (CIA Factbook, 2005). Albania is bordered by the Adriatic and the Ionian Sea in the West, Greece in the South, Forum Yugoslav Republic of Macedonia (FYROM) in the East and Kosova and Montenegro in the North-East and North. One of the main characteristics of Albania's history has been its constant struggle to ensure its survival as an independent entity. It was occupied by the Ottoman Empire for five centuries. Albania gained its independence for the first time on 28 November 1912. However, the dream of having an Albanian state inclusive of all areas was shattered when Serbia, Montenegro and Greece occupied large parts of the country. Although the Great Powers recognised the independence of Albania in December 1912 at the London's Conference, a year later a commission appointed by the Great Powers determined the contemporary Albanian borders (Biberaj, 1998). This decision gave priority to the territorial interests of neighbouring countries and half of the Albanian territory was excluded from Albania proper. For instance, Kosova was annexed to Serbia, the southern region of Cameria to Greece, other parts to what is today the Western part of Macedonia and Serbia, leaving half of the Albanian population outside Albania (Biberaj, 1998).

The country was occupied again during World War I by a number of foreign countries and further efforts were made by neighbouring countries to divide it. Albania's independence was preserved only thanks to the support of the US President Wilson at the Peace Conference in Paris. In the years to follow, Albania was characterised by political instability and a medieval patriarchal social structure as well as a very rudimentary economy.

In 1928 Ahmet Zog, who served the country as a prime minister from 1922-1924, proclaimed himself King of Albanians and transformed the country into a monarchy. Although in the late 1920s King Zog turned to Italy for economic assistance, the economy remained underdeveloped. In 1925, agriculture contributed over 90% of the national income. Moreover, in 1938 right before the Italian occupation of Albania in 1939, industrial output counted for only 4% of national income and annual per capita industrial production was only USD 8 (Zickel and Iwaskiw, 1992). Although Italy made some improvements in the Albanian infrastructure in order to open up interregional commerce, there were real setbacks during World War II.

1.2   Some features of communist Albania

The end of the Second World War found Albania destroyed and characterised by pervasive poverty, high rates of illiteracy, blood feuds (especially in the Northern Region of Albania) as well as other problems, such as widespread disease and the subjugation of women. The new government of Albania led by Hoxha had a very difficult task in reducing and eliminating the majority of these overwhelming issues of the post-war Albania. In the communist period, Albania experienced all the features of a Soviet type system, if anything in an extreme and rigorous form. In this regard Clunnies-Ross and Sudar (2000) list the following characteristics of the Albanian system:

> *collective and state farms, with a very small part of arable land in private plots; state owned industry; a ban on private trade and enterprise and on commercial investment from abroad; centrally directed allocation of labour; state management of all external transactions; domination by the single Party of all spheres of social life (p. 8)*

For a number of years, as a result of alliances with the communist world, Albania benefited from millions of dollars of credits as well as technical assistance since many specialists from allied communist countries came to work in Albania. This technical assistance improved considerably the living standards in the country. In this respect, Albania had relations with ex-Yugoslavia (1944-1948), Soviet Union (1948-1956), and China (1956-1978). After 1978, Albania pursued a policy of self-reliance and complete isolation since Hoxha regarded all other communist countries as having betrayed the principles of communism.

In terms of foreign trade, Albania directed its resources toward heavy industry and food grains that were not Albania's comparative advantage (Brancati, 1996). Moreover, the direction of foreign trade was politically conditioned to and from other communist countries. These autarkic tendencies were not only focused in trade but also in other aspects of social life. Albanians were not allowed free movement inside and outside the country; they had no connection with the outside world either through tourism or through other sources of information. Albanians were subjected to the creation of the '*new socialist man*', as defined by the Albanian stable identity and communist consciousness (Vickers and Pettifer, 1997).

Furthermore, it has to be mentioned that during communism Albania was transformed from a highly agrarian country to a more industrialised country. Nevertheless, at the beginning of the post-communist transition, Albania still had a very large proportion of its workforce in agriculture. According to estimates of the World Bank in 1999, 55% of the labour force worked

in agriculture, a much higher proportion than any other post communist country. The education and health reforms that took place during communism provided Albania with significant advantage at the beginning of transition, a young, healthy, and also well-educated population.

1.3 Post communist Albania

At the beginning of the 1990s, reforms were undertaken all over Central Eastern Europe (CEE) to transform the political and economic systems. Albania was no exception. The centralised system, the most extreme in the entire CEE, that had been in place for almost 50 years and where the state was responsible for everything was no longer sustainable. In 1990, in comparison to 1985, the population increased by 10% but the agricultural production increased only by 1.1% and the industrial production only by 5.6% whilst the government expenses increased by 30.7% (ACER, 2000). By the beginning of 1990s, the country was in a deep economic and social crisis. This crisis was the result of Albania's isolation and its self-reliance principle that set its socialist model apart from that of its neighbours. Revolts and emigration were the prelude of the establishment of the market economy. Albanians similar to their counterparts in CEE had great expectations towards the future. Although they did not know how it was going to be, it was certainly going to be better than what they were leaving behind.

After 14 years of transition, Albania is still struggling to establish itself as a proper democracy where the rule of law, and law enforcement, are the norm rather than the exception. Although national elections have been held five times since the collapse of communism, the international organisations that have observed all these elections are not fully satisfied with the progress the country has made. The elections that were held in July 2005 were attended by international observers and noted by the EU in informing its decision on signing a Stabilisation and Association Agreement (SAA). According to international organisations, these elections still failed to fulfil the standards of free and transparent elections because of problems related to the electoral process.

However, the July 2005 election opened the way to a peaceful change in the governing party and a handover of power from the Socialist Party to the Democratic Party. The Democratic Party had previously won the elections in March 1992 and had led the country's reforms in the period 1992-1996, in which Albania made considerable progress, especially in economic terms. The eight-year socialist government opened the way to important reforms such as the reform of public administration, the signing of various initiatives such as the Stability Pact for South Eastern Europe (SEE) in 1999 which aim is to encourage cooperation in the region, World

Trade Organisation (WTO) in 2000, Free Trade Agreements (FTA) with the countries in the SEE region, and more importantly, the initiation of negotiations for the SAA in 2003.

Despite these reforms, the political leadership failed to establish full respect for the rule of law, to fight organised crime and corruption, to establish a well functional judiciary system, a modern and efficient public administration, to improve institutional capacity at central and local levels, and to encourage civil society which has a very important role to play in a country like Albania where it was non-existent during communism (COM, 2003; 2004; OECD, 2004).

Despite a general distrust by the people in the state and its institutions, it seems that both the political elite and the population in general share the same aspirations toward Albania joining the EU. Although the perception of the EU and how it can help the country has sometimes been overestimated, there is no doubt that it acts as a great motivator for the political elite and the public administration to further strengthen the reforms in the country and for the population to support them.

1.4   Main characteristics of the Albanian economic transition

The first years of transition were very difficult. Inflation reached 237% and GDP decreased by 50% between 1990 to 1992 (Muco, 2001). Although Albania was released from the constraints of central planning, the market mechanisms were not yet established and the state was weak in exercising its regulatory and organisational functions. The main objective of economic reform was macroeconomic stabilisation.

The economic reform in Albania was mainly informed by a neo-liberal approach (as in other countries in transition) in line with the Washington consensus whose aim, through a rapid liberalisation of prices and trade, tight fiscal and monetary policies, the privatisation of state enterprises and the promotion of private enterprises, was to achieve the transformation of the centrally planned economy into a market economy. The policies designed for transition countries aimed for less intervention of the state leaving everything to the market. However, these policies have been widely contested in recent years because of the great burden they imposed on the people of these countries (Kolodko, 2000), as the drop in output and the increase in unemployment were excessive and have only recently recovered to the levels of pre-transition in some countries.

Also, privatisation did not prove to be such an easy process as had been expected and social polarisation increased. The Albanian transition has been difficult to predict. In the first years of transition, Albania was considered as very successful in pursuing most of the policies recommended by the World Bank and the IMF and achieved macroeconomic stability. By 1993, the growth of GDP was positive and the budget deficit started to decrease from 31% in 1993 to 6% in 1995 (Muco, 2001). The restrictive monetary policy of the Bank of Albania, which was given authority through the law "On Bank of Albania" and whose main instruments were the exchange rate and the credit ceiling kept inflation under control too. Small-scale privatisation was almost finished in 1995. The success of the Albanian transition was judged by these macroeconomic indicators.

But in 1997, Albania was hit by a very severe crisis accompanied by social and political instability. Vaughan-Whitehead (1999) and Clunies Ross and Sudar (1998) have looked at the specific reasons for this crisis. Whilst the common wisdom has been that the collapse of the fraudulent pyramid schemes led to the Albanian crisis, the above-mentioned authors see this as rather misleading. The real reasons for the crisis were the collapse of industrial activity and the absence of substituting activities from an emerging trade and services sector, a weak regulatory and legal system, a non-functional banking system, which brought about the development of an informal credit market, and the lack of a sense of responsibility inherited by the past.

This crisis put a considerable number of enterprises out of business, and encouraged many investors to leave the country for security reasons. It also increased the lack of trust in the government and its reforms. The war in Kosovo in 1999 had its impact on the fragile Albanian economy too, as a considerable amount of public and private resources were redirected toward care for over half million refugees that entered the Albanian borders (EBRD, 1999).

In the years following these two shocks, the country experienced a steady growth in pure macroeconomic terms. After 1997, the levels of GDP growth were almost stable reaching 7-8% per annum. By the end of 2000, the GDP had returned to the level of 1989 although it should be recognised that this level was extremely low. Thus, Albania is the only country in South East Europe, which exceeded its own 1989 GDP level, achieving 116.3% in 2002. The 2002 average rate for SEE as a whole was 79%.

However, Albania's GDP per capita is still one of the lowest in Europe at approximately €1,600 and the impact of the economic growth on the poorest levels of the population is rather limited

(COM, 2004). Albania is still mainly an agricultural country with almost 50% of the GDP coming from this sector. Since its extreme reduction at the beginning of transition, industrial output makes only a small contribution to the level of GDP, as shown in Table 1.

Table 1.1: Main macroeconomic indicators (%)

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003 (est)	2004 (proj.)
GDP growth	13.3	9.1	-7.0	12.7	8.9	7.7	6.8	4.7	6	6
GDP per capita (in USD)		819	667	811	1,014	1,078	1,238	1,410	1,765	na
Inflation	7.8	12.7	33.2	20.6	0.4	0.1	3.1	5.4	3.3	3.0
Unemployment	13.9	9.3	14.9	17.8	18.0	16.8	14.6	15.8	15.0	na
Government deficit	-10.1	-12.1	-12.9	-11.4	-12.1	-9.1	-8.2	-6.9	-5.6	-6.0
Growth of industrial production	6.0	13.6	-5.6	4.1	6.4	5.0	6.5	2.0	na	na
Share of industry in GDP	11.7	12.2	12.4	11.9	11.9	11.5	11.7	11.4	na	na
Growth of agricultural production	13.2	3.0	1.0	5.0	3.7	4.5	1.4	2.1	na	na
Share of agriculture in GDP	54.6	51.5	56.0	54.4	52.6	51.0	49.0	48.1	na	na
Exchange rate	93.0	104.5	148.9	150.6	137.5	143.7	143.8	140.2	123.1	na

Source: EBRD (2004) Transition Report 2004

Industry remains generally obsolete, non-viable and unable to compete with European industry. Albania needs to rapidly develop a new national industrial base including the few industries that have been successfully restructured and privatised, as well as new green field investments. The level of inflation has been kept very low, due to the tight monetary policy advised by the IMF, which has required a combination of high levels of interest rates, and lending restrictions.

However, there are still many difficulties in the Albanian transition. Prominent among these is *unemployment*. The economic and social changes at the beginning of the 1990's caused a significant increase of unemployment rate. The unemployment rate decreased gradually during 1993, since many of the unemployed individuals left the registered unemployed scheme because, in compliance with the Law on Privatization of Land, they received arable land. From a high of 22% at the end of 1993, the unemployment rate fell to 12.4% at the end of 1996. Due to the difficult crisis in the spring of 1997, the unemployment rate increased, reaching 14.9 %. Unemployment continued to increase until the end of 1999, since when it has levelled off at 15% by 2003. According to figures of the Bank of Albania (2005) the rate of unemployment in 2004 was 11%.

The *balance of payment* is in a high deficit. Albania can be considered mainly as an import economy. Its main trading partner is the EU and more specifically Italy, Greece, Germany and outside the EU, Turkey, Bulgaria and some other countries. Remittances, from Albanians working abroad, help to cover the huge trade deficit that amounts to over 20% of GDP (WIIW, 2002). Foreign direct investments have been low due to continuous political instability and the

risks associated with investing in such an environment. The cumulative FDI inflow in Albania during the period 1989-2002 has been USD303 per capita (EBRD, 2003). Although there have been some improvements in the recent years, mostly in terms of privatisation, such as the National Commercial Bank and the Mobile Communications in 2000 and the Savings Bank in 2003, FDI in Albania still remain the lowest in the SEE region at 2.2% of GDP in 2002 (Broadman et al., 2004).

The disparity between different population groups, and the high level of poverty, are also problems of the Albanian transition with one quarter of the Albanian population living in poverty. *Poverty* has a marked spatial and regional dimension in Albania. The rural areas and the mountain regions are the poorest in all dimensions of poverty (De Soto et al., 2002) and this situation is very much related to unemployment and to underemployment that is more problematic in these regions. But it is not just the lack of income and the material health that make Albanians poor. The results of a qualitative research of the World Bank in ten districts in 2002 showed that:

> *people experience poverty as a lack of hope and emotional well-being, a lack of access to basic services, a lack of physical security, and an inability to sustain family traditions (World Bank, 2002: 121)*

While macroeconomic policies have been actively pursued, microeconomic developments have been disappointing, as I discuss further on with a focus on the private sector development.

1.4.1 The development of the private sector in Albania

The private sector was non-existent during the communist period in Albania. It was created both by the entry of new firms after the liberalisation of entry conditions and by the privatisation of state owned enterprises. The privatisation of services and small shops was fast and had a positive effect in supplying the population with goods and services opening the way for the privatisation of large enterprises.

The private sector in Albania accounts for 75% of GDP and 71% of employment. It grew rapidly the first years of transition. As early as 1995, it accounted for 70% of all employment in Albania (EBRD, 1996).

Table 1.2: Active enterprises by size class and year of creation

Year of creation	Size class				Total
	1-5 employees	6-20 employees	21-80 employees	Over 80 employees	
Until 1996	23,232	948	401	208	24,789
1997	1,725	81	35	7	1,848
1998	4,085	156	39	13	4,293
1999	5,529	121	29	9	5,688
2000	6,850	138	31	12	7,031
2001	6,633	72	12	3	6,720
2002	6,091	26	3	1	6,121
Total	**54,145**	**1,542**	**550**	**253**	**56,490**

Source: Adapted from INSTAT (2003) "Business Register, 2002"

As the table above shows, 43% of the active enterprises in Albania were created before 1996. The boom in enterprise creation occurred in 1993 and 1994. Starting from a base of less than 2000 in 1991, as many as 9000 enterprises were established in 1993 and a further 16400 enterprises in 2004. In 1996 and 1997, the number of enterprises created was lower because first, many people thought that was easier to invest their money in pyramid schemes and second, because of the political and economical instability that followed the collapse of pyramid schemes in Albania and the increased political and business risks associated with that.

A characteristic of Albania throughout the years of transition was the creation of very small businesses, mostly in the trade and services sector. This structure is still the same. According to data from the INSTAT (2003) 99% of the enterprises are considered as SMEs according to the Albanian definition[1] of SMEs and, 95% of all active enterprises in Albania are micro-enterprises. As shown in the tables below, 70% of active enterprises operate in the trade and services sector.

Table 1.3: Active enterprises and employment by size class, 2002

Size class	Number of enterprises	Percentage	Number of employed	Percentage
1-5 employees	54,145	95	70,009	35
6-20 employees	1,542	3	15,408	8
20-80 employees	550	1	22,837	11
Over 80 employees	253	1	93,111	46
Total	**56,490**	**100**	**201,365**	**100**

Source: INSTAT (2003) "Business Register, 2002"

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[1] The definition of SMEs in Albania is regulated by Law No 8957 dated 17.10.2002 according to which:

Micro-enterprises	0-5 employees
Small Enterprises	6-20 employees
Medium Enterprises	21-80 employees
Large Enterprises	> 80 employees

After 1999, employment in private firms increased more rapidly than in public firms. This situation can be explained by the acceleration of the privatisation reform in Albania in early 2000, which was followed by an increase in the share of employment in the private firms in the industrial sector by about 9 percent in 2002 (SMEDA, 2005)

Table 1.4: Active enterprises and employment by economic activity, 2002

Economic activity	Number of enterprises	Percentage	Number of employed	Percentage
Agriculture	916	2	4,350	2
Industry	55,36	10	89,529	44
Construction	1,878	3	13,879	7
Transport	8,495	15	26,793	13
Trade	27,396	48	37,493	19
Services	12,269	22	29,321	15
Total	56,490	100	201,365	100

Source: INSTAT (2003) "Business Register, 2002"

The distribution of firms across the country indicates that there are also huge geographical differences. Tirana has 33 firms per 1000 inhabitants, the largest ratio in the country. Durres ranks second, with 26 firms per 1000 inhabitants. The poorest areas have the smallest ratios Kukes with three firms, Dibra with four firms and Lezha and Shkodra with six firms per 1000 inhabitants respectively (SMEDA, 2005).

So far the contribution of SMEs to economic growth has been mainly a result of the spontaneous efforts of people to create these enterprises to escape unemployment, rather than one based on well-organised microeconomic policies, which is the role of the state to design, initiate and implement. From a short-term perspective, these spontaneous efforts can help to alleviate poverty in Albania but the challenges of EU accession, to which Albania aspires, mean that its private sector should be competitive and its growth sustainable.

In terms of institutional infrastructure for entrepreneurship, Albania has suffered from institutional deficiencies for many years now. Different studies and reports (OECD, 2003a; OECD, 2004a; CEC, 2004; Muent et al., 2000; Hashi, 2001) have indicated that the business climate in Albania is unfavourable. The level of corruption is high, the legal and regulatory framework has been in continuous change, and sometimes not clear in its aims, which has made it even harder for enterprises to perform their activities.

Support structures, whether donor programmes or business development agencies, are present in Albania in order to give the right skills, knowledge and information indispensable for

entrepreneurship and small business development, especially when one considers that no prior business culture existed in Albania. Different studies that have been undertaken concerning the small business sector, have continually addressed the issue of advisory services being mainly concentrated in the capital and in some other cities with little or no provision for remote or rural areas (OECD, 2003a). Hashi (2001) has also pointed out the proliferation and fragmentation of different support programmes (financial or otherwise) that have reached only a small number of enterprises.

Conclusions

Historically, Albania has been subject to foreign domination and has suffered numerous wars in its struggle for independence. In 1912, after 500 years under the Ottoman Empire, Albania proclaimed its independence and formed the first Albanian state. Although a year later half of her territory was divided among the neighbouring states, Albania continued to exist as an independent country.

As a consequence of her history of wars and instability and of her economic history as a feudal society transformed into a centralised communist society after WWII, Albania has remained poor and under-developed by all standards. The alliance with the communist block during WWII and the subsequent establishment of what the communist regime called the dictatorship of proletariat created another historical bottleneck for the country. Despite the considerable improvement in the living standards during the communist period, the total isolation of Albania, after the break of relations with China in 1978, put the country in a serious economic and social crisis that were contributory causes toward the collapse of communism.

The Albanian transition has been difficult and characterised by various crises and recoveries. Nevertheless, in pure macroeconomic terms, the country has enjoyed steady growth of 5-6% per annum. The SME sector has emerged since the beginning of transition and has shown great flexibility throughout the various crises facing the country. However, SMEs are facing a number of constraints and difficulties that if not addressed may prevent them from achieving their full potential. The difficulties of the fragile Albanian democracy in establishing and enforcing the rule of law and in the full implementation of reforms reflect, among other reasons, the legacy of a short tradition of statehood. These difficulties have also been a burden to the private sector, which could have contributed more in the economic and social development of the country.

CHAPTER 2

TRANSITION, INSTITUTIONS AND GOVERNMENT

Ultimately good economics will also have to be good anthropology and sociology and political science and psychology.

(Hirshleifer, 1996)

Introduction

The collapse of the post-communist regimes in CEE has been one of the most dramatic adjustments in economic systems in recent history. Despite the high attention that this region received, the *'ignorance'* or the lack of precedence made it one of the most difficult development experiments ever experienced. After 15 years of transition there are still no theories or conceptual frameworks decisive in explaining the process of transformation from central planning to market economies. The mainstream economic theories with their emphasis on social engineering proved to be flawed. Economics through its view of atomised individuals lost sight of people's behaviours.

The literature on institutions has been very influential recently and has been applied to explain the different performances of post communist countries. These countries share with each other path dependencies of similar political and economic conditions including conditionalities placed on them by international organisations and the EU. However, these countries are very different in terms of structural and causal variables that were left out of the analysis in designing policies at the beginning of transition and subsequently proved to be crucial in explaining why countries pursuing the same policies had non-convergent economic performances. Moreover, these theories open the way to the consideration of an alternative paradigm that Stiglitz (1998: 1) calls *"development as a transformation of the society"*.

In this chapter, I review the most recent developments in the economic science and how they can be applied to better understand the transformation of post-communist countries. The rationale for the most influential methods of transformation pursued in post-communist countries together with their drawbacks and advantages opens the way for my discussion of the transformation process as a large institutional change process and to the use of institutions to explain the multidimensionality of transformation.

For my argument, in Section 1, I focus on two of the main influential approaches discussed in the literature on economic transition. Their advantages and critiques open the ground for the discussion of what I consider to be the most appropriate approach for studying the transformation process, namely the institutional approach. In Section 2, I draw attention to the recent prominent literature on institutions. I highlight its emphasis on the role of institutions, their emergence, the role of polity and possible path dependencies and use these as connecting bridges to the case of post-communist transformation that can be best explained by this theoretical underpinning.

I conclude by pointing out that transition is not just a technical process. Transition is a process that encompasses all fields of life and if one wants to get a better understanding of this process should look at the different institutional frameworks in place in terms of laws and regulations, and also culture and social values people hold.

2.1 The journey to capitalism: economic transition or multi-dimensional transformation?

The phrase transition to a market economy has been widely used in reference to the process of post-communist transformation by regarding it as just a passage from a centrally planned economy to market economy. The economic sphere was overly emphasised at the beginning of transition because transition was considered as an exercise of getting the prices right in the market. This neo-classical view was *'static'* and *'frictionless'*, institution-less, and culture-less and thus its explanatory value was limited. It neglected the fact that the economic performance of a country is very much affected by the success or failure of its institutions.

However, there was an agreement in the literature at the time that the core aim of transition was the allocation of resources from the state to the private sector, which would ensure greater efficiency and faster growth (Blanchard, 1997; Kolodko, 2000). Moreover, there was agreement that the objectives of transition were to include: the introduction of flexible relative prices, macroeconomic stabilisation, and the provision of incentives to firms through the privatisation of the economy and new entry, and also, the design of an adequate institutional framework (Roland, 2000). Nevertheless, many disagreements emerged in relation to the particular paths pursued to fulfil these objectives in terms of the sequencing and the speed of reforms.

2.1.1 Shock therapy versus gradualism

Two main approaches for the transformation from plan to market have been discussed in the literature. The first one that gained certain appeal in the early years of transition is called *shock therapy* or *big bang* and the second one is called *gradualism* or *incrementalism*. Advocates of the former approach (Sachs, 1993, 1996; Aslund, 1999) claimed that in order for transition economies to restart economic growth as soon as possible, a radical liberalisation of prices was needed along with stabilisation, and privatisation, so as to take advantage of the *"window of opportunity"* (Balcerowitz, 1995) or the institutional vacuum created at this stage whereby *"constraints of social structures and political institutions were temporarily suspended"* (Karl and Schmitter, 1991).

This approach is mainly identified with the Washington consensus view of transition. These policies were to be implemented as soon as possible, in order to avoid a potential reversal and asset stripping of state-owned enterprises. However, experience proved that these were just means and should not be confused with the ends (Stiglitz, 1999) or what were the real outcomes expected by such a process i.e. sustainable growth. As Kolodko (2000) argues, the policies on transition economies can be heavily criticised for being based *"on poor prognosis and wrong economics"* (p. 95). The Washington consensus considered transition as just a technical problem with too much focus on liberalisation and privatisation, and on simple advice policies that did not reach deep down in the societies of these countries.

In addition, the institutions were ignored in the transition process. One reason was their slow development (Murrell, 2005), as outlined in an explicitly pessimistic manner in the New Institutional Economics (NIE) literature. Shock therapy supporters believed that only market forces could lead to functional institutions without making any reference to the past. In terms of institutions, what shock therapists advocated were considered as passive policies in institutional design based on ideas of *invisible hand of the market* or voluntary designs. Basically, they supported a gradual voluntary institutional development, which would ensure no government intervention in the process. Shock therapists argued the natural selection of efficient institutions, which is a very neo-classical argument and also used for a while in the NIE literature.

On these grounds, individuals through their maximising efforts are believed to lead to the selection of efficient institutions. But what ensures the creation or adoption of efficient institutions? This *functionalist* explanation, although overcome by some advocates of the NIE (North 1990; 1994; 1999; Mantzavinos, 2001), claims that inefficient institutions will lose out in

the competition with efficient ones. However, it omits an explanation for the origin of institutions and the processes involved (Langlois, 1989). Not surprisingly, this approach was influenced by strong ideological reasons at the beginning of transition. Any chance for the state to get involved or be more active was dismissed due to fears of a return to communism. The Western advisers considered these policies to be more efficient, faster, controllable and that would simultaneously lead to a change in institutions.

In this regard, the informal institutions in terms of norms and culture, as well as the knowledge available in these societies were not taken into account or, it was thought they would adjust immediately to the new game. But, the most efficient solutions are not always selected spontaneously. This leads to the adoption of certain social rules that are not the characteristics of a wealth creating game. Moreover, the stock of knowledge people in post communist societies possessed was less than sufficient to interpret the new and complex phenomena that the systemic change entailed. Thus, this process as advocated by shock therapists left apart new path dependencies that could have been created during the transition period.

Some authors such as Pejovich (2003), while considering the interaction between formal and informal institutions, argue that due to a possible conflict between the two in post-communist economies it was better to have a voluntary institutional design rather than one by fiat. While I agree that certain intentionality is needed in creating institutions, I argue that by fiat does not mean that the institutions designed should be identical to certain Anglo-Saxon ideals because history has clearly shown that some countries that have adopted the same institutional designs have not had the same economic performances (North, 1990). It is obvious that institutions are often transplanted from the West to the countries in transition although it is well known that *"best practice in institutional design is a flawed concept"* (World Bank, 2001).

To extend the argument further, market is itself an institution and in order for it to work, it needs other complementary institutions that uphold markets and make them work properly as even advocates of the market supremacy such as World Bank (2001) have started to support in recent years. However, because the market forces at the time were weak, they led to the creation of big market failures and contributed to economic decline, higher figures of unemployment, increased poverty, social inequalities and widespread corruption (Kolodko, 2000; Sokol, 2001; Marangos, 2002). Moreover, no efforts were made to ensure the policy process was effective, efficient and accountable (Eikert and Hanson, 2003).

On a more specific level, shock therapists considered the post-communist individual to be detached from his/her broader context and affected only by economic principles. Hence, the economic policies that were used in transition economies lost sight of the fact that *"economic principles are neither timeless nor independent of the civic setting and the prevailing institutions"* (Davidson and Davidson, 1996; cited in Marangos, 2002). Also, the right balance between capitalist values, such as individualism and self-interest, and civic values were not taken into account (Marangos, 2002). The cruel reality is that the self-interest and individualism encouraged by the market without any particular institutions to ensure that civil values remained unspoiled resulted in non-cohesive societies, as it is often the case in post-communist countries today (Bateman, 2000; 2003; Marangos, 2002).

Contrary to the shock therapists, the gradualists saw the development of proper institutions as a prerequisite for the creation of a functioning market economy. According to them, the institutional structure was crucial in ensuring the channelling of resources to sustainable and equitable long-term growth. Gradualists considered the market not to be the *per se* of reforms in post communist economies. To them, the institutions that would make the market functional were the *"Achilles' heel"* (Svejnar, 2002). According to gradualists, proper attention should have been given to the legacies of the past and how they might have influenced people's behaviour.

With the collapse of communism, the formal institutions of communism may have been dismantled, but the old social institutions such as ways of behaving, norms and practices were still available and people adapted their behaviours to the new environment not *"on the ruins of communism"* but *"with the ruins of communism"* (Stark, 1996). In this sense, rather than talking about transition from one point to the other, it makes more sense to speak about transformation. While some advocates of the legacy approach did not leave much room for a *"systematic explanation of institutional innovation"* (Beyer and Wielgohs, 2001), many gradualists considered the institutions of communism as being there, so it was better to consider them as potential assets to be recombined in innovative ways (Stark and Bruszt, 1998) as initiated by the governments of these countries.

Hence, transition rather than being just a path dependent process can be conceptualised as a path shaping process by polices that take into account the institutional structure in place whether formal or social. Thus, the main issue is the readjustment of existing institutions to the new economic framework. It is not as important to develop new and sophisticated formal institutions

as much as it is important that the institutional structure is consistent with the country's history, culture and traditions.

Moreover, gradualists saw an important role for the state in the process of institution building. They emphasised a *transition by design* that is more comprehensive and requires the state to be an architect in the process, and also requires a better knowledge of the contexts where the design is taking place. Kolodko (2000) argues that if there is a choice between an institutional building *by design* or *by chance*, the former should be adopted. Obviously, this decision needs the commitment of the governments towards institution building. Although the capacity of the post-communist state could have been an objective reason not to use this method of institutional design, the rationale was another.

Thus, the state had a role through policies (Kolodko, 2000) or through strategic choices (Hausner et al., 1995). In countries where the rules were very different from the ones introduced in the post socialist period, it usually required a more active role for the state in order for the new behaviours and the enforcement of new regulations to become possible. Institutions need not only to be built but also need to be *lived* by individuals, and as such is a learning process that takes time. As Kolodko (2000) argues in those societies where the central planning was less rigid, the learning is faster.

Thus, gradualists have been supportive of a big bang approach to institutional change. The introduction of a regulatory framework since the beginning of transition would have led to increased credibility toward reforms because, as Arrow (2000) argues, transition is *'expectation'* dependent as much as it is path dependent. Also, the development of the institutional framework since the beginning of transition would have eliminated the problems related with the two extremes of state or market led development. Yet, the role of the state[2] has been highly emphasised in recent years with many authors agreeing that the laissez faire is wrong (Polanyi, 1957; North, 1999; Hodgson, 2004). Surprisingly enough, the WB (1997: 38) also agrees that *"countries need markets to grow but at the same time need capable state institutions to grow markets"*. However, the fear for the failure of the state in post-communist contexts was a significant factor. As different authors argue, the state's failure to design the proper institutional set up may lead to the informal institutionalisation taking over (Kolodko, 2000) or to *"bandit capitalism with pervasive corruption and deceit"* (Stern and Stiglitz, 1997), as it is today the case in many post- communist transformation economies.

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[2] In Section 3 of this chapter, I will discuss more in detail about the state.

2.1.2 New institutionalism: the right approach to study post-communist transformation?

I have argued that the approach applied in transition economies did not prove to be helpful in understanding the problems of everyday life and the particularities of each country in terms of their political, historical, economic or social nature. It assumed that individual behaviour and informal structures would immediately adjust to the newly established formal institutions by consequently disregarding the social and cultural context. In addition, the recent literature in post-communist transformation economies shows an emphatic shift from this orthodox neo-classical view of transition to an institutional view of transition.

In this regard, an institutional view on the (trans)formation process avoids the ideological tensions at the beginning of transition regarding the state and the market. It is acknowledged by many scholars (Ostrom, 1993; Stiglitz, 2001) that state and markets are not mutually exclusive and one can find different combinations of market and non-market structures in different societies. Under the institutional perspective, the argument focuses on different forms of institutional arrangements in the form of democracies, markets and civil societies. However, the process of constructing institutions in a society is not clear-cut because whilst individuals might engage in constructing the institutions in a society in order to make economic life more efficient as the NIE suggests their actions might be shaped by the cultural context in which they are placed, and in the forms of subjective meanings they associate to specific actions. The institutional change process, it can be argued, leads to systemic shifts when people's behaviour is responsive to the new economic environment. As North (1996) summarises:

> It is the admixture of formal rules, informal norms and enforcement characteristics that shapes economic performance. While the rules may be changed overnight, the informal norms usually change only gradually. Since it is the norms that provide legitimacy to a set of rules, revolutionary change is never as revolutionary as its supporters desire and performance is different from what is anticipated. And economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. This implication is that transferring the formal political and economic rules of successful Western market economies to Third World and Eastern European economies is not a sufficient condition for good economic performance (North, 1996: 353)

In this regard, the focus of attention should not be on just the formal institutions and the content of laws, rules and enforcement mechanisms. Particular attention should also be directed toward the individual and his mindsets. This stance means that individuals will understand, interpret, and value these formal institutions in different ways based on their existing mindsets that are in turn very much affected by the historical, social and cultural context. Thus, the individual

should be placed at the core of the transformation process, as the agent of change and policies should be designed in accordance with this core.

The transformation of post communist economies then should be focused on transforming the individual. Yet, by taking this position that the process of transition is more of a cultural nature, I do not intend to position myself in the group of sociologists that consider the individual as over-socialised and that automatically adheres to the norms of the society. In this regard, I am in agreement with Granovetter (1985) who points out that the social context affects, influences, directs, but does not determine the actions of individuals.

This perspective, as advocated by new institutionalism, finally acknowledges the fact that the transformation of post communist economies is a complex and multifaceted process that requires not only the formal institutions, in terms of constitutions, laws and regulations to be in place, but at the same time, a redefinition of cultural and social values that are able to accommodate, legitimise and internalise the new formal institutions as reflected in the political, economic and legal systems. In this context, the transformation should be considered as a triple process, which involves the discussion of not only the economy, but also of the society and polity.

These three aspects overlap and therefore, the discussion of different economic phenomena should be in conjunction to social and politics phenomena. This approach may appear to lack coherence but, as North (1990) states the use of *building block theory* facilitates the study of the different aspects of the phenomena of interest by allowing a flexibility of relations between different blocks. Thus, the use of a *building blocks* methodology, which allows for layers of sociological and historical variables, to introduce a new perspective of the social actors into the framework, is appropriate.

My discussion shows that there are no unique paths in terms of institutions or policies. Rather, culture, states and markets operate simultaneously thus affecting and shaping each other (Orru, 1991; cited in Buinea, 2001). Hence, I believe that the NIE is the right approach for studying the transformation process in post-communist countries, as it is both multi-faceted and multi-dimensional.

2.2 The role of polity and ideologies in the transformation process

2.2.1 Institutions-definitions and emergence

Life in a society without institutions would be solitary, poor, nasty, brutish and short

(Hobbes, 1651; cited in Mantzavinos, 2001)

Although there is consensus on the importance of institutions in determining economic performance (Mathews, 1986; North, 1990), there is no coherent body of theory that links institutions to economic growth. Moreover, there is no coherence in defining institutions, since the term is variously defined and discussed under different areas of social life. In this section, I emphasise the main schools of institutional thought, what stands in the core of each and, what they offer in terms of institutions' emergence and the role of different actors in the process. I do not completely review these schools of thought; instead, I concentrate on some ideas that stem from the work of Douglas North (1990) and its *"Institutions, Institutional Change and Economic Performance"*, one of the most cited new institutionalists.

There are two main traditions in institutionalism: The so-called the original or the old institutionalism associated with the work of Commons, Veblen and Ayres, and the new institutionalism mainly associated with Coase, Williamson and North. There are significant methodological discrepancies between the two approaches that have made difficult any attempt to bridge the ideas of these schools of thought. However, the later works of North (1990; 1994; 1997) show some inclination toward the ideas of old institutionalism. A broader survey of these approaches shows that there are differences between the two in terms of how they define institutions, and also in terms of institutions' emergence, evolution and persistence.

The Old Institutional Economics (OIE) considers institutions as habits of thought widely embedded in the cultural or historic context. This emphasis on methodological holism that is more associated with sociology than with economics has made it difficult for the OIE to gain acceptance among economists. The degree of methodological holism among old institutionalists differs from one author to the other. For example, Commons (1934) in his definition of institutions as *"collective action in control, liberation and expansion of individual action"* (p. 69) gives some space to individual action, but still under the collective processes that institutions are designed by.

Furthermore, the OIE emphasises an analogy with Darwinism and the spontaneous emergence of rules and selection of the more efficient ones in an evolutionary process as prescribed by Veblen (1899) and that continues to be advocated especially by Hodgson (2004). Moreover, the OIE has always worked based on informal or inductive methods and for these reasons its appeal has not been high considering the economists' proclivity to intellectual rigour. For example, Coase (1984) expresses his dismissal by saying that: *"without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory, or fire" (p. 230)*. In general terms, the OIE is based on the role of the society in defining values, mores, and formal institutions without denying the interaction and feedback processes between the individual and the society. It focuses on the habits and norms but it gives space to societal constraints with regard to choices individuals make.

Alternatively, the NIE is based primarily on the strand of transaction costs and property rights literature in economics, such as that of Ronald Coase (1937; 1960) and his respective essays on the "Theory of the Firm" and "The Problem of Social Cost". Coase made clear, in what is called the Coase theorem, that *"in a world of zero transaction costs, the efficient solution that produced the highest aggregate income would prevail"* (cited in North (1990: 93). Thus, since it is costly to transact, institutions matter. The property rights approach was pioneered by Demsetz (1967) and Alchian and Demsetz (1972). Although of a quite functional nature, because they assume that the property rights are selected efficiently in the market, they opened the way for other approaches of a more explanatory nature. Taking these broad features into account, many scholars have considered the NIE to be merely an extension of neo-classical economics that still bases its arguments on behavioural assumptions and individual utility. However, as I discuss in the next section, the work of North has overcome many of the assumptions of neo-classical economics as it has taken a broader and more subjective perspective that although it keeps some of the assumptions of neo-classical theories, is very much attached to the subjectivism and the evolutionary nature of the Austrian school of economics.

In this regard, the NIE has embraced concepts of *'bounded rationality'* (Simon, 1957), *'transaction costs'* (Coase, 1937), *'ideologies and mental models'* (North, 1981; 1990), which have enriched it with more explanatory power in discussing real world events. The emergence of institutions under the NIE is part of a political process that aims to reduce the constraints that individuals face in terms of information costs, agency costs, opportunism, uncertainty, measuring the quality of goods and services and enforcement of property. All these transaction costs and their evolution give rise to different rules of the game in a society, if I am to borrow the language of game theory. In general, the NIE differs from the OIE in its start of analysis

from the individual and his behaviour. North, however, gives special emphasis to informal rules and culture in shaping the behaviour of the individuals. To summarise, whichever strand of institutionalism one is concerned with, the focus is on institutions as rules of the game. In other words, institutions are a mean for reducing uncertainty and for creating certain predictability to human interaction or exchange between various parties.

Another concern in the literature on institutions has focused on issues of collective choice as reflected in the work of Olson (1965) on *"The logic of collective action"* that questions the willingness of self-interested individuals to work on the benefit of the group they are part of and builds on issues of free-riding. The NIE, by incorporating issues of collective action in its analysis, draws attention to the fact that all the individuals in a society, whether operating in markets or involved in politics are to a considerable degree affected or motivated by self-interest (Olson, 1997). Moreover, in the tradition of Axelrod (1984) or Ostrom (1990) the concern is more focused on the kind of institutions that prevent the careless use of common resources and that induce cooperative behaviours.

Furthermore, there are no agreements in the literature on institutions as to whether they are the product of an invisible hand process or of a conscious design. Earlier authors in institutionalism, such as Menger (1883) argue that institutions can be designed purposively, thus they are pragmatic in nature, although not of a particular research interest, and they can be organically created as the *"unintended consequence of human efforts to resolve individual problems"*. Similar views are found in the Austrian NIE tradition. For example, Hayek (1967) emphasises the evolutionary nature of institutions and according to Rutherford (1994) he was one of the first to make an analogy with biology and natural selection, which was adopted later on by those working in the tradition of evolutionary economics. A feature of his work is the non-intentionality that characterises natural selection. The spontaneous emergence of institutions is connected to entrepreneurial acts of individuals to resolve new problems they have encountered in the environment in which they operate. Once this innovative solution has proved to be beneficial for the individual, other actors will also follow it. This evolution gives raise to behaviour that is widely accepted, since it has been proved to resolve the problems of various individuals. According to this Austrian theory of institutions, there is no anticipation in the process. It is rather an evolutionary process of trial and error that leads to the creation of knowledge.

Alternatively, the design of institutions can be a matter of *'collective choice'* or *'common will'* whereby different actors agree about the presence of a social problem that needs to be resolved

and, after a process of communication, they decide upon the conscious choice of institutions and thus, the results are anticipated. However, the fact that the need for such an institutional design was decided consciously does not mean that the results of the collective choice are those intended (Rutherford, 1994). The outcomes of this process are very much related to the prevailing interests that the actors have at the time, and to the particular stock of knowledge that these actors possess, which will make them interpret and decide upon the solution (Rutherford, 1994; Mantzavinos, 2001). This perspective can explain the emergence of sub-optimal problem solutions or institutional arrangements in many countries. The idea of an institutional framework is how individuals gain a common stock of knowledge they can draw upon to interpret different actions or behaviours in their environment. However, nothing in my discussion of the literature suggests that institutions being created are efficient because institutions are *social constructions and as such they reflect bounded rationality, power struggles and transaction costs.*

Moreover, Mantzavions (2001) warns about the importance of distinguishing between the reasons for creating institutions and the consequences of using them. The limited cognitive ability of human beings is at the centre of institution creation (Hayek, 1960; North, 1990; Mantzavinos, 2001). As Hayek (1960) argues, *"rules are a device we have learned to use because our reason is insufficient to master the full detail of complex reality" (p. 66).* Further, Hayek (1945) argues that all economic problems are knowledge problems. Each of us has a stock of knowledge that we use in times of uncertainty, and it is according to our particular stock of knowledge that we interpret past and present experiences, trying to create solutions to new problems encountered in the present environment and anticipated in the future.

Hence, the importance of institutions as a mean of achieving social coordination is widely accepted. Thus, the institutional framework simplifies the environment. Whilst this is the reason for the creation of institutions, the effect of their existence is connected to the stability they give to human interaction. In this regard, institutions structure human interactions by reducing the uncertainty that is derived by not having an expectation of what other people would do in a situation. Also, institutions are a mean of coordination in a complicated world.

2.2.2 The role of polity

The economic growth and development of a country are basically unaffected by the type of government it has, if the cost of transacting in both the political and economic spheres is zero. However, when transaction costs are positive, the distribution of political power within a country and the institutional structure of its rule making institutions are critical factors in economic development. (Coase, 1964)

In this section, I discuss the state as not only the main actor in defining formal rules, but also as the enforcement agency of the rules of the game. However, my emphasis on the role of the polity does not exclude from my analysis the role of beliefs and mental models that give legitimacy to a set of rules.

The literature on governments recognises two different views on the economic role of the state. The first is the '*normative*' or '*market failures*' view of government, which is the traditional view on the state, and the second is the '*positive*' or the '*government failure*' approach, which is mainly discussed under the public choice literature. More recently, there have been writings under what is called an institutionalist approach.

The first approach, mainly associated with the work of Musgrave (1959) and the welfare state literature, considers state intervention as necessary for *"correcting of allocation, of distribution, and of business cycles"* (Karlsson and Karlsson, 2002). Markets, under this approach, are considered to be efficient and in the rare cases they are not, the state is the right actor to correct what markets fail to achieve. The government is seen as a benevolent and omnipotent actor that should use its fiscal and legal power to adjust the allocation of resources and the distribution of wealth and power (Musgrave, 1959; Stiglitz and Heertje, 1989).

The government failure approach has been designed to challenge the normative view by emphasising the (in)efficiency of the government intervention in economy. As Karlsson and Karlsson (2002) argue, the use of the micro-economic assumptions for state actors has been one of the major innovations sparkled by the public choice literature. In this regard, state intervention in the economy has been criticised based on the discussion of factors such as the self-seeking motives of individuals that thrive to increase their utility, which can be equally applicable to states. Moreover, the objectives of states are often determined by certain groups of individuals, which then lead to the creation of allocative inefficiencies, organisational slacks and rent-seeking activities. From this perspective, the polity is seen as a corrupted force that by being irrational prevents the rational management of the economy. Furthermore, the short-time horizons of politicians, i.e. narrow interest groups dominating the state intervention, have also

been pointed out under this tradition (Skreb, 1997). In addition, the rationality assumption according to which state actors have all the necessary information to take decisions has been relaxed.

Despite this theory, there is no rich empirical research that determines what are the costs of market or state intervention in achieving the allocation of resources. Recent events have proved that a degree of both state and market should exist in every country. The institutionalist theory of the state questions the character of the market. The market is itself a political construct which, in order to work properly, needs another set of institutions to support it, such as property rights and trade laws (Karlsson and Karlsson, 2002). Moreover, in a dynamic world full of uncertainty, innovation and other entrepreneurial activities, there is no benchmark toward which to identify market failures (Chang and Nolan, 1994; Chang, 2002a; Karlsson and Karlsson, 2002). Thus, an institutional approach can justify either of the propositions for less or more state interventions. According to NIE, the state is important in designing an institutional framework that is indispensable for the operation of both the state and the market. As to whether this is efficient, the literature has offered opposing views. However, these opposing views have recently tended to converge in their abandonment of functional arguments of the polity.

The new institutional theories of the polity were initially focused on property rights. They extend from what Eggertsson (1990) calls the *'naïve theory'* of property rights that claims they will adapt in the basis of changes in prices and thus maximise the community's wealth (Demstez, 1967) to *'interest group'* theories of property rights that seem to consider all the decisions regarding property rights as taken based on issues of power distribution or narrow interest groups. While the first theory ignores information problems and inefficiency accounts, the second one takes as given the social and political institutions in a society and concentrates only on the interaction between different interest groups. Moreover, the later implies that those in power do not have any interests of their own which is very naïve view (Eggertsson, 1990). Olson (1965; 1997) in elaborating his collective choice theory considers actors in the polity to be affected by self-norms of motivation as other social actors but without excluding the chance of altruistic acts and actions that are motivated by principles and moral beliefs, as happens in any sphere of life. Certain views are found in the public choice or positive theories of government (Buchanan, 1975) and in North (1990).

North (1990) combines many of these perspectives and includes in his analysis the polity, economy and culture in the decision-making processes. He sees the state as a third, coercive party. According to him, one cannot leave the state out of the process since it is the polity that

specifies and enforces the formal rules in a society. While neo-classical theories have ignored any substantial role for the state, for North enforcement cannot be taken for granted and is subject to internal codes of conduct, social environment and the state itself. North (1990) argues that:

> *Third party agreement means the development of the state as a coercive force able to monitor property rights and enforce contracts effectively, but no one at this stage knows how to create such an entity. Indeed, with a strictly wealth maximising behavioural assumption it is hard even to create such a model abstractly (p. 59).*

In North's theory of the state there is evidence of some duality of its role. On the one hand, the state is an important agent in specifying the rules of the game, in terms of the competition or cooperation in a society, in order to increase economic efficiency and welfare but, on the other hand, the state can specify property rights that are not efficiently based on its needs as a ruler, such as fiscal needs. To overcome this issue, North (1990) explores the need for a theory of ideology. According to him, the state finds itself first, in the difficult position of raising its revenues through tax collection and second, in creating a set of rules of the game that will lower transaction costs for a wealth maximising game. Thus, an ideology, that will constrain individual behaviour and that will make the contractual relations between the ruler and the constituents legitimate, is needed. Eggertsson (1990) or Mantzavinos (2001) discuss state under the same lines.

The role of the government as a third party enforcement agent has also been acknowledged by old insitutionalists like Hodgson (2004). He argues that this acknowledgment is not to romanticise the state quoting Sened (1997), according to whom:

> *Governments do not create such structures out of benevolence or moral concern. They grant and protect property rights in order to promote their own interests. But in doing so, they fulfil two crucial social functions. The function of maintaining law and order that is necessary condition for economic growth and affluence, and the function of arbitrage between conflicting interests (p. 123).*

Up to now, I have argued the inexcludable role of the government. However, it can be really dysfunctional sometimes as the transition case suggests. The literature on transition, in particular, the work of Frye and Shleifer (1997) on *"The Invisible and the Grabbing Hand"* and Shleifer and Vishney (1998) on *"The Grabbing Hand: Government Pathologies and Their Cures"* is concerned with different types of governments. According to these authors, there are three different views under which the government can be discussed.

The invisible hand model that is more in tune with the mainstream institutionalist view of the state considers the state as *"uncorrupt and benevolent"*. The state only provides *"basic public goods, such as contract enforcement, law and order, and some regulations, and it leaves most allocative decisions to the private sector"* (Frye and Shleifer, 1997: 354). The government's role under the helping hand is much more extended and, to a degree, is similar with the normative view on the government. In the grabbing hand model, which the authors consider to be prevalent in a number of Eastern European Countries, i.e. Russia or SEE, government is interventionist and not organised with a number of individually operating bureaucrats who pursue their own agendas and take bribes (ibid. 354). These authors have compared Poland with Russia focusing on the legal and regulatory framework in each of these countries, from an enterprise perspective. Their studies have shown that in none of these countries does an ideal model of government exist, but they can approximate the Polish model more to an invisible hand model and the Russian one to a grabbing hand model where the *"government is ineffective in providing basic services, courts are ineffective in resolving disputes, and in the extreme, agreements are enforced privately"* (ibid. p. 355).

In this section, I emphasised the role of the state in the process of institutional design. However, as the new institutionalism theory emphasises the government is just one side of the coin when it comes to economic development. That said one has to be cautious that a number of studies under this school of thought consider formal institutions as the real institutions and see all social problems as power politics. Yet, other factors need to be taken into consideration, such as informal institutions and what kind of paths their coexistence with the formal ones can create. In the next two sections, I review work on the interaction of formal and informal institutions and also work on path dependency as one of the *'burning'* arguments in the literature on institutions in transition economies.

2.2.3 Interaction of formal and informal institutions

In the modern Western world, we think of life and the economy as being ordered by formal laws and property rights. Yet, formal rules even in the most developed country make up a small (although important) part of the sum of constraints that shape choices. In our daily interactions with others, whether within the family, in eternal social relations or in business activities, the governing structure is overwhelmingly defined by codes of conduct, norms of behaviour, and conventions (North, 1990: 36)

In the previous sections, I discussed formal institutions. However, the role of informal institutions is widely accepted by the NIE academic literature in explaining growth and economic development. Moreover, the experience of post-communist countries and the problems with their economic performance have increased the strength of the argument for

incorporating informal institutions in discussions about institutional change and economic performance.

As I mentioned earlier, North (1990) was among the first to incorporate informal institutions in a revolutionary attempt to theorise institutional change bridging different academic disciplines. Under North's definition, institutions are constraints that guide interaction. Thus, institutions not only provide a framework for human interaction but also define what kind of behaviour is acceptable. He distinguishes between formal institutions, informal institutions and their enforcement characteristics. Institutions are made up of formal constraints such as rules, laws, constitutions whose aim is to facilitate exchange, political or economic; informal constraints such as norms of behaviour, conventions, and self-imposed codes of conduct that *"come from the socially transmitted information and are part of the heritage we call culture"* (p. 37) and their enforcement characteristics. *Informal rules underlie and sometimes complement or substitute the formal ones* (North, 1994) and they are the *old ethos, the hand of the past or the carriers of the history* (Pejovich, 1999).

The literature on informal institutions and their role in economic development has been strongly influenced by theories of social capital and in particular by the work of Putnam (1993). His research was based on a longitudinal study, designed to map the attitudes towards national and local government over a period of 11 years between 1977 and 1988. Putnam showed how the different economic performance of Northern and Southern Italy were affected by their different historical and cultural traditions of civic engagement. Well-developed Northern Italy is characterised by horizontal bonds that gave rise to participation and active engagement in the public life. On the other hand, Southern Italy has a tradition of vertical bonds that gave rise to dependency and clientelistic attitudes that have harmed economic development further and have widened the gap with the wealthier part of the country.

In this regard, Putnam answers the question *"how to make democracy work?"* by emphasising *"vibrant networks and norms of civic engagement"*, which promote *"habits of cooperation, solidarity and public spiritedness"* as opposed to *"vertically structured politics, a social life of fragmentation, and isolation, and a culture of distrust"* (p. 15; 89-90). He also emphasises the very important role of history in the process through his application of path dependency approach and historical institutionalism. Goodman (2004) provides a critique of Putnam's study and argues that Putnam has left out of the analysis the important role that the government and its actors can play in terms of building social capital. Thus, a credible commitment by the

government in terms of enforcing property rights can help to increase the levels of trust in a society.

Fukuyama (1995) in discussing trust, as one of the facets of social capital, takes a cultural perspective. According to him, *"a nation's well being, as well as its ability to compete, is conditioned by a single, pervasive cultural characteristics: the level of trust inherent in a society"* (p. 7). It is precisely the level of trust in an economy that according to Fukuyama (1995) will lead to the creation of social capital that *"is transmitted through cultural mechanisms like religion, tradition, or historical habit"* (p. 26). Moreover, he argues that the organisational structures one can notice in a society are very much related to trust in societies. High trust societies, according to him, are more able to create large organisations, or if not, they can be better in networking small ones. On the other hand, in low trust societies one can see small firms in the form of labour intensive types or family businesses with no trust in others to create modern and well established organisations. According to Fukuyama, because size will determine what sectors a country can participate in globally, trust is of immense importance.

However, whilst such studies based on cultural perspectives, have tremendous value on a general level, by simply considering the levels of social capital and trust to be homogenous in a country, they miss out very important differences among individuals and processes they are involved in. In the next chapter, I discuss this, with a reference to entrepreneurship. No discussion regarding the role of institutions in the economic performance of a country is complete without reference to the relations between the formal and informal institutions (North, 1990; Mantzavinos, 2001; Nee, 1998; Pejovich, 2003; Putnam, 1993). The difficulty of institutional economics in incorporating both these types in a theory of institutions derives from the fact that formal and informal rules are driven by distinctly different mechanisms.

While formal institutions are, in most cases, the outcome of designated policies and are enforced through third parties such as legislators or judges (North, 1990; 1994; 1999; Mantzavinos, 2001; Pejovich, 2003), their impact on economic performance is related to their interactions with informal institutions, which emerge spontaneously through the process of problem-solving (Mantzavinos, 2001). They are embedded in a web of social norms, networks and trust in a society and are enforced informally as a by-product of ongoing social relationships (Granovetter, 1985; Nee, 1998).

Pejovich (1999) argues that there could be four different types of relations between the formal and informal rules. *First,* formal rules can suppress, although cannot change, the informal rules.

Second, formal rules can be in direct conflict with informal ones. *Third,* formal rules are either ignored or rendered neutral, and *fourth,* formal and informal rules cooperate with each other (p. 170-171). It is clear that formal rules can be either in conflict or in harmony with informal ones. While the former case can bring with it various costs of enforcement of the formal rules, in the latter case the enforcement is expected to occur informally. Based on these types of relationships between the two forms of institutions Pejovich (2003) has designed an interaction thesis according to which:

> *When changes in formal rules are in harmony with the prevailing informal rules, the incentives they create will tend to reduce transaction costs and free some resources for the production of wealth. When new formal rules conflict with the prevailing informal rules, the incentive they create will raise transaction costs and reduce the production of wealth in the community (p. 349).*

Nee (1998) speaks about congruent, decoupled and opposing norms. These could stand for what Pejovich (1999) calls cooperation between formal and informal institutions, ignoring formal institutions and resisting formal institutions that are meant to *"bend the bars of the iron cage"* (Nee, 1998: 88). Still, Mantzavinos (2001) includes in his analysis possible relations between formal and informal institutions in terms of being neutral, complementary, substitutive, or conflicting with each other but, as he argues, as long as no coherent theory is available it is difficult to understand what are the reasons that might lead to the emergence of any of these relationships. However, Mantzavinos (2001) argues that complementarity between formal and informal institutions does not always contribute to wealth maximising games in a society. In this respect, he gives the example of communist economies whereby at the time the formal rule of banning private property and the informal one for minor efforts in state-owned enterprises although complemented each other, they did not produce any broader economic benefits (p. 156).

Mantzavinos (2001) in his *"Individuals, Institutions and Markets"* elaborates on the kind of institutions that will have positive impacts in the economic development of a country. While appreciating the role of each of them individually he agrees with other scholars that one cannot be understood without the other. According to him, in terms of formal institutions *"first secure property rights and, second, economic institutions maintaining open markets are the sine qua non for wealth creating market processes"* (p. 240). While these provide only the content of the appropriate formal institutions, there is the problem of enforcement that needs a credible commitment on the part of the government through either creating the *"precedent of responsible behaviour"* or through reputation building (which history has proved often not to be the case) or

through constitutions that are structured based on the rule of law and market-preserving federalism (p. 245).

In terms of informal institutions, Mantzavinos (2001) makes a distinction between (1) *social conventions* as social rules that are "*to a large degree self-policing in the sense that, after their emergence, no individual has an incentive to switch from the rule that everyone is following*" (p. 101); (2) *moral norms* that "*require a kind of behaviour that, while socially beneficial, seems to be-at least prima facie-contrary to the interests of the individuals themselves*" (p. 106); and (3) *social norms* that "*provide solutions to different problems...(and) vary tremendously among different places and times*" (p. 118). While moral rules, in a way are culture dependent, social norms differ with the social setting and also the time. Thus, social norms "*are adaptive devices to environmental changes in the social setting... (and) are transformed whenever a relatively permanent shift in the social environment takes place*" (p. 123). Based on this definition, Mantzavinos (2001) takes an invisible hand approach to the adoption of social norms, through trial and error experimentation and learning. Once a solution proves to be successful then it is followed by other people in the community, defining a social norm whose deviation is thereafter sanctioned.

Moreover, with regard to the emergence of both formal and informal institutions, Mantzavinos (2001) states that it is "*rather a seldom case that the spontaneous evolutionary process of the emergence of informal institutions and the conscious design of a polity coincide in an institutional mix that is relevant for a wealth creating economic game*" (p. 253). In the case of transition economies, many new formal institutions are being introduced that tend to shift incentives from bargains in political markets that do not contribute to anything other than rent seeking activities to gains in the economic market exchanges. According to Pejovich (1999), some of these formal rules have emerged spontaneously as a response to the requirements of the game while the others have been passed by rulers in order to change the game. He uses this distinction to advance his proposition that institutional change in transition economies, occurs by either fiat or voluntary contracts. Pejovich makes an explicit argument for voluntary contracts and the role of the market in institutional design. Nevertheless, I agree with Mantzavinos (2001), who argues that is by no means evident that the right institutional mix will arise automatically as the majority of institution-free models emphasise. Moreover, it is not easy to understand what the right kinds of polity and informal institutions are that would lead to the creation of a positive game institutional framework.

Unfortunately, in transition economies, the speed with which formal rules have been introduced has been high, but the behaviour of economic actors toward adopting the new ways has not been that satisfactory. In situations where new and old ways of doing things coexist, it is in many cases easier for the economic actors to use the old ways with which they are familiar. The consequences of such habits, in many post-communist countries have been the use of personal networks to serve market behaviours although in the majority of the cases they are not the legitimate formal rules. In this regard, the learning that takes place in these societies occurs at a much slower process of trial and error that is finalised when people are able to *'live'* the new institutions.

In terms of studies being undertaken in transition economies that take into account the informal rules, the evidence is not satisfactory. Among the first to write about the importance of informal rules were Grabher and Stark (1997) and Stark (1996) from a sociological perspective. Raiser (1997) wrote about informal rules as a neglected dimension in the process of institutional change in post-communist countries. According to him, *"a crucial role for informal institutions in all societies is to facilitate exchange both by supporting self-enforcing rules of the game and by fostering trust in third party enforcement through the state"* (p. 27). In addition, he argues that possible policy implications are: (1) a strengthening of the civil society, which will have a positive effect on trust; and, (2) clear signals of commitment by the governments which will increase their credibility.

A history of use of discretionary power, and inconsistencies in formal rules and policies after the collapse of communism have contributed to the prevailing features of exchange in many of these countries: namely, corruption and the emergence of shadow economies (Broadman et al., 2004; Feige, 1997; Clague, 1997). Sometimes, informal institutions are adopted because the formal rules are inefficient and the individuals find that it is less costly to make informal arrangements than to depend on the formal rules (Feige, 1997; Pejovich, 1999; Smallbone and Welter, 2003b). Feige (1997) mentions some studies, which have shown that informal norms such as corruption or personal networks have been beneficial in countries where compliance with formal rules is very costly. However, he argues that while this activity may reduce transaction costs, it can also harm the social fabric by jeopardising the principal of the rule of law and make long-term change even more difficult (p. 26).

Therefore, there is a difficult balance between formal and informal rules. The way that informal norms are created makes it difficult for any effort to change them through deliberate policies. Nevertheless, it is necessary to design ways to speed the process of learning in these societies,

and at the same time to understand the basic context under which individuals are required to change their behaviour. Individuals will do what the particular environment imposes on them and at present it imposes non-compliant behaviours. In the following chapter I elaborate on some of the issues that the interaction of both formal and informal institutions brings to the study of entrepreneurship in a post communist setting.

2.2.4 Path dependence as a combination of formal, informal institutions and learning processes

Where you can get to depends on where you are coming from and some destinations you cannot get to from here. Path dependence can produce durable differences in performance between two societies even when the formal institutions, resources, relative prices and individual preferences in the two are similar.

(Putnam, 1993: 179)

Path dependency has gained certain appeal in the recent years and is used in different areas of study. Its appeal is also significant when discussing institutional change in post communist transformation economies. The concept has been widely used in the not very explanatory meanings of *"history matters"* or *"past influences the future"* (North; 1990). However, serious attempts are made to enhance its explanatory power and its coherence as a concept (Mahoney, 2000; Schwartz, 2003,) because uses of this type make it difficult to determine the mechanisms that animate the structure of events and the place that institutions have in this causal chain.

In the first section of this chapter, I addressed some of the issues and choices made at the beginning of transition that have been considered as having path dependency connotations. In this section, I review the literature on path dependency as a possible factor for the slow institutional transformation in post-communist economies. Path dependency manifests itself in the coexistence of old and new behaviours, learning processes, policy choices at the beginning of transition and their implications.

Originally, path dependency was developed as a concept to interpret the persistence, or lock in, of sub-optimal solutions in the form of backward technologies, although better alternatives were available, due to their increasing returns (David, 1985; Arthur, 1989). Thereafter, North (1990) has been among the first scholars to adopt this concept with reference to institutional change in historical perspective. When used with reference to institutions, path dependence means that once a choice about a particular institutional set-up has been made, then this past choice will be reflected in future ones and *"rather than being a story of inevitability in which the past neatly predicts the future, it is a way to narrow conceptually the choice set and link decision making*

through time" (North, 1990; p. 98). Moreover, *"process, sequence and temporality"* have been considered as important in adding to the social explanation of the concept.

Different works in the field agree to the presence of three defining features of a path dependent analysis. *First,* path dependency analysis is the *"study of causal processes that are highly sensitive to events that take place in the early stages of an overall historical sequence"* (Mahoney, 2000: 510) where *"early historical events are contingent occurrences that cannot be explained on the basis of prior conditions"* and that in situations like this *"large consequences may result from relatively small and contingent events"* (Pierson, 2000: 251). This first characteristic outlined in the literature provides what Schwartz (2003) calls the first leg of a path dependency approach that deals with the presence of small events, random circumstances or historical accidents.

Second, the process of path dependency is marked by *"deterministic causal patterns"* or what can be thought of as *"inertia"* which is the one that creates the reproduction mechanisms (Mahoney, 2000: 510-511). Moreover, since the emergence of formal institutions is to allow for impersonal exchange, then it makes sense that institutional arrangements cannot be very flexible; thus, complexity is inherent in the concept of institutions. Therefore, complexity and inertia reinforce each other and make difficult the altering of an institutional framework.

Third, one of the strongest arguments in path dependency is the increasing returns argument. Schwartz (2003) argues that once we remove this argument then path dependency is not any different from other theoretical arguments such as cognitive blindness or deliberate use of power to maintain the status quo. In the context of institutions, the increasing returns are explained by the knowledge that the social actors gain in the process. The social learning is a crucial element in setting up and reproducing an institutional framework. In this regard, North (1990) argues that:

> *the economies of scope, the complementarities and the network externalities that arise from a given institutional matrix of formal rules, informal constraints and enforcement characteristics will typically bias costs and benefits in favour of choices consistent with the existing framework (p. 76).*

This means that once individuals learn how to use institutions to solve their social problems and once people in a society share the same mental models, the costs of switching institutional frameworks are high (Mantzavinos, 2001). Moreover, since under a particular institutional framework certain political and economic organisations are created (North, 1990), they will

have a stake in maintaining the status quo. Thus, the increasing returns argument explains why actors are locked into a particular path and why they are so inclined to preserve and rationalise an institutional framework although it may be the wrong path, which explains why institutions are self-enforced or self-produced.

2.2.4.1 Reproduction mechanisms

Path dependency arguments acknowledge that institutional change is a very incremental process and after a shock or a disruptive process, an institutional framework comes into place and becomes stable and durable due to the above-mentioned reasons. Thereafter, the change can be expected to become more endogenous as a consequence of changes in the values and mental models of people, or as a result of different bargaining powers.

However, Thelen (1999) takes a different approach by focusing on the mechanisms of reproduction and ways of knowing them, which then will assist finding ways to reverse them. According to her: *"Institutions rest on a set of ideational and material foundations that if shaken open possibilities for change. But different institutions rest on different foundations and so the processes that are likely to disrupt them will also be different though predictable"* (p. 397). In this respect, she argues for paying attention to various reproduction mechanisms and how can they be best understood in terms of the degree they will accommodate or resist the pressure for change. The approach she suggests underlies a better knowledge about the mechanisms of reproduction by giving rise to a certain change *"by design"* rather than one *"by choice"*.

Different authors (Mahoney, 2000; Pierson, 2000; Lindner, 2003) have identified various reproduction mechanisms. Lindner (2003 based on Pierson, 2000) argues that one of the reasons for path dependency is the interest of those with the *bargaining power* not to relinquish the status quo. The power explanations can be found in Mahoney (2000) and also in North (1997; 1999), according to which the elite that has a stake in maintaining the existing arrangement will make sure to promote its reproduction. In times when those that have the bargaining power are also not credible, there are more chances that a strong coalition of actors that consider change to be important will challenge the stability of institutions. However, the interdependence between different sub sectors does not leave much space for change.

Mahoney (2000), on the other hand, identifies reproduction mechanisms based on the different approaches under which path dependency has been studied. The most common approach is the

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utilitarian approach in economics. This evaluation can be attached to the work of North (1990), who sees institutional reproduction in terms of the benefits of learning effects, coordination effects, adaptive expectations, as well as costs imposed by irretrievable investments (p. 91). Since, according to this approach, the only possible reason for change in institutions is based on the interests of different actors, competitive pressures would be more appropriate for discussions in the market rather than in the social world (Mahoney, 2000). As such, he takes the example of property rights and how can they stabilise expectations of different actors and also encourage them to take a long-term perspective.

North has incorporated in his work insights from cognitive sciences with a special attention to the role of ideologies and mental models involved in institutional efficiency. According to him, institutions whether formal or informal, involve a degree of knowledge and learning in the society. Institutions are nothing more than shared mental models that individuals use in solving different problems. North and other authors within the NIE school of thought argue that the transactions costs of measurements and enforcement of contracts in the exchange process are considerable and these ideologies cannot be ignored in the process.

Whether a set of rules is efficient or not is very much dependent on the subjective perceptions of the political and economic actors. This argument is away from rational choice arguments according to which, actors possess all the information feedback necessary to make the right choices or to correct the models through which they interpret the world. The rules of the game can be perceived to be fair or not based on the expectations about the transactions costs involved and thus, will promote a set of exchange processes in the society. In this respect, the judgement of institutions in regard to a specific problem solution is related to the knowledge people possess or the expectations created based on their stock of knowledge. According to North (1990):

> *the way in which knowledge develops influences the perceptions people have about the world around them and hence the way in which they rationalise, explain, and justify the world, which in turn influences the costs of contracting. People's perceptions that the structure of rules of the system is fair and just reduce costs; equally their perception that the system is unjust raises the costs of contracting (p. 76)*

The ideologies, or the mental models, of individuals are created based on the stock of knowledge that each actor possesses. Knowledge can be formal or scientific and it is transmitted through education or through culture. This knowledge is what people use to create institutions and once the institutional knowledge is created is difficult to alter it. However, as I mentioned previously, nothing in these arguments suggests that the social knowledge the institution

presents is true and will be durable for a certain period of time. Sometimes societies have accumulated a kind of knowledge that does not equip them with the means to solve new problems that have emerged in the environment.

Thus, mental models or subjective perceptions are very important factors in explaining circular evidence or causation regarding institutions. It is due to their perceptions that individuals collect and interpret information which gives rise to different organisational structures. Moreover, the behaviour of individuals toward formal institutions is a volatile act that is deeply influenced by the values of the structures within which the individual is *"embedded"* (Granovetter, 1985; Fukuyama, 1995). Thus, informal institutions are a decisive element in channelling information and knowledge in a society.

The reproduction of institutions can be also considered as an outcome of the legitimacy attached to the institutional framework. The legitimacy explanation considers institutional transformation as resulting from *"changes in actors' subjective beliefs and preferences, not changes in power distribution of actors or changes in the utility functions of actors who are assumed to have constant preferences"* (Mahoney, 2000: 525), which opens the ground for social explanations to these social phenomena. In this regard, Schwartz (2003) drops the increasing return argument for an argument based on the socialisation of actors and the fact that those with more power are those who will impose their social realities on other people. Accordingly, it is worth stressing the importance of knowledge and learning in any process of institutional change. Since they are not distributed evenly those that have more of each will be able to change the path endogenously. This contradicts path dependency arguments according to which, change occurs only during critical junctures.

2.2.4.2 Path dependence arguments in transition-some issues for further consideration

These theoretical discussions on the reinforcing mechanisms of certain institutional arrangements (reinforcing mechanisms are different from the mechanisms that set in place a certain path) support some of the possible arguments that can be developed further in post communist contexts. While there is no doubt that, from a path dependency perspective, the creation mechanisms of certain institutional arrangements in transition were made on the critical juncture created at the beginning of 90s, I think it is more of an argumentative value to focus on their reproductive mechanisms. In the same terms, path dependency arguments become stronger because of temporality issues and choice of institutions.

Following the arguments in Section 3, in terms of formal and informal institutions, two important mechanisms can be outlined. On one hand, the arguments related to power distribution are of an explanatory nature, especially in terms of discussing the formal institutional framework, which has suffered deficiencies for many years. It is not new to mention that different institutions or policies adopted are maintained based on power considerations. On the other hand, the arguments for path dependency in transition are mainly associated with the informal rules inherited by the communist past and how they still manifest themselves and have locked actors into them without being able to adopt new behaviours.

In this regard, I think that two issues or propositions are worth elaborating further with regards to my case study of Albania concerning these path dependency arguments in a business environment.

First, although a certain institutional framework might be in a certain path it does not mean that there is no scope for intervention based on the efforts to shape the path through well designed contextual policies that open the way to a process of knowledge accumulation based on the particular characteristics of this context, differently from the critical juncture's arguments.

Second, while there is no doubt that people in these countries have given legitimacy to informal institutions, which might have created a certain pattern of reproduction it is more difficult to state that actors are really locked in this path. The majority of the behaviours one might encounter in transition could be just a short-term response to the inefficiencies of the system.

Conclusions

In this chapter, I argued that the post-communist transformation is more than just a process of change in the structure of prices in the market. It is a multidimensional process that encompasses all spheres of life, or to quote Stiglitz, is a "transformation of the society". By reviewing the most influential perspectives on transition, I showed that institutions are crucial in this process and that any discussion on the transformation and the behaviours it induces should be held with a reference to institutions.

I made reference in this chapter to the new institutional approach and the work of Douglas North as it incorporates various disciplines in explaining change. The application of the new institutional approach allows the use of different disciplines in explaining the behaviour of people by challenging the majority of the studies that have concentrated on formal institutions, as given in the content of laws and regulations, with very little acknowledgment of the legacies

of the past and the ways people learn or are encouraged to do so. Moreover, I discussed the role of the state under the institutional perspective. Furthermore, I argued the importance of informal institutions and the problems that their coexistence with formal ones creates. I avoid deterministic cultural perspectives that do not leave much space for entrepreneurial behaviour and the roles of good designed policies.

My rationale for the discussion of institutions, formal and social, and their interaction was to open the ground for understanding their influence on entrepreneurship and business behaviour in a post communist context, and more specifically, of the kinds of entrepreneurial behaviours they induce. I also discussed the concept of path dependency as part of institutionalism with the main aim to further develop this concept in a post-communist business context. In the next chapter, I discuss these issues on institutions with a reference to entrepreneurship in post-communist contexts.

CHAPTER 3

ENTREPRENEURSHIP, SMEs ROLE, GROWTH DETERMINANTS AND THE PARTICULAR INSTITUTIONAL FEATURES AFFECTING THEM IN TRANSITION ECONOMIES.

It must be considered that there is nothing more difficult than to carry out, no more doubtful of success, no more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in those who profit by the new order, this lukewarmness arising...partly from the incredulity of mankind, who do not truly believe in anything new until they have had actual experience of it

(Machiavelli, 1537; cited in Barreto, 1989)

Introduction

Entrepreneurship is one of the most researched areas in the social sciences over the past two decades. While left out of the analysis of neo-classical growth theories, entrepreneurship has currently regained its role as one of the determinants of economic development. Neo-classical growth theories have considered economic growth for many years as *'a production function of capital and labour'* (Solow, 1956), and subsequently, have widened the model with the inclusion of *'knowledge'* (Romer, 1986). However, these models ignore important factors like vision and strategy that, with time, allow renewal and growth via competitive advantage and dynamic capabilities (Venkataraman, 1997; Alvarez and Barny, 2000; Ibrahim and Vyakarnam, 2003).

Nevertheless, different authors (Baumol, 2002; Acs and Audretsch, 2003; Audretsch and Keilbach, 2004) argue that entrepreneurial activity is another important determinant of the economic performance of different countries and should be included in the analysis. Yet, not only has this task been complex, but also it is still difficult to find a consensus in the literature regarding a definition for entrepreneurship and entrepreneurial activity. In this chapter, I put forward two broad propositions that account for this lack of consensus in the literature:

First, entrepreneurship is an encompassing activity. Thus, different authors attribute different activities to an entrepreneur based on the kind of approach and time period within which they have studied entrepreneurship. The literature generally shows an inclination toward the entrepreneur as depicted by Schumpeter. Nevertheless, many other attributes have been

associated with the entrepreneur, whether related to the entrepreneurial process or to the outcome of this process, which is of more societal interest. Hence, attributes attached to entrepreneur have included: *'role of change agent'* (North, 1990; OECD, 1997), the role of *'allocating resources among alternative uses'* (Say, 1828; Hebert and Link, 1998), the role of *'speculator'* (Cantillon, 1755), *'the introduction of new combinations'* (Schumpeter, 1934), *'risk-taker'* (Knight, 1921), *'alertness to opportunities'* (Kirzner, 1973), *'discovery, evaluation, and exploitation of goods and services'* (Venkataraman, 1997) or other such activities that have in their core human ingenuity and creativity.

On the other hand, the European Union also shows a particular interest in entrepreneurship. In its *"Green Paper on Entrepreneurship"* it used a broader definition for entrepreneurship that incorporates many of the attributes of entrepreneurship summarised above:

> *Entrepreneurship is the mindset and process to create and develop economic activity by blending risk-taking, creativity and/or innovation with sound management, within a new or an existing organisation (CEC, 203: 6).*

Second, the fact that the interest in entrepreneurship is linked to economic competitiveness or development means that none of the activities I described could be possible for entrepreneurs unless certain legal and social institutions are present. The same applies to both developed and developing countries with the only difference being the kind of institutional infrastructure that exerts more influence over certain periods of time.

Thus, in the course of this chapter, I emphasise the importance of context as one of the determinants of whether entrepreneurial activities will be present or not. The economic impact of entrepreneurship and small firms in particular is not uniform-neither in space nor in time. Moreover, the benefits given to entrepreneurship or its status have differed from one country to another thanks to different cultural, economic and political contexts while also having been subject to change in tune with the challenges posed by changes in the world environment. The post-communist countries offer a perfect case study in terms of the enormous social and economic transformation that are experiencing and the scope for entrepreneurship and forms of entrepreneurship they offer.

Based on these two broad propositions, I discuss in Section 1 the role of entrepreneurship and small business development with an emphasis on some of the main empirical researches undertaken. In Section 2, I highlight the rationale for the high

stake placed on entrepreneurship in post-communist contexts. I move the discussion in Section 3 to the main theoretical approaches on entrepreneurship with an emphasis on the main entrepreneurial aspects that drive the market process. In Section 4, I discuss the different forms entrepreneurship can take, thus paving the way for the discussion in Section 5 about the most relevant formal and social institutions for productive entrepreneurship. The theoretical support of my propositions will be part of my concluding remarks in this chapter.

3.1   Why encourage entrepreneurship and small businesses?

Swedberg (2002) reviews some of the last thoughts of Schumpeter on entrepreneurship as a function. In these writings, especially *"The Obsolescence of the Entrepreneurial Function"*, he is concerned with the broader social institutional setting where the entrepreneur carries out his/her activities. Schumpeter worried about people becoming accustomed to change, and large corporations using new technologies in a routine fashion. According to him, capitalism demystified everything in society including entrepreneurship (p. 17). Nevertheless, the evidence shows that entrepreneurship not only is more active than ever, but it has found its expression in the small business sector which is: (1) more flexible and perceives and adjusts more rapidly to new technologies (Jovanovic, 1993; Carree and Thurik, 2003); (2) is closer to changes in customer tastes thanks to changes in information technology, increases in the wealth and the development of the services sector.

The interest in entrepreneurship and small business development is articulated in the form of its significant contributions to economic growth. However, the SME sector's contribution to economic growth is shrouded in ambiguity. The evidence is mixed and cannot prove any causality or independence of this sector as a source of economic growth. Also, it is hard to find convincing arguments in the literature regarding the reasons of differing contributions of the SME sector in different contexts. The answer might lie in the institutional settings, which is the focus of my research.

3.1.1. Entrepreneurship and economic growth-what empirical studies suggest?

Several attempts have been made to link empirically entrepreneurship to economic growth. Schmitz (1989) and Aghion and Howitt (1998) have introduced endogenous growth models to relate the two. Schmitz's model has been less influential in the literature as it considers

entrepreneurs as just imitators in the market. Aghion and Howit's model shows that more competitive structures in an economy contribute to higher rates of growth. However, the study by Thurik and Wennekers (2004) provided more explanation. They argue that there is a two-way causation between changes in the level of entrepreneurship and in the level of economic development. According to them, in advanced economies the increase in the levels of entrepreneurship leads to a Schumpeter effect in growth and in developing economies, the rates of growth are lower as a result of a *refugee* or *shopkeeper* effect as reflected by the increase in self-employment. So, the underlying assumption is that the encouragement of entrepreneurial activities in an economy increases competition and flexibility, making the economy more dynamic and able to cope with significant economic fluctuations.

Similar results are presented by Acs et al. (2005) based on the Global Entrepreneurship Monitor (GEM), 2004 survey results. The *'virtuous circle'* of entrepreneurship and economic growth is emphasised in this report. So far, the data support the assumption that there is a U-shape relationship between GDP and entrepreneurial activity. As mentioned in the study of Thurik and Wennekers (2004) countries that have lower GDP levels have a high rate of entrepreneurial activity for *'necessity'* reasons. Then, with the rise in the GDP the entrepreneurial activity reaches its lowest point to rise again in countries reaching a GDP higher than USD 40.000. In these countries, entrepreneurship is more connected to *'opportunity'* rationale as the welfare systems are well developed and act as a safety net for the unemployed. It means that people go to business because they think there are some opportunities to exploit (p. 39-40).

Audretsch and Keilbach (2004), along the lines of endogenous economic models, introduce the notion of entrepreneurship capital and incorporate it into a production function to count for the different regional performances. They define entrepreneurship capital as *"a region's endowment with factors conducive to the creation of new businesses"* (p. 951). Discussing the regions' endowments, they take a broader perspective on what constitutes an infrastructure for entrepreneurship. In this regard, they include the propensity of individuals to take risks in a particular region and also:

> *a regional milieu that encourages start-up activities such as an innovative milieu, the existence of formal and informal networks, but also a general social acceptance of entrepreneurial activity and the activity of bankers and venture capital agents willing to share risks and benefits involved (p. 951).*

The study was conducted in Germany and had as a measure for entrepreneurship capital the number of start-ups in proportion to the population of the region in the industrial sector. Based

on longitudinal data, they provided evidence that the regions that had large number of start-up creation had a better economic performance.

The study is interesting from a research point of view because of the introduction of a new form of capital in the production function. This variable is taken as exogenous in the study and the reasons why some regions are more endowed with this capital than others are not discussed. However, the study reinforces the proposition that entrepreneurship is not the activity of a single person that has an idea and will act upon that. Entrepreneurship is a *'collective effort'* and in order for the entrepreneurial qualities to unfold a solid infrastructure for entrepreneurship is needed. Moreover, these studies do not draw any conclusions about the direction of causation when linking entrepreneurship to economic growth.

The link between entrepreneurship and economic growth is grounded in discussions of increased competitiveness, jobs, innovation and regional development. Since the work of Schumpeter on entrepreneurship and creative destruction, dynamic change has been characterised as one of the features of a sound economy. The economic well being of a society is related to a large extent to business dynamics[3] (Davidsson et al., 1993).

In terms of *employment generation*, the great stake on this sector was placed directly after the Birch Report (1971) according to which, 80% of net job gains in USA were provided by the birth of new firm and firm expansions. Although its results are still controversial, it has informed the whole discourse on SMEs and government policies in encouraging this sector. New and small firms are major providers of jobs (Audretsch, 2002); small firms are more flexible thus they are quicker in creating employment than large firms (Storey and Johnson, 1987; Gallagher and Miller, 1991; Storey, 1994). Moreover, fast-growing firms are the ones that provide the majority of the jobs in an economy. According to Storey (1994) *"out of every 100 small firms, the fastest growing four firms will create 50% of the jobs in the group over a decade" (p. 113).* Similar results come from data in Northern Ireland (Bridge et al., 2003).

Although many have questioned the claims concerning job generation (Keasey and Watson, 1993; Hallberg, 2000; Biggs, 2002) there is empirical evidence to support the argument. The small business sector accounts for the largest share of jobs in many countries. 99.7 % of employers in USA are small businesses (Small Business Administration, 2000) and in EU only

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[3] Davidsson et al., (1993) consider business dynamics as businesses' births and deaths or expansions and contractions.

one percent of businesses employ more than 50 employees (Department of Trade and Industry, 2000). However, other authors (Hallberg, 2000; Biggs, 2002) argue that the quality of jobs small businesses offer is not good in terms of wages and other benefits that large organisations provide to their employees. The GEM (2004) survey results are also not very optimistic in terms of job creation. When asked about the number of people they intend to employ in the next five years, 75% entrepreneurs responded 0-2 jobs. The evidence is similar for countries at different income levels, despite the different rationale for entrepreneurs' decisions.

In terms of innovation, small businesses are considered to be more innovative in skill intensive industries rather than capital-intensive industries (Beck et al., 2003). However this evidence stands for advanced economies rather than developing countries (Biggs, 2002) as in the latter countries the role of SMEs is more associated to technology transfer or the *"imitation processes"* (Baumol, 1993a).

With regard to *regional development*, small businesses typically locate in certain areas where there is little incentive for large enterprises to locate and also some industries are organised in such a way that a chain of processes is realised by different specialised firms within a local productive system. So, the small firm sector due to its adaptability and flexibility could offset for the lack of economies of scale in individual firms through networks and business alliances (Franičević and Bartlett, 2001).

3.1.2 Entrepreneurship and the determinants of business growth

The potentialities of the sector have encouraged research on the determinants of its development. The most cited work is *"Understanding the Small Business Sector"* by David Storey. Storey (1994) has identified three sets of factors that influence growth, which are: the entrepreneur, the firm and the strategy. The first column in Table 3.1 below identifies fifteen factors that are mainly related to entrepreneur's characteristics and the resources he possesses. The firm-related factors are shown in the second column. Factors like sector, location, have proved to be influential in business growth as they have a great impact on the opportunities of the entrepreneur. Age is also an important firm-related factor that affects the motivation of the entrepreneur towards growth.

Table 3.1: Factors influencing growth

The entrepreneur/resources	The firm	The strategy
1 Motivation	1 Age	1 Workforce training
2 Unemployment	2 Sector	2. Management training
3 Education	3. Legal form	3 External Equity
4 Management experience	4. Location	4 Technological sophistication
5 Number of founders	5. Size	5 Market positioning
6 Prior-self employment	6. Ownership	6 Market adjustments
7 Family history		7 Planning
8 Social marginality		8 New products
9 Functional skills		9 Management recruiting
10 Training		10 State support
11 Age		11 Customer concentration
12 Prior business failure		12 Competition
13 Prior sector experience		13 Information and advice
14 Prior firm size experience		14 Exporting
15 Gender		

Source: Storey (1994) Understanding small business sector

The final important set of growth determinants are those related to the strategy of a business, shown in the third column. Storey (1994) identifies these as the actions taken by an entrepreneur given a certain set of physical and human resources, and also the opportunities or obstacles in the external environment. According to Storey (1994), a firm will grow rapidly when it possesses as many characteristics from each set as possible. The prerequisite for rapid growth is to have a combination of characteristics in each of these three sets. Storey's research on business growth determinants has opened up the way for considerable further research that defines business growth determinants in different contexts. Such noteworthy research is that by Barkham et al. (1997) in four different regions of UK, Davidsson, (1991) in Sweeden, Morrison et al., (2003) in Australia, that look at the impact of various factors on business growth[4]. All these studies have in common the following characteristics: (1) the distinction of internal factors, that are under the entrepreneur's control and, external factors, that are related to the environment; (2) the discussion of entrepreneur's, firm's and environment's characteristics; (3) the conclusion that business growth is an alignment of abilities (related to entrepreneur's characteristics), intentions or needs (related to firm's characteristics) and opportunities (related to external factors). As Morrison et al., (2003) point out:

each of the variable sets of intention, ability and opportunity are linked intrinsically, and business growth is unlikely to be achieved should one be missing or unduly weak (p.423).

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[4] I extend the discussion of business determinants in Chapter 6 by emphasising their characteristics in a transition setting.

The only difference in these studies is the measuring of each of these factors. The majority of these studies are based on objective measures as I discuss later on in this thesis, but Davidsson (1991) is more inclined toward the use of entrepreneur's perceptions about the above-mentioned factors in order to capture insider's knowledge.

In this section, I identified the roles the SME sector can fulfil in an economy. While these roles form a general expectation and are shrouded with ambiguity, it is important to note that they vary depending on the specific context in which the SME sector is studied, whether it is an advanced economy or a developing one or a specific economic sector. This knowledge on entrepreneurship and small business has also influenced the emphasis on this sector in transition economies. In the next section, I draw on some of the reasons why entrepreneurship and small business were encouraged in post-communist economies.

3.2   Entrepreneurship and small business sector in post-communist contexts

Entrepreneurship and small business development were highly emphasised at the beginning of transition. However, the high stakes placed on entrepreneurship and SME development as having *'system transformation capacities'* did not hold well in the post communist context as the experience of these countries has shown.

Entrepreneurs have been perceived for a long time as carrying the values of hard work, self-reliance and determination that support the capitalist order, and upon which is based the prosperity of this system. The small business sector and entrepreneurship, as intimately linked to capitalism, has also been considered to be the source of growth of the middle class. Thus, the emergence of the private sector as an agent of change in *'achieving the norms, values and rules of conduct'* was considered to be crucial to the performance of the market economy and therefore, in promoting the freedom of individuals through their free choices (Brezinski and Fritsch, 1996; Scase, 1997). If it were to happen, it would have had an impact on the process of democratisation in post communist countries. This assumption was associated with the political rationale on transition policies namely, minimal state intervention. Nevertheless, it was not the only reason for the encouragement of entrepreneurship and the SME sector in transition economies.

One important reason for the encouragement of entrepreneurship and SMEs was the unbalanced structure of entrepreneurial organisations with a focus on big firms as functional to the central

planning, but abnormal to a market economy (Smallbone, 2001a; Chilosi, 2001). The shift towards a more balanced economic structure was accompanied by large dismissals, which the private small business sector could have absorbed satisfactorily. The same applied to the process of privatisation, as the entrepreneurship fostered in enterprises is the element that underpins the higher productivity of the privatised firms. Moreover, SMEs could have introduced more flexible production processes and a wider range of products to consumers considering the inflexibility of production processes inherited from central planning (Smallbone, 2001b).

Nevertheless, as I mentioned in the previous chapter, the whole policy approach in these countries was based on mainstream economics. The same applied to entrepreneurship and SMEs. On one hand, the overemphasis on the process of privatisation and a top-down transformation of the economy did not contribute to the creation of better and more efficient enterprises to replace the old ones. On the other hand, the focus on the speed of the process or *'privatise now, regulate later'* (Stiglitz, 1999) contributed to the creation of strong interest groups with a stake in maintaining the monopolies and hampering efforts to create competitive markets in these countries. So, people with good connections to the reformers who in turn had the right information were the ones that benefited more from the privatisation process by converting the limited *de facto* property rights in *de jure* ones and, at the same time, opened the way to protective and predative activities away from productive investment and longer economic horizons (Feige, 1997: 29; Stiglitz, 1999).

Yet, this bias toward privatisation from above can be understood to some extent as a result of the largest share of the output of the state sector in GDP and the large number of employees in this sector. The *'privatisation from below'* (Winiecki, 2001; Boettke and Leeson, 2002) or the *'bottom up transformation'* (Brezinski and Fritsch, 1996) was not given proper attention through the creation of the enabling conditions for entrepreneurship and the creation of the *de novo* private sector. Special attention was given during transition to the Holy-Trinity (liberalisation, stabilisation and privatisation) without much consideration for the emergence of the new private sector and the encouragement of entrepreneurship.

This textbook macroeconomic approach neglected the real microeconomic problems of transition, including the small business sector. The *'bottom up transformation'* that occurred in some of the countries in transition, like Poland or Hungary, has been spontaneous and only in more recent years there has been a more organised approach towards entrepreneurship and SMEs. The private sector in all post communist countries emerged pretty quickly with large

numbers of small and medium enterprises established that made up for a large share of the private sector in these countries. However, the contribution of this sector has not been very satisfactory even though in many countries the SME sector accounts for a large share of the private sector. The evidence of transition also shows that many new firms have been created mostly in the trade and services sector, which is quite worrying in terms of sustainable development (Arzeni, 1996; Scase, 1997; Bateman, 2000; Hallberg, 2000).

The value placed on entrepreneurship is also an important element in ensuring the supply of entrepreneurship in post communist countries. Generally speaking, an entrepreneurial culture is the sets of beliefs, attitudes, norms that underpin a successful role model in a society. This culture needs to be embedded at all levels in order for entrepreneurship and small businesses to have a respectable place in a society (Gibb, 1996). In this respect, the social appeal of being an entrepreneur and then becoming wealthier, exerting power and having feelings of achievement should have been part of the payoffs for entrepreneurship in societies where the only business culture previously existent was what Bateman (1997) calls the *'bureaucratic-administrative'* business culture, which encouraged neither entrepreneurship and innovation nor constructive and efficient entrepreneurial activities.

Moreover, considering the legacy of the past, entrepreneurs in many transition economies have been mainly associated with *speculators* or *exploiters* that made use of the economies of shortage at the time and were part of the black market. The situation is not much different nowadays in many of the post-communist contexts, where entrepreneurship is still associated with tax evasion, corruption, criminality and other non-compliant behaviours. As Chilosi (2001) points out:

> *if an entrepreneur instead of being subject to the rule of law, must look for protection of politicians and local authorities, lobby them and bribe them together with bureaucrats, and the social prestige attached to his status is inadequate, then the psychological advantage of choosing entrepreneurship in relation to other life alternatives, such as being a rentier or an employee, maybe drastically reduced (p. 341).*

The place of the entrepreneur in the process is of particular interest to my analysis. Seen through the lenses of the orthodox economics, there was no place for the entrepreneur to be an agent of change since in the world it describes, all economic agents have access to the information they need and use it to make informed decisions and judgements. As Blaug (2000) argues, the mainstream economics focuses on just the outcome of an economic process (the equilibrium state) but lacks a theorising about the competitive process to get to the state of equilibrium (if at all).

Nevertheless, it is widely accepted that the role of entrepreneurship in economic progress remains unsurpassed. In previous sections, I brought evidence on the theoretical and empirical literature that links entrepreneurship to economic development. In the rest of the chapter, I discuss what makes entrepreneurship a consequence of economic development. Do countries that are not well developed economically and that do not have a proper institutional set-up lack a supply of entrepreneurs?

3.3 The entrepreneur in economic theory

The entrepreneur is at once one of the most intriguing and one of the most elusive in the cast of characters that constitute the subject of economic analysis (Baumol, 1993a: 2)

So far, I have accepted the role of the entrepreneur as a catalyst of change and a driver of economic performance. However, I have not found any definite answers with regard to a possible direction of causation. Nevertheless, it is obvious that entrepreneurship, as are other forms of economic activity is influenced by the broader political, economical and cultural context, as I will make evident in this section. The Austrian school of economics considers entrepreneurship as omnipresent in a society and entrepreneurship to be not *"the particular feature of a particular social group... (but) it is inherent in every action and burdens every actor...* (Mises 1949: 252). Baumol (1990) makes a similar statement and argues that if an economy is not growing, it is not because entrepreneurship is missing, but because the incentives for entrepreneurial activity that are present in that context may be inadequate.

These arguments open the ground for deeper considerations of the institutional frameworks in a society, the structure of payoffs in that society and the kind of activities that these incentives are tied to. Therefore, the main issue is how a certain structure of incentives channels the behaviour of agents to activities that are productive in terms of their contribution to economic development. In this respect, I review some of the main theories on entrepreneurship and what they offer in terms of the entrepreneurial function and the institutional infrastructure needed for entrepreneurship. Thus, I refer mainly to:

> ➢ Schumpeter's view on entrepreneurship as innovation
> ➢ Kirzner's view on entrepreneurship as arbitrage
> ➢ Institutional views on knowledge inherited in both of the above mentioned processes

Entrepreneurship in the literature has been interpreted as involving both innovation and arbitrage respectively related to the work of Schumpeter and Kirzner. Beside the differences in conceptualisation, it is clear that both these activities require knowledge and information. Given uncertainty, entrepreneurs perceive external events and formulate plans according to their experience and knowledge.

3.3.1 Entrepreneurship as innovation

Schumpeter's ideas on entrepreneurship are amongst the most cited in the literature. His seminal book *"The Theory of Economic Development"* (1934) explores the role of entrepreneurs in economic development. He moved away from static, orthodox views on perfect competitive markets to more dynamic, evolutionary views. According to him, the market process is dynamic and is characterised by creative destruction as the driving force in the economy. It is this essential feature of capitalist systems that, according to Schumpeter, drives economic development. Moreover, Schumpeter (1947) considers entrepreneurship as characterised by three particular elements:

> *Firstly it can only be understood ex post; but it can practically never be understood ex ante; that is to say, it cannot be predicted by applying the ordinary rules of inference from pre-existing facts. Secondly, it shapes the whole course of subsequent events and their long-run outcome. It changes social and economic situations for good and creates situations from which there is no bridge to those situations that might have emerged in its absence. Thirdly, the frequency of its occurrence has something to do with the quality of the personnel available in the society, with relative quality of personnel and with individual decisions, actions and patterns of behaviour (p. 150).*

Schumpeter views the entrepreneur as the person who destroys routines and existing structures by introducing *new combinations* far from the equilibrium position, which earns him or her monopoly position in the market for a period of time, until other actors follow him or her into these markets:

> *The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production and transportation, the new markets, and the new forms of industrial organisation that capitalist enterprise creates (ibid. p. 137).*

But, innovation means better knowledge on the part of the entrepreneur. According to Mantzavinos (2001), innovation has a social dimension in terms of the profit motivation of the individual who has perceived a new problem and gives a new solution to it and also, in terms of knowledge about the needs of a particular consumer group that will consider an innovative idea as a solution to the problem they face. In this respect, innovation is an endogenous product of

the interpretation of the environmental feedback by individual entrepreneurs. Stemming from this, another feature of Schumpeterian entrepreneurship is leadership. It is the vision and the leadership qualities that will enable the entrepreneur to initiate *creative destruction* (Ibrahim and Vyakarnam, 2003). Moreover, based on leadership qualities and an inclination toward innovation, entrepreneurship is just a temporary condition. For Schumpeter, once the entrepreneur has finished with planning and implementing an innovation his role has ended.

Besides the fact that Schumpeter sees economic development as a consequence of entrepreneurship, he does accept that the formal and social environment bound the entrepreneurs in pursuing their innovative activities. Individual behaviour, according to him, is not independent of institutions and social forms of organisations. Rather, individuals are more acted upon than acting:

> *There is very little conscious reality...it is society that shapes the particular desires we observe...wants must be taken with reference to the group which the individual thinks of when deciding his course of action...the field of individual choice is always, though in very different ways and to very different degrees, fenced in by social habits or conventions (Schumpeter, 1934: 91).*

The *"circular flow"* he is talking about might mean a stable socio-economic system for many (Goss, 2005). Nevertheless, Schumpeter speaks of social sanctions and how they can inhibit an entrepreneurial venture. In this respect, he argues:

> *the reaction of the social environment against one who wishes to do something new. This reaction may manifest itself first of all in the existence of legal or political impediments. By neglecting this, any deviating conduct by a member of a social group is condemned, though in greatly varying degrees according as the social group is used to such conduct or not (Schumpeter, 1934: 86; cited in Goss, 2005).*

In this regard, since one of the drivers of innovation activities, according to Schumpeter, is the appropriation of super-normal profits as a result of a temporary monopoly position in the market it is important that rules and regulation exist that will make this likely to happen. In this context, the institutional framework is important for establishing the content and the dynamics of the competition. Mantzavinos, (2001) considers the content of the competition to be determined by the influence of legal rules and social norms and by the kind of knowledge that is transmitted which together channel the innovative potential in productive directions.

The state has an important role to play in the protection of intellectual property rights and the strict enforcement of patent protection to ensure that innovative activity is encouraged (Baumol,

2002). Societal institutions have also their role (Mantzavinos, 2001). For example, in post-communist countries bribing of officials has become quite socially acceptable as a phenomenon so entrepreneurs in these countries accumulate knowledge on how to deal with the officials rather than how to get engaged in more productive activities. Nevertheless, the dynamics of the competition determines the kind of quasi-rents that will be appropriated by the entrepreneur:

> *By regulating the distribution of the effects of innovative activity, that is, by allocating gains and losses, the institutions determine simultaneously the dynamics of the competitive process in the market (ibid. 171).*

Entrepreneurs value what the quasi-rents from the monopoly position will bring to them. Thus, it is important that the institutional framework ensures that it is the entrepreneur and not somebody else such as the government or other economic actors that appropriate these profits. Moreover, as Schumpeter himself notes, entrepreneurship can be productive only when the rents accruing to the entrepreneur are durable but not permanent. Thus, it is important that the rents last long enough to encourage people to innovate, but short enough not to cancel out any productivity gains achieved by it and encourage people to keep trying to improve productivity (Karlsson and Karlsson, 2002), which is the essence of creative destruction according to Schumpeter.

3.3.2 Entrepreneurship as arbitrage

Kirzner (1973) is known for his dynamic theory of entrepreneurship. He is concerned with alertness of individuals towards unknown market opportunities. According to Kirzner, the opportunity to which agents are most alert is profit. He is interested in arbitrage activities through which entrepreneurs observe errors in markets and exploit situations where they can buy cheap and sell high. Based on the Austrian tradition, Kirzner considers alertness to be the unconscious or unplanned learning process undertaken spontaneously by entrepreneurs through interaction with other individuals in the market place (Ibrahim and Vyakarnam, 2003).

Yet, he also says that it is not the entrepreneur who creates opportunities; the entrepreneur responds to these opportunities and without him doing so, *long-term benefits may remain untapped.* Kirzner builds very much on the work of Hayek and Mises, both of the Austrian tradition. Hayek (1972) has been very influential through his idea of the *'discovery process'* whereby the entrepreneur not only diagnoses already existing information but also creates knowledge himself. Mises, on the other hand, is concerned with the profit opportunities in the

market to which the entrepreneur is drawn which are linked to *"uncertainty of future constellations of demand and supply"* (Mises, 1963: 293; cited in Swedberg, 2000).

However, Kirzner, and the Austrian tradition he draws on, which associates entrepreneurship with arbitrage, has been criticised for not taking into account the creativity that is part of entrepreneurship (Blaug, 2000; Ibrahim and Vyakarnam, 2003). Regardless, more recent works of Kirzner tend to overcome some of the problems related to his entrepreneurship theory. In Kirzner (1999) we see the inclusion of multi-period markets, where uncertainty over the future is prevalent and which requires imagination and innovativeness. With regards to these markets, Kirzner emphasises:

> *the futurity that entrepreneurship must confront introduces the possibility that the entrepreneur may, by his own creative actions, in fact construct the future as he wishes it to be. In the single-period case alertness can best discover hitherto overlooked current facts. In the multi-period case entrepreneurial alertness must include the entrepreneur's perception of the way in which creative and imaginative action may vitally shape the kind of transaction that will be entered into in future market periods...To be a successful entrepreneur one must now possess those qualities of vision, boldness, determination and creativity... (Kirzner, 1999: 10-11)*

Nevertheless, Kirzner does not try to reconcile his view of entrepreneurship with that of Schumpeter. These psychological qualities an entrepreneur should possess make possible the recognition of price differentials in the market, hence profit opportunities by:

> *disrupting what others have to see as the old fashioned ways of doing things, to ruin rudely and even cruelly the confident expectations of those whose somnolence has led them to expect to continue to make their living as they have for years past (Kirzner, 1999: p. 13).*

3.3.3 Innovation, arbitrage and the market process

Consequently, the entrepreneurship's role is to be alert towards opportunities and to drive the market process through his competitive behaviour. In the market, there is space for both kinds of behaviour. The first type of behaviour is that related to arbitrage (Kirzner, 1973; 1997; 1999), in terms of opportunities that already exist in his single period markets and that can refer to imitative entrepreneurs (Baumol, 1990) or routine entrepreneurs (Leibenstein, 1968). The second type is of the Schumpeter style where there is much more space for creativity and imagination and where the actions of individual entrepreneurs will lead to extraordinary discoveries in the market.

My discussion above makes it clear that both forms of entrepreneurship are present in the market and they are its driving forces and produce *the selection order*. The arbitrage, as I previously mentioned, is a process of trial and error by which entrepreneurs experiment with different methods until they find the one that can offer to them *pure entrepreneurial profits* (Kirzner, 1973). This opens the way to a process of learning in the society whereby other imitators in the market, which were not that creative, try to achieve some benefits from the opportunities in the market. In this respect, (1) this is a process that is merely based on the knowledge of the actors in the market and as long as the type of knowledge being used is common then there is place for coordination in the market.

On the other side, innovation is a process by which one of the actors in the market process has certain knowledge that leads to complete variation of the market order. Thus, (2) the Schumpeterian innovator destroys the coordinating power of the market institutions and creates a whole new wave of change. To these two forces Mantzavinos (2001) adds a third one that is not stated so specifically in the literature on entrepreneurship. According to him, the third force that drives the market is (3) the accumulation of knowledge in an evolutionary process as learning histories or problem solutions of entrepreneurs. In this sense, economic change can be rightly conceptualised as a coordination of knowledge (Hayek, 1945) rather than a coordination or allocation of resources as the neo-classical theories advocate.

Going back to Kirzner's work, an important space is given to entrepreneurial errors. The entrepreneur's knowledge may be incorrect at times. Subjective judgements of what constitutes an opportunity have their part in entrepreneurial errors. While they could be negative in several aspects, it contributes to the accumulation of knowledge in a society. First, entrepreneurs themselves learn how to adjust in the future. Second, the learning of other entrepreneurs is facilitated, in terms of changes to their products or services, to avoid the mistakes of the non-successful entrepreneur (Acs and Storey, 2004).

To conclude, it is the interaction or simultaneity of these processes that gives rise to changes in the market and also to institutional change for as long as the old institutional framework is unable to coordinate economic actors' actions. Also, it is exactly this type of entrepreneurship that has positive societal outcomes that go well beyond the pure profits of one entrepreneur to wealth creation in a society as a whole.

3.4 Forms of entrepreneurship

The entrepreneurship theories I discussed earlier consider entrepreneurship as the act of a constructive individual who brings economic development through his actions of innovation and arbitrage, both of which are based on accumulated knowledge. But, none of these authors speaks about entrepreneurial activities that are not productive. As Baumol (1993a) points out, *"entrepreneurship is not a synonym for virtuousness...it cannot always be relied upon to promote the interests of the society"* (p. 11). In this context, Baumol in his respective articles *"Entrepreneurship: Productive, Unproductive and Destructive"* (1990) and in *"Formal Entrepreneurship Theory in Economics: Existence and Bounds"* (1993b) was among the first scholars to make a distinction between innovative and imitative entrepreneurship as two forms of productive activities, and also between unproductive and rent-seeking entrepreneurship as activities that add no value to the GDP of the countries concerned, only contributing to the wealth of the individuals involved in these entrepreneurial acts.

The first two definitions draw upon Schumpeter, but Baumol (1990; 1993a), as other authors (Rosenberg, 1982; Leibenstein, 1968) have done, makes sure to include within entrepreneurial acts imitative activities or adaptive responses, based on the rationale that in not a single instance, an individual will produce or present in the market a product that is an exact copy of that of the innovative entrepreneur. Hence, these activities can be also examined as entrepreneurial acts in themselves and might also lead to innovation since any individual in the market, even the most passive one, can be considered as having creative potential (Mantzavinos, 2001) and thus, some '*subsidiary innovations*' (Cauthorn, 1989) can occur.

Despite the fact that the latter two forms of entrepreneurship that Baumol (1990; 1993b) talked about are expressions of individuals' entrepreneurial qualities in the form of innovative acts, they do little to contribute to the economy. That is why productive entrepreneurship, more than just a cause of economic development, is a consequence of it when it is employed in *wealth creating* or *positive-sum games* or, in societies that have well defined rules of the game that allow for the channelling of entrepreneurial acts towards productive uses that in turn will have an impact on economic development.

Unproductive entrepreneurship is attached to negative or zero-sum games and can take the form of corruption, extortion, smuggling, organised crime or other such activities considered illegal activities. Rent seeking entrepreneurship is more specifically connected to activities of market

actors who lobby the government, the bureaucrats or other officials to obtain advantages in the form of subsidies, tax avoidance or other such related benefits.

As Baumol (1990) suggests, from a policy perspective it is more effective to influence the allocation of entrepreneurship than the supply of entrepreneurs at any given time in a society. The latter is very much a matter of psychology or cultural characteristics that are not so easily amenable through policy. Thus, the government can more easily alter the structure of payoffs for entrepreneurship, under a framework of social norms and attitudes, in order to make the most of the entrepreneurial talent that is already present in the society. Moreover, in a later work Baumol (1993b) by attributing to the entrepreneur's existence the profit drive considers entrepreneurial talent to be:

> subject to reallocation by changes in the relative prices it commands in different occupations...If there is money to be made by improvements in the steel production processes, one can be confident that persons with entrepreneurial talent will appear in that sector of the economy. But if a greater return is offered to innovative devices for financial manipulation, entrepreneurial entry into that field will not be long delayed (p. 203).

To summarise, the fact that some countries are performing more poorly than others is not so much related to the supply of entrepreneurial talent in these countries as to the particular institutional context or motivational mechanism that drive them on. Therefore, the form that the entrepreneurial activity takes depends not only on the range of economic opportunities present in a society, but also on the socio-cultural and politico-legal context that is in place. Unless a certain institutional setting is in place, in terms of formal and informal institutions, the transactions in the market will be beneficial only for the parties involved and will emerge as what Baumol (1990) calls unproductive or destructive entrepreneurship.

In the case that payoffs for unproductive entrepreneurship are present, the quality of the entrepreneurs is an issue together with the burden that such activities will have on productive activities. I mentioned in the previous chapter the importance of institutions as both knowledge-based and knowledge transmitters, which emphasises the necessity in post communist economies to find the correct balance between 'getting the prices right' and 'getting the institutions right'.

These views on entrepreneurship reflect once again the need to look at the broader institutional framework and its impact on the risks/reward tradeoffs that economic actors face. Going back to the case of transition economies, institutions were ignored and analysts looking only at markets lost track of how these markets develop, but they cannot be understood without taking an institutional perspective. Since the main goal of transition economies is economic growth, an

emphasis should be placed on those institutional arrangements that encourage the entrepreneurial aspect of human behaviour, as I discuss in the following section.

3.5 Institutions relevant for entrepreneurship

The notion that our productivity problems reside in the "spirit of entrepreneurship" that waxes and wanes for unexplained reasons is a counsel of despair, for it gives no guidance on how to reawaken that spirit once it has lagged (Baumol, 1990: 894)

I have emphasised the fact that in order for entrepreneurship to take the form of a productive activity, it has to be surrounded by the appropriate institutional infrastructure. In this section, I highlight some of the most important institutions for productive entrepreneurship with a special emphasis on the case of post-communist economies and their particular institutional characteristics. In Chapter 2, I shed some light on the dynamics of institutional change taking place in post-communist countries. How institutional change influences entrepreneurship is of special significance. However, seen from the lens of economic theories of entrepreneurship the discussion so far has not acknowledged the kind of social institutions that might have an impact on the forms entrepreneurship takes and therefore, on economic development. I discuss this issue in this section together with the types of formal institutions that affect entrepreneurship.

I mentioned above that the economic literature on entrepreneurship and business development has emphasised market failures or size disadvantages in the case of the small business sector and I have given the rationale for intervention in such cases (Storey, 1994; Gibb, 2000; Bridge et al. 2003; OECD, 2003b). Interventions range widely from those that aim to create an environment that is conducive to businesses and that encourages as many people to start a business as possible to those that are more specific to the SME sector itself and that are related mostly to their size disadvantages compared with large firms.

The first years of transition offered an especially relevant case for a focus on environmental factors since policy focused on macroeconomic stabilisation and issues such as inflation, interest rates, and aggregate demand. With regard to the second group of factors, there are four main arguments in favour of SME support. The most commonly cited argument in the literature is the elimination of market failures, caused by lack of information or non-competitive market structures (Storey, 1994; Curran and Storey, 2002).

The second argument is linked to size-related disadvantages of SMEs, such as difficulties in accessing finance as a result of collateral-based approaches used by commercial banks, large

fixed costs, the absence of economies of scale and scope in key production units. Third, positive externalities, such as diffusion of information on products and strategies or imitation and demonstration effects that can be achieved through the development of SME sector, provide another argument in favour of support to this sector. The final argument has to do with the lack of awareness of SMEs about the usefulness of business services that can be achieved, especially through public policies (OECD, 2003b). However Wren and Storey (1998), Curran (2000), Gibb (2000), Hjalmarsson and Johansson (2003) are sceptical about the efficiency of these policies.

More recently, the focus of analysis has turned to institutions such as *property rights and rule of law*. These two sets of institutions are influenced by the governments and the different ways in which they perform their roles. The most important function of property rights' systems is to implement the optimal combinations between productive and unproductive entrepreneurial activities that translate into positive sum-games in a country (Baumol, 1990; Foss and Foss, 2000).

Also, while entrepreneurship is associated with creativity and boldness of individuals, an efficient system of property rights ensures that the economic actors possessing these qualities feel they can enter certain transactions. At the same time, the rule of law gives entrepreneurs a certain security that their business activity will not be stolen, extorted or damaged. The polity is the main designer of both these institutions, and so the credibility of the government in terms of law enforcement is important for entrepreneurial activity. In this context, Feige (1997), by taking into account the case of post communist countries, states that:

> a history of policy reversal and arbitrary confiscations had destroyed the credibility of the government pronouncements and policies. Thus, the informal norm of distrusting government policy militates against every effort to establish the formal rule of law. In the absence of effective state institutions that can protect and enforce newly created property rights, these rights will remain uncertain and their exercise will involve high transaction costs (p. 30).

The low credibility of the government or what some authors (Raiser et al. 2001; Smallbone and Welter, 2003b) have called the *'syndrome of mistrust'*, with a reference to the communist period and the close ties that individuals had with each other, brings with it non-compliant behaviours and forms of unproductive entrepreneurship. Moreover, property rights and the rule of law as crucial institutions in ensuring entrepreneurship reflect the misguided overemphasis on finance[5] by the neo-classical economists and by the policies pursued in transition economies. While

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[5] For more details on the "finance first" approach in transition, articles by Pissarides (1999; 2000; 2002), Bartlett et al. (2002) could be of interest.

finance is decisive in turning ideas into practice, not many entrepreneurs would be willing to invest their money in an environment that does not offer certainty and security for investment. The same applies to capital flows from abroad. Investors need confidence to invest their money and only a settled institutional framework can boost confidence and remove uncertainty and facilitate economic development.

Property rights and rule of law are important in encouraging entrepreneurship. However, other institutions are more crucial. Since the emphasis is on the competitive process, in both Schumpeter's and Kirzner's theories on entrepreneurship, a special focus in terms of institutions should be applied to those institutions that encourage entrepreneurial behaviour. Thus, it is important to differentiate between those institutional frameworks that allow for competition and give incentives to the entrepreneurs to act upon opportunities already in the market, or upon new ideas and solutions, and those that restrain entrepreneurship.

The first one has to do with the *barriers to entry*. Barriers to entry are usually connected to economic barriers such as those related to technology or resources and government restrictions that can be institutional in nature or policy-driven (Broadman et al., 2004). By this logic, we would expect that the lower the barriers to entry are, the higher are the chances that entrepreneurs will be alert to opportunities and will act upon these opportunities. As mentioned previously, this situation has been highly experienced in transition with large number of businesses concentrated in the sectors of trade and services, where the barriers to entry are lower. Moreover, different studies undertaken in transition economies have indicated that the inconsistency of policies and regulations by the government have created certain insecurity and caution in the business community about undertaking investments. The most important barriers to entry are administrative burdens, high tax rates, high cost of credit and, corruption and anti-competitive practices of other businesses (Hashi and Mladek, 2000; Hashi, 2001; Bartlett and Bukvic, 2001; Bartlett et al., 2002; Broadman et al., 2004).

These barriers not only discourage many entrepreneurs from pursuing their ideas in the market, but they also lead to an *adverse selection* of entrepreneurs in the market. According to Chilosi (2001), because of the above-mentioned difficulties in conducting business in these areas, the most successful entrepreneurs are those that are better in bribing or getting along with politicians and bureaucrats. This situation creates rent-seeking entrepreneurship which harms productive entrepreneurship that will contribute to economic growth. Furthermore, some of these barriers, i.e. corruption, are widely considered in the literature as a legacy of the past or an informal institution and take the form of petty corruption such as bribing. As many

entrepreneurs spend their time dealing with the inefficiencies of the system, the resources that could be utilised for productive uses are diverted, thus harming sustainable entrepreneurship in these contexts (Smallbone and Welter, 2003a).

The second type of institutions are those that encourage *the alertness to previously unknown knowledge*. As I mentioned before, entrepreneurship needs a bundle of social capabilities in terms of social institutions and social polices (Abramovitz, 1989; Olson, 1997), which will support the acquisition and diffusion of information and knowledge which are indispensable for entrepreneurship. This knowledge can be in terms of innovation or research and development, as well as knowledge in other new forms of organising production. Support organisations have a role in facilitating the dissemination of knowledge and in helping entrepreneurs to find the necessary linkages for their activities.

So far, my analysis has not made it clear that the exercise of entrepreneurship under situations of risk and uncertainty have an impact on investment and profit decisions, as well as on organisational behaviour. For Schumpeter, risk-bearing is not well specified or is not intrinsic to the entrepreneurial function. Risk and uncertainty, and gains that come from acting upon them, have been part of the entrepreneurial function under the tradition of Cantillon (1755) in his *"The essence of commerce"* and also Knight (1921) in his *"Risk, uncertainty and profit"*. Knight draws a distinction between risk and uncertainty based on the possibilities for each of them to be known. He excludes the chances for knowing the probability distribution of uncertainty. Knight shows his opposition to equilibrium theory by making a clear argument that what drives an entrepreneur are profits under situations of uncertainty.

In this respect, it is necessary to mention the importance of critical judgements that the entrepreneur should exercise under these conditions, which is another step away from the neo-classical rationality assumption (Ibrahim and Vankyarman, 2000). On the contrary, Schumpeter considers risk-bearing as a function of the capitalist, who provides money for the innovative ideas of the entrepreneur. However, in transition contexts, where there is hardly any accurate information and there is structural change on the way, the uncertainty cannot just be overcome and left to capital markets that are not well developed, as in the cases Schumpeter describes. Usually, in these contexts is the entrepreneur/owner that finances the business bears the risk.

In this regard, those institutions, whose aim is to *decrease the uncertainty* and to provide incentives and stability for individuals to take risks, are indispensable for entrepreneurship to occur. In general, the main aim of an institutional framework is to create certainty for human

interaction. The framework of liberty (Winiecki, 2001) is needed more than the freedom for entrepreneurship. Economic actors need to feel secure in pursuing their activities and in retaining the profits connected to their activities. Moreover, institutions offer people a framework of certainty for their actions and give them sufficient energy to concentrate on what is really unique to them (Mantzavinos, 2001) and to encourage the creativity of these individuals.

3.5.1 Social institutions relevant for successful entrepreneurship

My discussion so far, has emphasised informal institutions. Under new institutionalism, informal institutions are culture-related and can be associated with national cultures (Hofstede, 1991), trust and social relations (Granovetter, 1985; 2000; Putnam, 1993;Fukuyama, 1995), the place of the entrepreneur in the society (Chilosi, 2001; Smallbone and Welter, 2001a; COM, 2004) or other factors that have an impact on entrepreneurship by their interaction with formal institutions. While I discussed in the previous chapter the importance of factors like culture, trust and social capital in terms of their impact on economic development, I summarise below some of the studies in this field that have a more direct connection to entrepreneurship and the behaviours they induce on entrepreneurs.

Granovetter (1985) argues that all economic activities are enmeshed in a wide range of social relations, and that in social life all exchanges are simultaneously economic and social. Granovetter uses the concept of *embeddedness* in order to stress the role of *"personal relations and structures of such relations in generating trust and discouraging malfeasance"* (p. 490). So, the impact of past dealings with an individual is very important in making decisions about future relations. Moreover, the concept of embeddedness means that when entrepreneurs are trying to fulfil their economic objectives, it cannot happen without taking into consideration the wide range of cultural, political or social factors that have an impact on individuals' choices, opportunities and constraints. As Granovetter (2000) observes, successful entrepreneurship is:

> *some combination of social cohesion sufficient to enforce standards of fair business dealing and an atmosphere of trust, along with circumstances that limit the non-economic claims on a business that prevent its rationalisation (p. 258).*

However, the emphasis on embeddedness should be taken cautiously, especially in contexts where social ties are strong because it might bring free-riding problems (Olson, 1965) and, to make it more difficult, when the need is recognised, to pass from social networks to broader

networks of exchange, based on the rule of law and formal institutions (Woolcock, 1998; Ledeneva, 2004). This process of course involves learning, since the way to construct and to participate in new exchanges is different.

Game theoretical approaches, when used to explain the nature of cooperation in different societies, take a more rational perspective based on pure economic reasoning. A seminal work on the topic is the *"Evolution of Cooperation"* by Robert Axelrod (1984) that tries to give an answer to the question: *how can cooperation emerge in a world of self-seeking individuals?* Based on Prisoners' Dilemma games, he drew some very important conclusions on how cooperation can emerge and can be sustained based on an evolutionary game perspective. He uses for its analysis simple games, such as Tit for Tat, where the player first cooperates and then does whatever the other player did in the previous move. The past is important in the process to judge the behaviour of the players before starting a game. However, Axelrod gives more importance to time perspectives in maintaining cooperation. Moreover, when discussing about time perspectives, he considers two important aspects worth taking into account.

First, the interaction between players has to be long term in order for cooperation to emerge and to be sustained. He stresses *'the shadow of the future'* in terms of the importance of future encounters between players that lead to the second aspect: the players must care about their future together. Since their relationship will be long term none of them has any incentives for deceit because it would be unproductive.

Although Axelrod considers the players to be not necessarily rational, rationality cannot be excluded from the analysis and it is used when players decide with whom to start the cooperation. In certain decisions, the information gained from personal relations with other individuals is a valuable mean for entering transactions. Moreover, trust, according to Axelrod, is not as relevant in maintaining cooperation as is the durability of the relationship between the players.

This idea can be introduced quite well in the business context and the impersonal relations between business partners based on reciprocity that can be self-policing. Thus, trust follows rather than precedes the cooperation between players. By this logic, it seems that Axelrod's theory is very close to rationalistic perspectives that are based on the best self-interest of individuals. However, Axelrod positions himself more in the evolutionary approaches and in a process of trial and error whereby the best-proven strategies so far will be the ones players will adopt.

Therefore, my discussion opens the ground for various considerations of the economic behaviour of entrepreneurs and the contextual factors that have the biggest impact on a particular moment as I will elaborate further in the case of Albania.

3.5.2. Opportunities

My focus on the institutions relevant for entrepreneurship, up to this point, has reflected on the opportunities they offer for entrepreneurs. More specifically, entrepreneurial opportunities are considered to be the main phenomenon in explaining entrepreneurship (Davidsson, 2003; Sarasvathy et al. 2003). Following Davidsson (2003), the literature on entrepreneurship has been quite controversial with regard to the definition of this concept and the creation of such an opportunity. He observes that taking the concept at face value, as used by Shane and Venkataraman (2000) it might sound as though entrepreneurship is connected to only favourable or profitable opportunities. He considers it important to pay attention to who creates the opportunities, whether they already exist or whether it is the entrepreneur that creates them. While he makes a distinction between the objectivist, objectivist-subjectivist and subjectivist views on opportunities[6] in my discussion so far I have utilised the second view.

The objectivist-subjectivist view, consistent with Shane and Venkataraman, (2000) and Davidsson (2003), considers opportunities to be 'out there' independently of particular actors, but dependent on the institutional infrastructure. Whether individuals will look at these opportunities and act upon them is very much connected to their individual perceptions, knowledge, skills and systems of motivation.

In this respect, institutions play a very important role in defining opportunities, thus making them be 'out there'. Since institutions are a means of imposing stability and structure in a country, they perform an important task in the process of entrepreneurial discovery for two reasons: first, institutions make the formation of expectations easier; and, second, institutions make it possible for the entrepreneurs to be alert to what is unknown (Sarasvathy et al., 2003). Moreover, from a broader macroeconomic perspective, institutions determine whether the opportunities are going to contribute to the *joint surplus*[7] or not.

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[6] Objectivist-opportunities exist out there as ready to use entities
Subjectivist-Creative-opportunities are created in the entrepreneur's mind and it is meaningful to talk about these opportunities.
[7] Joint surplus-this is another term used by Baumol (1990) in trying to connect the impact of entrepreneurship to economic development or social interests rather than the mere profit of the entrepreneur himself.

In a transition context, the literature distinguishes between two types of entrepreneurship, 'necessity' based and 'opportunity' based or entrepreneurship induced by pull and push factors (Storey, 1994; Scase, 1997; 2002) with the balance however, weighing toward the former. This means that although different countries might have the same rate of start-ups, which often is equalled to entrepreneurship, they have not the same outcomes from the entrepreneurial process. Research on transition economies shows that many people have just been thrown to self-employment as a result of dismissals occurred during industrial restructuring in these economies. Despite the ambiguity of entrepreneurship in these contexts, it is accepted that these businesses offer some small contributions, in terms of employing themselves and some other people, and in terms of offering a wide range of products and services to consumers (Scase, 2000).

Scase (1997; 2002) argues that there is a difference between proprietorship and entrepreneurship expressed through psychological characteristics, attitudes toward trading and the inclination toward capital accumulation. Thus, he considers the real entrepreneur to be the one that has not only a bias toward profit, but also toward capital accumulation and business growth as a form of achievement, which is consistent with Schumpeter (1934) who considers the entrepreneur as the one that has the desire:

> to found a private kingdom, ...the will to conquer,...the joy of creating, of getting things done, or simply exercising one's energy and ingenuity[8] (p. 93).

According to Scase (2002), transition economies are a kind of "booty" capitalism where:

> entrepreneurs constitute a very low proportion of small business proprietors... (who are) highly likely to have little commitment to setting up enterprises for longer term capital accumulation rather than short term personal gain (p. 9).

Bateman (2000) makes a reference to small-scale proprietorship by considering SMEs as mainly engaged in "petty services and simple arbitrage, and small scale retailing and importing activities..." This is the dominant form in transition economies due to reasons of uncertainty, to needs for cash flow by the owners to achieve a certain business consumption pattern and at the same time to sustain a standard of living. The articles by Scase, however, consider the reasons for the boom of proprietors or really small retailing activities related to personal characteristics of people and, to societal characteristics by implying path dependency in the communist period

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[8] Swedberg (2000) makes a translation of Schumpeter's formulations in modern language as follows:
1) the desire for power and independence, 2) the will to succeed and 3) the satisfaction of getting things done (p. 16). Goss (2005) gives an explanation under the same lines too.

without much reference to the structure of payoffs in these countries. The studying of institutional issues in transition is not new, different authors (Hashi, 2001; Bartlett, 2002; Bartlett and Bukvic, 2001) have been studying institutional barriers in the SEE. However, Smallbone and Welter (2000, 2003) are among the few authors who have done substantial work on the institutional infrastructure by attributing mainly to it the patterns of entrepreneurship and small business development in these countries.

Institutional studies in transition also take into account path dependency issues. Interestingly enough, while there is consensus that path dependency is present in transition, there is no consensus with regard to its starting point. Some authors (Aidis, 2003) see path dependency as connected to legacies of the past, while others (Holmes, 1995; Ott, 2002) see it as starting at the beginning of transition and the wrong policies being pursued in these countries. The cultural approaches towards transition emphasise the habits of the communist period such as dependency and lack of initiative, passive or submissive personalities, distrust for public authorities and disrespect of the law (Holmes, 1995), which are not characteristics of entrepreneurs or productive entrepreneurship.

Thus, the institutional arguments in terms of payoffs for productive activities need to be counterbalanced by these approaches taken to explain transition that in my opinion are quite deterministic in terms of the problems of post-communist transition. The balance between the habits of the past and the familiarity with them and the situational factors to which people respond seems vague and needs to be considered further. Are these values inherited by the past or is path dependency begun at the start of transition with the political and social chaos experienced by these countries as a result of the lack of the state?

Holmes (1995), in discussing the case of Russia, posits the question *"Cultural legacies or state collapse?"* The reform inhibiting baggage, which Russians carry with them, is only situational and is very much context imposed. He draws attention to various examples of entrepreneurs in Russia not engaged in productive entrepreneurship and to thousands of Russian citizens who do not find it difficult to play by the rules of the game once they are in the context where it is played as a wealth-creating game. Based on these arguments, Holmes questions the explanatory power that one can place on cultural legacy theories. Nevertheless, he does not deny their impact on the whole process of post-communist countries' transformation. The *crisis of governability* is more plausible as an argument to him, to explain why transition economies are performing poorly. He considers the weak states created in these countries as the main reason

for the performance of these countries. Thus, more than the cultural legacy, it is the *anti-totalitarian* hangover that created path dependencies.

The examples from post-communist countries do not point to any shortage of entrepreneurs. They provide evidence of very entrepreneurial acts in these contexts, which unfortunately are directed toward unproductive or destructive activities and thus towards negative or zero-sum games that contribute little to economic development. Thus, the structure of incentives in the society takes a leading role in ensuring that entrepreneurship will play its role as a catalyst of change. I support the argument of the Austrian school of economics that entrepreneurship is an aspect of human behaviour that is omnipresent in a society. Whether it is utilised or not, depends very much on the formal and informal institutional infrastructures present.

Conclusions

My task in this chapter was twofold. *First,* I highlighted the main theoretical breakthroughs in the field of entrepreneurship and small business research. *Second,* I identified the kind of entrepreneurs one expects to see in transition economies, the main characteristics of entrepreneurial acts and their main determinants. At the beginning of this chapter, I made two broad propositions and I highlighted the support the theoretical and empirical research has given them.

The first proposition related to the encompassing nature of entrepreneurial activities and how these activities have changed within the context and period of study. While there is an overall consensus for incorporating the Schumpeterian entrepreneur in every discussion of entrepreneurship, it is also common in the literature to include other activities, such as imitation or incremental change as part of an entrepreneurship process that can also positively affect economic development. Moreover, both these processes pave the way for a more important process in the society, that of knowledge accumulation, which stands as the basis of any process of institutional change and economic development these countries are going through.

The second proposition related to the *'collective'* nature of entrepreneurship in terms of the social, legal and cultural institutional frameworks that create a set of incentives for entrepreneurs to be alerted to opportunities and to act upon them or to exploit them. I stated that these institutions can have different contents and forms based on the particular characteristics of

the context we are studying, in terms of the country or region, and also in terms of the economic sector in which we are interested. I explore these with a reference to the manufacturing sector in Albania in the remainder of this thesis.

The literature review showed that of particular interest are institutions such as property rights and rule of law that allow entrepreneurs to feel safe in their endeavours and reap the benefits of their entrepreneurial acts. Moreover, since innovation, arbitrage and accumulation of knowledge are part of the market process, I showed that institutions that support them, in terms of access to technologies, resources, social capabilities and policies, should be available in order that the entrepreneurial efforts are directed toward productive uses with positive impacts in economic development rather than towards unproductive or destructive uses which are often discussed in transition studies. Thus to conclude, it is of research interest to find out how current institutional arrangements, or the social or economic phenomena, affect the quantity of the entrepreneurial effort, the directions it takes and the likelihood of its success in a setting such as a post-communist state, Albania.

CHAPTER 4
METHODOLOGY

Research results obtained by different methods are like the pieces of a jigsaw puzzle that provide a full image of a certain object if put together the right way.

(Miller, 2003)

Introduction

Earlier in this thesis, I suggested that post-communist transformation is a multidimensional process that encompasses all spheres of life and that I was in agreement with Stiglitz (1998) who argues for the need for a paradigm shift in transition to consider the transformation process as a *"transformation of the society"*. I also suggested that the institutional approach is more appropriate for understanding this process and adopted a definition in which institutions structure human interaction by reducing uncertainty and by acting as a mean of coordination. I moved my discussion in Chapter 3 to the concept and main theories of entrepreneurship with an emphasis on the SME sector. Also, I showed that entrepreneurship takes different forms depending on the formal and social institutional framework.

I also showed that entrepreneurship is a collective effort and is influenced by a set of institutions that can be different in content and form, based on the particular characteristics of the context under study, in terms of the country or region and also in terms of the economic sector in which one is interested. I discussed the innovatory role of an entrepreneur, as described by Schumpeter, but I also included other activities such as imitation or incremental change as part of an entrepreneurship process that can also have positive impacts in economic development. These processes, I argued, contribute to the accumulation of knowledge, which is the basis of the process of institutional change and economic development, in these post-communist countries.

This Chapter explores the methodology and epistemological considerations of my research. I use the concepts of entrepreneurship and entrepreneurial activities linked to the small business sector, excluding from my analysis other forms of entrepreneurship such as corporate entrepreneurship or public entrepreneurship. My rationale arises from my interest in small business development not only because it was the sector in transition economies which accounts for the highest share of the private sector and was discriminated against during communism, but

also because of the fact that the whole current discourse on entrepreneurship by the EU and other leading international organisations is on small business development.

Moreover, I discuss opportunities for entrepreneurship under the new institutional approach. In addition, I explain some methodological considerations in terms of the philosophy underlying my study, the choice of research design and the reasons for using triangulation in answering my research question as part of Section 1. I discuss my conceptual framework in Section 2 and then I explain my main quantitative and qualitative pieces of research in Sections 3 and 4 with a particular focus on the operationalisation of my variables of interest and also on the different practical issues of my research from the questionnaire and topic guide design, to issues of sampling and contacting people. These sections explain the choices I have made in the course of my research.

4.1 Methodological considerations

The philosophy underlying my study is pragmatism[9]. Pragmatism is not committed to any system of philosophy and reality and does not see the world as an absolute unity. A pragmatic approach is less interested in the origin of ideas than in the outcomes to be realised and measured (Kaplan, 1964). For pragmatists truth is what works at the time and it is not based on a rigid dualism between the mind and a reality completely independent from the mind (Creswell, 2003). The research question is more important than the method used or worldviews that hardly enter the picture unless in a more abstract way (Patton, 1980; Tashakkori and Teddlie, 1998). As Snape and Spencer (2003) argue:

> ...*the purism about the epistemological origins of a particular approach may undermine our ability to choose and implement the most appropriate research design for answering the research questions posed (p. 17).*

Pragmatism, as a philosophy of research has challenged the formality of the paradigm-method link (Howe, 1988; Maxcy, 2003) that has predominated research for a long time. From this perspective, both quantitative and qualitative methods are compatible and a researcher can use them both.

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[9] Pragmatism, as a philosophy, derives from the work of Peirce, James and Dewey. However, my use of pragmatism in this thesis is related to the recent interest in it in employing mixed methods in doing social research. Pragmatism paves the way to different worldviews, assumption, methods, techniques of data collection, and so on since according to pragmatists knowledge claims arise out of actions, situations, and consequences rather than antecedent conditions (Creswell, 2003: 9-11).

Pragmatists study what is consistent with their value systems or what they find is important to study. They study those units of analysis and those variables that are useful to answer the research question. They believe that there are causal relationships to explore, but they also believe that the explanation will be influenced by the values of the researcher. Table 4.1 summarises the *axioms* of pragmatism:

Table 4.1: The axioms of pragmatism

Paradigm	Pragmatism
Methods	Quantitative +Qualitative
Logic	Inductive +Deductive
Epistemology	Both objective and subjective points of views
Axiology	Values play a large role in interpreting results
Ontology	Accept external reality. Choose explanations that best produce desired outcomes
Causal linkages	There may be causal relationships but we will never be able to pin them down

Source: Tashakkori and Teddlie (1998)

Based on this philosophy my research employs a multi-method design. According to Morse (2003):

> *this is the conduct of two or more research methods, each conducted rigorously and complete in itself in one project. The results are then triangulated to form a comprehensive whole (p. 190).*

I made this choice based on the belief that to reach a more comprehensive understanding of the relationship between the development of business sector and institutions in Albania, data from two levels of analysis needed to be collected. Viewing a phenomenon from the diverse standpoints of different actors in the process of SME development means that I ensured plurality in my study and also a strong balance between breadth and depth. This multi-method design has enabled me *to make good judgements in the service of doing wise actions* in the form of the policy implications of my research for poverty reduction and economic growth, through a better understanding of the business dynamics in a post communist transformation economy, such as Albania.

In this sense, I have worked with two units of analysis, entrepreneurs and organisations. Multi methods provide different perspectives on the phenomenon studied and more importantly they allow the obtaining of data from different units of analysis. Based on that definition, I make sure to keep each method intact and not to violate assumptions or sampling for each method, because

each is based on a particular paradigm, or a set of assumptions, regarding reality and knowledge of that reality.

Specifically, the data from the entrepreneurs was collected by an enterprise survey and the data from organisations was qualitative and collected by interviews. The results of each project were triangulated with other information collected by secondary sources such as statistics, laws and other documents. According to Greene (1989), the choice of mixing methods is a political choice based on the fact that multiple and diverse ways of knowing should be valued in the light of the partiality that knowing involves.

4.1.1 Formalism versus anti-formalism

My study is based on two main theories: one, entrepreneurship and small business development theories and two, the NIE theory. Theories of business growth are empirically based theories and are based on the creation of models that incorporate various variables that can have an impact on growth. In this respect, the language of these theories is quite formal. However, the fact that these studies employ contextual based variables to explain growth makes them prone to informality as well. The same applies to the other theory I employ in this study. Various authors (Clague, 1997; Pejovich, 1999; 2003) consider the NIE as basing its fundamentals in neo-classical economic theories and being no more than an extension of these theories to bring them closer to the real world.

Seen from this perspective, it means that NIE uses the formal language of mathematics and symbolic logic in drawing models instead of looking at multiple and subjective point of views that are characteristic of more constructivist paradigms. Nevertheless, the fact that I look at the opportunities for entrepreneurship through the lenses of the NIE means that although my study employs a formal empirical model, it makes the context intelligible through the use of a narrative history of events in the form of social and historical variables that are of a more subjective nature to explain the phenomena of interest.

This stance might imply that my study is highly informed by a positivist paradigm, which is concerned with objective realities and pure knowledge free of interests, values and beliefs, since I have collected entrepreneurs' perspectives through a survey. Having a generalist implication, the survey does not bring strongly the voices of social actors, i.e. enterprises in the study, although the entrepreneurial behaviours associated with growth such as incentives and

disincentives provided by the institutional framework are prone to subjective interpretations of the environment by the entrepreneur himself and are difficult to measure or quantify.

However, the perspectives of other actors in SME development are very important in increasing the explanatory power of my study by presenting the dynamics of the relationships between the business community and the state and other intermediate organisations. This factor is reflected in the qualitative interviews I conducted which have captured diverse perspectives, knowledge realities and my values as a researcher in the process.

4.1.2 Inductive versus deductive

To the extent that a theory allows one to expect some outcomes based on certain antecedents, there is no satisfactory theory of entrepreneurship and small business that has yet achieved this kind of determinism (Bygrave, 1989). Many efforts have been made over the years to create an explanatory framework for entrepreneurship and small business, but the debates still continue and the need for research in the field remains. This lack of theoretical explanation is related: first, to the heterogeneity of the work that has been done in the field; and, second, to the heterogeneity of the small business sector itself (to a certain extent it is the second that has caused the first). Also, the environment is in continuous change which makes it difficult to create a model that would work well for businesses in different sectors, different sizes and also, with different entrepreneurial characteristics.

Yet, business growth studies are mainly empirical growth studies (Ardishvili et al., 1998) that concentrate on the factors that lead to the growth of a business in terms of antecedents to growth or consequences of growth (Davidsson and Wiklund, 2000). As a result, the literature on small businesses is informed by a multitude of factors that can influence the success or failure of a business. However, there is no consistent pattern to the determinants of business success and growth (Ray, 1993; Gibb, 1996 cited in Jones and Tilley, 2003). While researchers might be able to identify the determinants of growth, no predictive model will emerge (Smallbone et al., 1995), given the instability and the diversity of the small business sector.

Thus, there is an inductive-deductive logic in researching small business growth. Nevertheless, the balance clearly weighs more on the deductive approach, since the research is based on quantifiable observations and statistical analysis (Remenyi et al., 1998; Saunders et al., 2000). Moreover, the *deductive inference* rests on the creation of predictions on the basis of the

conceptual framework that is constructed from the literature, and also from instrumentally using the variables to understand some of the patterns of business growth in Albania.

The inductive approach takes the form of a contextual analysis prior to the deductive approach. In my study, it rests in the understanding of the context in which the research is carried out and its particular focus. Thus, the inductive approach consists of finding out what variables best represent the small business characteristics in the Albanian context and, more importantly, the formal and social institutional features of this context that are worth analysing further. The survey reflects the patterns of small business growth but it misses out important information on the meaning of lived experiences, entrepreneur's interpretations of growth determinants or sense-making of why some factors act as barriers to the growth of SMEs in their particular context. For this reason, my research has built on information about the individual thoughts of particular entrepreneurs and how they cope with the problems in the Albanian business environment.

As I mentioned before, I am interested in a macro-level study of SME development in Albania that incorporates the perspectives of all actors involved whether policy makers, business support programmes, associations or SMEs. It is this aspect that gives my study a constructivist flavour. It also increases the explanatory power of my study not only through its multiplicity and contextualisation, but also by *the intertwinement of facts and values*. Although I believe in the beneficial value of the dialectical position[10] of mixing methods (Maxwell and Loomis, 2003) concerning the two different understandings of reality, knowledge and the place of values in research, my choice of these methods has been more technical than epistemological. The groups of actors I was interested in were very heterogeneous which limited my choices to this method design but enabled me to answer my research questions.

4.1.3 Triangulation

Triangulation is a rather new concept in doing social research. Whilst the most discussed type of triangulation is the methodological triangulation, the literature is informed with other forms triangulation can take while doing social research. In this respect Denzin (1978) speaks about

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[10] Dialectical position: To think dialectically is to invite the juxtaposition of opposed or contradictory ideas, to interact with the tensions invoked by these contesting arguments, or to engage in the play of ideas. The arguments and ideas that are engaged in this dialectic stance emanate from the assumptions that constitute philosophical paradigms—assumptions about the social world, social knowledge, and the purpose of science in society (Greene & Caracelli, 2003).

triangulation of data referring to data collected from different sources, triangulation of time referring to studying something in different periods of time and triangulation of space referring to different contexts where a social phenomenon can take place.

Methodological triangulation means that various methods can be used in order to better examine or explore the phenomenon of interest. Greene et al. (1989) argue that in its original definition triangulation can be understood as the aim:

> to increase the validity of constructs and inquiry results by counteracting or maximising the heterogeneity of irrelevant sources of variance attributable especially to inherent method bias but also to inquirer bias, bias of substantive theory, biases of inquiry context (p. 259).

The use of triangulation as a mean to increase the validity of a research is based on the fact that similar results achieved by different methods suggest increased validity. However, the use of different methods does not mean that the results of each of them will *"produce some nicely integrated whole"* (Patton, 1980). This expectation of convergence has placed triangulation in the spectrum of positivist researches that presuppose a single reality and interprets different accounts as just multiple mappings of the same reality (Silverman, 1985).

Different methods employed in social enquiry might look at the same phenomenon but they capture different dimensions, qualities or aspects of it, which, as Mathison (1988) argues might bring inconsistent and contradictory results. According to her:

> ...the value of triangulation is not as a technological solution to data collection and analysis problem, it is a technique which provides more and better evidence from which researchers can construct meaningful positions about the social world. The value of triangulation lies in providing evidence such that the researcher can construct explanations of the social phenomena from which they arise (p. 15).

In this respect, rather than just trying to increase the validity of my data through in depth interviews following the survey, my use of triangulation of quantitative, qualitative and textual analysis has been designed to enrich further my explanation construct about SME development in Albania.

4.2 Conceptual framework

Throughout this thesis, I have emphasised the role that institutions play in inducing entrepreneurial behaviour through creating stability and structures that facilitate the process of

entrepreneurial discovery. Moreover, they channel the entrepreneurial behaviour toward productive activities that add to economic development. I have used in particular work by Baumol (1990) and North (1990; 1994; 1997), which reinforces the arguments for the importance of institutions in economic performance in general, and more specifically in inducing productive or unproductive behaviours among entrepreneurs.

As I mentioned previously, I look at the growth aspect of entrepreneurship and SME development. The rationale for my decision is that growth is mostly associated with export expansion, increases in employment and capital investment, all factors that bring about economic development. According to the literature on business growth, understanding it, operationalising it, and finding ways to support it is mainly based on the belief that what matters is the quality of the businesses rather than their quantity.

To my belief, the challenge in studying SME growth stands on the ability to develop multidimensional models that incorporate many of the variables explaining growth because it is exactly the interdependence of many variables that can best explain the growth of SMEs. For the purpose of my study I see the growth of the SME sector as a function of three main sets of determinants of growth: opportunities, abilities and intentions of the entrepreneur. This position is consistent with the previous works of Davidsson (1991) and Morrison et al. (2003) that have incorporated these three sets of factors in a model of small business development. In the contexts of their studies, the forces that drive entrepreneurship are related to the characteristics of entrepreneurs and their commitment to growth and opportunities are related to productivity enhancing opportunities. In the context of transition, as my discussion in Chapter 3 showed, opportunities can be discussed in terms of the political, social and legal factors that determine the distribution of productive and unproductive opportunities (Baumol, 1990; Kozul-Right and Rayment, 1995; Venkataraman, 1997; Shleifer and Vishney, 1998).

The model I present in Table 4.2 conceptualises the impact that various institutions have on entrepreneurship behaviour and thereafter on decisions about business growth. I have categorised institutions the effects of which I discuss in different empirical chapters of this thesis. The first group of institutions is state related and is more concerned with formal institutions, such as rule of law and different regulations that affect business operations such as tax regulations, competition in the market, alertness to previously unknown knowledge and also enforcement characteristics of all these institutions. I discuss formal institutions in this thesis *first,* from an enterprise perspective based on the perceptions of entrepreneurs captured by the

survey analysis in Chapter 5 and *second*, I discuss the state and its formal institutions from a documentary and interview analysis in Chapter 7 and 8 of this thesis.

Table 4.2: Framework for analysing the impact of institutions on business growth

Formal Institutions	Informal Institutions	Organisations

1. Property rights and rule of law
2. Competition related regulations
  • Barriers to entry
  • Alertness to knowledge
  • Uncertainty reduction
3. Enforcement characteristics
	1. National/Societal Culture
	2. Trust and social relations
	  • Systemic trust
	  • Personal trust
	  • Moral attitudes
	3. Internally enforced codes of conduct
		1. Political
		2. Economical
		3. Social
		4. Educational

Incentives   Disincentives

BUSINESS BEHAVIOUR

Intentions   Abilities

BUSINESS GROWTH

The other group of institutions I discuss in my model of business growth is of an informal nature and consists of culture, especially business culture considering the total lack of private activities during communism in Albania. I also discuss various forms of trust existent in the society that open the way to different behaviour in the business community, such as self-enforcement of contracts and other regulations. These findings form part of my discussion in Chapters 5 and 8.

Another part of my model includes the organisations that are characteristic features of the institutional matrix. In this context, I discuss support organisations, whether state, donor or private funded, in Chapters 7 and 8 with an emphasis on the implementation of various regulations and other issues that are present in the Albanian business context. I also discuss their role with regard to the facilitation of alertness to previously unknown knowledge.

My model of institutions for entrepreneurship covers intentions and abilities of the entrepreneurs which are important elements in explaining business behaviour, especially with regard to decisions about growth. While intentions and abilities are individual or personal attributes and usually in the literature are discussed under psychological approaches to entrepreneurship, in a broader sense I think that the institutional framework and the organisations that are created under this framework exert a certain influence on them. This influence can be explained in terms of the educational structures that are in place that emphasise certain skills, or the culture and the business values that are more predominant over certain time periods, and their effect on the attitudes of entrepreneurs towards their business and therefore, their growth intentions.

However, despite this conceptualisation for the purposes of my study, I take the intentions and abilities as given within the particular institutional setting I am studying, and I look at their impact on business decisions about growth together with the incentives and disincentives for entrepreneurship that the institutional environment offers. Moreover, based on the objectivist/subjectivist definition of opportunities I adopted in Chapter 3, while the institutional framework creates incentives and disincentives and makes them be *'out there'* for the entrepreneur it is very much dependent on the entrepreneurs' intentions and abilities whether they will see them and how they will act upon the opportunities they see. I look at their effect on business behaviour as part of Chapter 5. Moreover, in Chapter 6, I discuss at a more explanatory level the nature of the relationship between the growth of the enterprises and a range of entrepreneur or firm specific variables and institutional variables part of my model. After presenting my conceptual framework, I move on in the rest of this chapter to the practical choices I have made in order to collect the data about the different parts of my model.

4.3 Survey Design

The rationale for using a survey method is that it allows the collection of a large amount of data from a sizeable population in a highly economic way (Remenyi et al., 1998; Saunders et al.,

2000). The survey method also offers flexibility that other methods do not offer. My interest in the state of the SME sector implies a need for generalisability so that the results of the research will be equally applicable in other research settings. Moreover, secondary data on Albania were not available so, I had to conduct my own survey.

Within the method chosen, survey research, I employed an analytical survey in order to explore the relations between different variables. As Gill and Johnson (1997) argue:

> *a thorough review of the literature is essential...since it helps the researcher elaborate the various possible relationships that might exist between and impinge upon, the phenomena whose empirical variation is of primary concern (p. 76).*

As I discuss in the course of this chapter, I used a personal interview questionnaire for collecting the data on enterprises. In order to ensure the standardisation of answers across the sample, I used a predetermined form of questionnaire to obtain the necessary information.

4.3.1 Growth measures

My variable of interest is the growth of SMEs. Of central concern in the research on small business growth are the measures used to define growth and the unit of analysis. These decisions influence to a large extent the differentiation between those businesses that have achieved growth and those that have not. I agree with Davidsson and Wiklund (2000), who believe that the literature on small businesses is full of overlaps with regard to the units of analysis that are used. It is often not clear in the literature, whether it is the entrepreneur, the governance structure or the business that is under analysis. However, their interchangeable use can only be acceptable in the case when the entrepreneur *"runs a single organisation which expands organically, not diversifying its activities"* (p. 31), which means that in the case of small and young firms there is no problem in overlapping units of analysis as they usually grow organically although over a longer period of time (Penrose, 1959).

Another issue I considered was the operationalisation of business growth and the indicators of growth that were more appropriate for the context of my research. There are some main indicators that have been used often in small business research. Employment generation is one among them. The rationale for its use is a macro-interest in entrepreneurship and small businesses as job creators. It is also the most commonly used indicator in small business research in post-communist economies. Moreover, from a resource based perspective,

employees are a very valuable resource. Nevertheless, there are some possible drawbacks in using it as an indicator for example in cases in which firms that do not grow in terms of employment use a more advanced technology or grow in other assets (Delmar, 1997). Thus, assets might be another growth indicator. Also, sales' growth has caught the attention of many researchers (Hoy et al., 1992; Barkham et al., 1997; Davidsson and Wiklund, 2000) as it is believed that an increase in sales precedes growth in other aspects.

The literature on measures of growth reflects once again the heterogeneity of small business research. So, any of the choices on growth indicators and determinants should be related to the theoretical perspective under which small business is studied and also to the particular context of the study. I have worked with two dependent variables: employment and business performance. Since I am studying the manufacturing sector and the needs of this sector for new technologies or fresh investments in order for it to become more competitive, the use of assets as a growth indicator would have been of great interest. However, it was not possible due to incomplete answers of the entrepreneurs. The first choice was influenced by the macro interest in SME development as a means of poverty reduction and economic development in the country. The second choice is related to more subjective perceptions of the entrepreneurs about their business that could also involve investment.

4.3.2 Growth determinants

Based on my research question and the theoretical framework I use, I measured a number of independent variables through the survey questionnaire. The choice of variables was based on the literature on entrepreneurship and SME development, not only in Western contexts where the institutional structure is stable, but also in transition economies that are going through large-scale institutional change. In post communist economies this change involves particularly changes in formal institutions, such as rules and regulations and also an adaptation of social norms and traditions to the newly established formal institutional environment. Thus, my questionnaire measured and quantified the following variables:[11]

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[11] I showed in Chapter 3, Section 3.1.2 that the literature on business growth (i.e. Morrison et al., 2003; Davidsson, 1991) equates intentions of entrepreneurs with firms' characteristics, abilities of entrepreneurs with entrepreneurs' characteristics and opportunities with the institutional infrastructure. Appendix 1 gives a summary of the variables of interest.

1. *Entrepreneur's intentions*

- *Firm's age-*has been often negatively correlated with growth. The older a firm, the more substantial its expertise in what it does. Thus the intentions of the entrepreneur to grow are decreased.

- *Firm's size-*it is negatively correlated with growth. For those businesses created for comfort reasons, when a firm gets to a size where the profits of the entrepreneur are enough to have a certain living standards the intentions to grow are lowered.

- *Manager's age-* according to Morrison et al. (2003) when entrepreneurs become older, they have fewer needs to grow the business because they may have fulfilled their aspirations. In a transition context, it is worth elaborating this aspect further, because many people, regardless of their age, were thrown into unemployment and the only viable solution they had was to start-up a business. Yet, many people did not have the chance to do something autonomous during communism, as private activities were banned.

- *Legal status-*the legal status of the firms is another important variable. Businesses that are formed as partnerships have more people to be accountable to, thus they might have more reasons to grow.

- *Reasons for starting up-*entrepreneurs might have different reasons for starting up a business. Those businesses that are created for survival reasons have a lower propensity to grow than those created because of entrepreneurial alertness. Also those businesses that might have been created as comfort zone businesses would grow until the owner/manager achieves a certain living standard that he/she sees as necessary.

2. *Entrepreneur abilities*

- *Education (general or business specific)-*The evidence is mixed so far with regards to this variable. While there is an agreement that the ability of the entrepreneur is important in making entrepreneurial intentions materialise, it is difficult to operationalise the kind of ability that is needed because to a certain degree this is contextual.

- *Entrepreneurial experience-*the same assessment applies to this variable; however, experience in a similar business may make the entrepreneur more prepared for unexpected occurrences in a business and how to handle them.

- *Business founder or not (new or privatised)*-entrepreneurs of newly founded businesses have looked at the broader market perspectives and how the business can compete in the market and taken into consideration their abilities. Entrepreneurs managing privatised businesses might have reached that position as part of the quick and sometimes chaotic privatisation process at the beginning of transition. They might not have the same aspirations and determination as other entrepreneurs to grow their business.

3. *Entrepreneur opportunities*

- *Location-* I look at various locations, as different areas offer different opportunities for growth. During the period of transition, not only in Albania, but also in other transition economies, there has been a trend to concentrate business development in main cities, especially the capital and the nearby areas.

- *Institutional framework-*As I mentioned in the theoretical framework, in a post communist setting the role of institutions is very important in giving the appropriate incentives to entrepreneurs to channel their activities toward productive uses that add value to the economy. For the purposes of my study, based on the institutional perspective, I constructed the following proxy variables for different types of institutions:

    o *Formal institutions-*Institutions are designed to create a stable structure for human interaction. In transition economies, unpredictability of laws, over-regulation in licensing, employment, environmental, foreign trade and tax issues, are all factors that can have an impact on the entrepreneur's decisions.

    o *Informal institutions-*In an environment in which formal institutions are not credible and the legacies of the past have not yet faded away, it is worth including in the analysis subjective institutions such as social norms and culture that are more difficult to change and are less amenable to deliberate policies. I have included in my analysis a set of variables designed to capture informal institutions such as: trust (personal or institutional), business values based on the fact that no private activity was present during communism, unfair competition, moral attitudes and kinship ties that are used to substitute or complement the formal institutions.

    o *Enforcement characteristics-*While many rules and regulations can be adopted fairly quickly, their enforcement might not happen at the same rate. While some rules are self-enforced because the parties in the process benefit by doing so, some other are not. This creates a need for third party enforcement. The efficiency of this process is the main issue. I have included questions related to corruption of public

officials such as additional payments that businesses have to give to them, other difficulties with government officials such as the arbitrary use of power, as well as questions related to courts and their fairness, affordability and impartiality.

o *Organisations*-I analyse this group of variables mainly through qualitative analysis. I have asked about support and advocacy organisations and their business support in the form of information, finance, technical assistance, partnerships and other such issues.

4.4 The Sampling Frame

The sampling frame for my study is all the small and medium enterprises operating in Albania (i.e. those that are registered and that are active). Probability sampling is the most associated with the survey research. In this context, I decided to use a stratified random sampling in terms of the sampling technique. By doing so, I made sure that the sample was representative as each of the strata was proportionally represented. Initially, I decided to divide the population of enterprises in two specific groups namely, the economic sector and the geographical area. My rationale behind these choices was that:

1) Characteristic of the SME sector in most of the countries in transition, including Albania, is their operation in the sectors of trade and services, as the barriers to entry are lower. So, in the case of a random sampling there could have been a chance that most of the enterprises in the sample would have been from the trade and services sector. But, different sectors face different issues.

2) The geographical area had to be used as a cluster in order to ensure that there were enterprises from different regions. This because of the fact that different regions offer different opportunities for business.

By this logic, all the enterprises, distributed among the specific regions, were part of my sampling frame. However, considering my limited time and resources and also the kind of analysis I was going to undertake meant that I would have had very few enterprise representatives from different sectors. So, I chose only the manufacturing sector among economic sectors. Moreover, as I mentioned previously, Albania was an overly industrialised country during communism but during the transition stage the reverse trend was noticeable. The manufacturing sector is weak, obsolete and under-invested but still contributes to over 40% of employment. All together, 6,275 enterprises out of 51,945 active enterprises in Albania operate in the industrial sector which provided another rationale for this decision.

My other decision regarded the particular districts I selected for my study. I decided to use seven districts: Tirana, Durres, Elbasan, Shkodra, Korca, Gjirokastra and Vlora. These seven districts served as my strata because Regional Development Agencies operated in all these districts, and thus helped in contacting enterprises. This decision involved some bias in the sample especially with regards to questions about support structures. Nevertheless, it was the best option available considering my time and other resources available to me.

4.4.1 Sample population. Which are the most reliable sources?

Having selected these two strata, I thought that acquiring a random sample would have been an easy process. Since 1994, INSTAT has created the Register of Non-Agricultural Enterprises that is updated every year according to EUROSTAT guidelines. INSTAT uses three declarations made by businesses in the Tax Office: the declaration of opening a business activity, declaration of changes in the nature of the business as well as a declaration for the closing down of the activities. However, there have been problems with the process due to separate district registers kept by the Tax Office. In addition, these were not updated for more than three years to exclude from the list those enterprises that did not pay taxes. According to INSTAT sources, the computerisation and the updating of the register of the Tax Office in 2003 has been an important step in the process towards having more reliable data about active enterprises and at the same time of different economic statistics computed by INSTAT.

Since the beginning of transition in Albania, 134,000 enterprises have been registered out of which only 52,000 are active. After 1995, a slower increase in the number of start-ups was observed while the survival and death rate of enterprises has become more stable[12]. The data from INSTAT enabled me to obtain a better representation of the population of enterprises in Albania. Based on this information, in March 2004, I contacted a specialist in the Sector of Enterprise Registration, who told me that the list of enterprises is confidential and that I could not get that kind of information. Although not very familiar with the possible changes in the laws on statistics, I was convinced that a list of enterprises and their addresses and contact telephone numbers were not among the statistics protected by law.

The director of the Regional Development Agency of Tirana suggested using their database of enterprises. However, *first,* this meant that my sampling frame would no longer include the

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[12] This figures exclude the unusual events of the year 1997 when it was experienced a very high rate of enterprise closure.

entire population of manufacturing businesses in Albania and *second,* their database did not include many manufacturing businesses. Using other lists of enterprises from Chambers of Commerce or other organisations working in Albania meant that I would have to relax the criteria for a sample that was best representative of the population.

Some time later, I contacted the director of INSTAT, Mrs. Milva Ekonomi, a very supportive and experienced woman, who not only showed her interest in my research, but also introduced me to a statistician in the IT Department in INSTAT, who helped me with the sampling based on my selection criteria. Based on the new Albanian law on enterprise definition, I decided to exclude the micro-businesses from my sample. Although they make up almost 98% of the enterprises in Albania, I decided to work with enterprises that had more than five employees because I could better identify any growth intentions and impediments to growth in these enterprises. As the INSTAT for many years has worked based on their specific definition of enterprises this decision did not prove to be an easy endeavour. Moreover, the database of enterprises, from which the sample was drawn, was last updated in 2002 which created some problems, as I discuss in the following section. After some attempts and thanks to the willingness of the IT employee to help me the sample I show below was selected.

Table 4.3: Sample selection

District	Number of enterprises with over 5 employees	Percentage to the total	Number of enterprises in the sample
DURRES	74	16.6	20
ELBASAN	30	6.7	8
GJIROKASTER	10	2.2	3
KORCE	48	10.7	13
SHKODER	30	6.7	8
TIRANE	233	52.1	63
VLORE	22	4.9	6
Total	447	100	121

Based on the criteria for the sector of activity and number of employees, I randomly collected a proportional quota based on the number of enterprises in each of the districts of interest. So, I had my sample of enterprises, 121 in total, together with information such as the name of the owner, the name of the enterprise, the address and telephone numbers of each of the enterprises.

4.4.2 Questionnaire Design. How to make it "enterprise-friendly"?

My questionnaire (see Appendix 2) was made up of 60 questions. The majority of them were closed questions. These kind of questions are easier to compare as they have been previously predetermined. The questionnaire was a mixture of list questions (i.e. Question 20, 21), category questions (i.e. Questions 6-10, 15-18) and Likert-style rating questions (that make up the majority of the questions). The questionnaire design was based on other business surveys previously used to investigate SMEs in transition economies to reach a degree of comparability of the issues of SMEs in different countries. Also the questionnaire aimed to collect data on *belief, attitude, attribute* and *behaviour* variables.

From the moment I designed my first draft of the questionnaire to the version I gave to enterprises I tried to have as much feedback as I could from either businesses or individuals, I had already interviewed for my research. One concern raised was the length of the questionnaire and the difficulties in convincing businesses spend much of their valuable time participating in the study. Although I tried to reduce the number of questions, it was not an easy process, because of the multi-dimensional nature of my research. However, as Sallant and Dillman (1994) argue, when there is a choice between a cramped questionnaire and an extra page the respondents would go for the later. Thus, I concentrated in making the questionnaire as easy and clear to follow as possible. Some questions were not very clear so I had to revise them. For example, in an earlier version of the questionnaire I asked only about *'the performance of the business'* (question 13) without specifying what kind of performance I was interested in. The answer could have been different depending on how people defined it. However, in the final version in addition to a general question on the performance of the business, I added Question 14 which asks about the performance of the business in terms of the various indicators of business growth.

After overcoming the issue of the length of the questionnaire, I was quite concerned with its translation into Albanian language. The total absence of business activities during communism had brought with it a lack of business vocabulary in Albania. At the beginning of 1990s, words were borrowed from English until an Albanian equivalent was available. However, I was more concerned that the businesses I would visit would not be familiar with many of the theoretical concepts or different definitions used in the questionnaire.

As part of my piloting, I chose three businesses in Tirana in order to test the questionnaire in terms of ambiguous questions, poor structure, too long questions, questions that tried to measure more than one thing at the same time and/or questions that were difficult to fill in. I also kept track of the time needed for an interview. During the pilot, I had made the mistake of not differentiating between businesses that were managed by educated entrepreneurs and those managed by less educated entrepreneurs. Later on, when I conducted the actual interviews, I realised that in some cases respondents with lower education levels could not understand various questions. Also, the time needed to fill the questionnaire varied from a minimum of 20 minutes to a maximum of 40 minutes.

In the case of a few questions that could be labelled as *sensitive* questions (i.e. Question 45), I tried to make them as impersonal as possible. Although the cover letter attached to the questionnaire, as well as confirmation either by me or other people that conducted the interviews that all the information they would give would be treated as confidential and used only for the purposes of this study, the responses still lacked total honesty because an interview based questionnaire lacks anonymity. The positive aspect was that my questionnaire did not require the respondents to provide a bulk of financial figures otherwise it would have been more difficult to get the answers. Businesses are usually hesitant to give that kind of information. For instance, one entrepreneur in Korca said to me: *"If you want a better idea not only of my business but businesses in general you better add a zero to all the figures you have"*. This statement was a signal of formal rules' evasion. However, as Healey and Rawlinson (1994) suggest, these questions were left towards the end of the interview in order for the respondent to build trust and confidence in the researchers.

I also attached a cover letter to the questionnaire. It explained who was doing the research, what the main aims of the research were and what was meant by being involved in the research. The headed paper from the School for Policy Studies, University of Bristol had a very positive impact. *First,* it enhanced the credibility of the research being undertaken as it was not carried out by any public or private institution in Albania, which are not particularly trusted; and *second,* as a legacy of the communist period education in Albania is very much appreciated, especially in foreign universities. Both factors, to some extent reduced the resistance of businesses to participate in the study and to help me with my research.

4.4.3 Choice of interview survey. How to contact the enterprises?

The most important issue I had to consider was how to contact the enterprises. Since the earliest stages of my PhD, I had excluded a postal survey from further consideration. This decision was because: *first*, the postal system in Albania is not very good; *second*, there is no prior experience with mail surveys in Albania, which made me a bit reluctant to use it; and *third*, and most importantly, the addresses of enterprise locations suffer from inaccuracies, which would have resulted in low chances of the questionnaires reaching the businesses and therefore resulted in a low response rate.

Yet, my problem also consisted of how to reach the enterprises considering the limited time and financial resources I had available. I requested another informal meeting with the director of INSTAT who, based on the experience of annual enterprise structural surveys conducted by INSTAT, suggested that I should go to districts other than Tirana myself and hire and train somebody to do the interviews in Tirana, where the majority of the businesses were located. This suggestion sounded like the best solution to me. Tirana is a wide spread district which would have made it very difficult for me to conduct the interviews myself within an optimal period of time. Also, the fact that I could have hired some interviewers from INSTAT was positive because it meant that they knew the area and also were familiar with survey questionnaires, which meant that the data they would collect were reliable. Furthermore, they did not need much training.

At the same time, I was resolving the issues related to sample framing and selecting, I was conducting interviews with policy makers or business support structures in Albania. One of the interviewees was the manager of a Small Business Credit Assistance Project (SBCA) financed by the USAID, Mr. Jeff Houghton who, considering my limited resources, suggested I could travel with his team in various districts. The same form of support was offered to me by the Regional Development Agency of Tirana. Furthermore, they facilitated contacts with the RDAs in other districts where I had to conduct interviews. In the districts other than Tirana, the presence of locals, such as members from the RDAs, proved to be a very good source of information. As mentioned previously, the addresses of the enterprises I had collected from INSTAT were not very accurate. In small districts, it was easy because in a way *everybody knew everybody* so by just mentioning the name of a business or its owner there was almost always somebody that could show where the business was located. Contrary to my expectations, the majority of the businesses were open to participating in the survey and felt very comfortable in

discussing many of the issues concerning their business, although some of the issues were not even part of the interview questionnaire.

In order to conduct the interviews in Tirana, I contacted the director of INSTAT again who introduced me to two of INSTAT's interviewers. I discussed with them my research and the survey questionnaire. After making sure that there were no misunderstandings of the questions and if businesses could have had any queries they would have been able to respond, I gave them the list of enterprises in Tirana together with the questionnaires. I agreed to meet every week with them for the six weeks they had available so they could give me any feedback on the interviews together with the completed questionnaires.

After the first week, they told me they had experienced problems with the addresses and that was difficult for them to follow the list of enterprises I had provided them with. The accuracy of the addresses was also an issue of concern for me. The reasons for this inaccuracy were many. As I was told by informal sources, after interviewers of INSTAT find the correct address of an enterprise it might not be entered in the database that INSTAT has due to the negligence of some employees. Another reason, according to different former colleagues of mine in INSTAT, was the difficulty in keeping very good records of the enterprises as enterprises might report incorrect addresses because of the overall mistrust present in the Albanian society, especially toward public institutions. Moreover, enterprises change location from time to time in order to escape tax controls, which increases the difficulties of the interviewers.

Whilst I could resolve the issue informally in small cities by just asking about the name of the entrepreneur, I could understand that in Tirana that same approach was not very promising. Tirana is a big district and businesses in the sample were located either in the city, the suburban towns or villages. Moreover, during the 1990s a considerable number of people from other parts of the country have immigrated to Tirana which meant that the chances that people knew well each other were slimmer than in other districts where I conducted the interviews myself. Given the time constraints, INSTAT interviewers suggested conducting interviews with businesses that were not in my list but that fulfilled my selection criteria. I was not inclined to do this because I wanted to follow all the procedures of a random sampling technique. However, the manager of the SBCA offered to help me with their database of enterprises. Based on my criteria, they randomly selected a sample of 140 businesses in the manufacturing sector. Now I had two randomly selected lists from two different sources. However, I found myself at the end of May 2004 with no questionnaires filled from Tirana yet.

Moreover, I still had to conduct questionnaire interviews in Durres and also some in-depth interviews with manufacturing businesses in Tirana. I contacted two other interviewers from INSTAT, whom with I followed the same procedures by explaining first my research and the questionnaire. However, this time I had to deviate from the starting sampling technique and agree with them that the questionnaires could have been filled in those enterprises that, although not in my initial list, fulfilled my sampling criteria and were more accessible in terms of location in Tirana. This move proved to be successful as by the first week of July 2004 I had 60 questionnaire interviews in Tirana ready for analysis. I realised that I should have selected two or three different random samples and work with different random lists of enterprises in order to avoid the problems with addresses' inaccuracies or businesses' hesitation to participate in the study.

4.4.4 Survey biases

As with all survey studies, my survey might suffer from some general shortcomings, as well as some more specific issues related to the particular context of my study. An interview-based survey that lacked anonymity might result in dishonest answers from the respondents. Moreover, by being a snapshot or a cross-sectional survey, it captures at best the issues as perceived by the enterprises at the moment the study was conducted. These perceptions might also be influenced by a number of different reasons. Furthermore, when asking something that occurred in the past, it might not be recalled properly.

Besides, in terms of specific biases to this research, as other surveys on barriers to business operation in transition economies have shown (see, for example Aidis, 2003), businesses might perceive the completion of the questionnaire as a way to take out all their frustration about the government and its structures. This means that the picture might be *painted more in black* than it really is. I can illustrate a possible subjectivity in the answers through the words of this entrepreneur in Elbasan, who after giving two consecutive answers to a question said, *"it is not good to complain this much about the government"*.

Another issue of concern in Albania is that people are very much involved in politics. This situation could have led to answers that were based on political views by those affiliated with different political positions. This could have been the case in cities like Shkodra or other cities that have a reputation of being always in opposition. As I recall from an interview in Elbasan, where two administrative staff were in the room answering the questions, they disagreed about

an answer and one of them said: *"I am supporting the Democratic Party and I want to complain about this government"*.

Another form of bias might be related to the fact that I contacted and conducted the interviews with some businesses in the presence of some RDAs members. This situation might have led to any bias on the responses to questions related to business support structures, but it was the only practical solution in my situation. Moreover, businesses would have not been willing to participate in the study unless it was facilitated through a person they trusted. When I went to Vlora to conduct the interviews there was a local resident driving me around and facilitating the visits to different businesses. The owner of one business that was a friend of my local contact said to me:

> *If you did not come with him I was not even going to let you in. I do not participate anymore in any kind of research. So far I have not seen any beneficial results for my business by studies that have been made (Entrepreneur in Vlora).*

4.4.5 Final sample

Due to the above-mentioned difficulties in terms of finding enterprises because of inaccuracy of addresses or unwillingness to participate in the survey my final sample was 110 enterprises as shown in the table below:

Table 4.4: Sample by districts

District	Number of enterprises with over 5 employees	Percentage of the total	Number of enterprises in the sample	Final Sample	Final sample percentage of the total
DURRES	74	16.6	20	18	18.26
ELBASAN	30	6.7	8	8	7.37
GJIROKASTER	10	2.2	3	3	2.42
KORCE	48	10.7	13	9	11.77
SHKODER	30	6.7	8	7	7.37
TIRANE	233	52.1	63	60	57.31
VLORE	22	4.9	6	5	5.39
Total	447	100	121	110	110

The table also shows that there is a very slight deviation from the proportional quota criteria that does not influence the results of the study. Moreover, the Tirana sample subset although random, does not totally represent the initial random sample, due to the problems I discussed in

this Chapter. Taking this into consideration, my sample is 2% of the population of industry based businesses and 25% of the enterprises in the regions selected for the survey.

4.5 Qualitative Data

The research on SMEs in transition has been widely concentrated on the external environment, and I argue its importance by taking an institutional perspective in explaining growth. But what I saw as a deficiency in the literature that it has been informed mainly by economic approaches to entrepreneurship, which are mostly focused on choices of individuals ignoring the fact that choices of individuals are related to the opportunity structures to which they are exposed. These studies have been homogenous and have lacked a clear focus on the characteristics of the entrepreneurs too. There are just a few studies, such as Aidis (2003) that have incorporated into the analysis other structures or organisations that are part of the framework where SMEs develop their activities.

For this reason, my intention in this research has been to incorporate economic and sociological approaches to explain the dynamics of small business growth, not only through exploring the influence of institutions and organisations in the growth of the small business sector in Albania, but also by examining the inferences of the local setting and the intentions and the abilities of the entrepreneur. This justification was the rationale to conduct qualitative research, which is committed to see the world from the point of view of the individual actors. Qualitative research, through its expression of certain preferences for contextual understanding, will make the business behaviour and the incentives and disincentives that guide it, understood in the context of meaning systems employed by the SMEs and other groups of social actors involved in SME development in Albania.

Qualitative research is a way to look at the story from another perspective or through the lenses of other actors in the process. In this respect, I undertook qualitative analysis in the form of interviews in order to discuss some of the main themes in SME development in Albania. I collected the data from a judgemental sample. Within the judgemental sample I used a heterogeneous sample in order to enable me to better understand the key themes of my research. Although this approach might appear as a contradiction, especially in the cases of small samples, the main rationale was to have cases from different levels of institutionalisation of SME support in Albania.

For this purpose, I undertook interviews with officials from the Ministry of Economy (2), the Small and Medium Enterprise Development Agency (1); business associations (3); donor programmes (3); financial institutions (1). Each of the interviewees was sent a consent letter (see Appendix 3), which explained the study and its aims. As with the survey, the headed paper from the School for Policy Studies, University of Bristol was helpful in ensuring their willingness to participate in the study. Moreover, I made sure to have a good understanding of the interviewees' context and to give a good picture of my research to them thereby establishing a degree of credibility in the process. Also, the interviewees were assured that no confidential information was going to be revealed so as to make interviewees more relaxed and open, increasing their level of confidence (Healey and Rawlinson, 1994).

The themes for the interview were defined prior to the meeting so participants would have a sense of the direction and focus of my study (Saunders' et al., 2000). I derived these themes from the literature, the theories under consideration, and the context of the participant's organisation. I collected the information I needed from these groups using a *'funnel interview'*. According to Tashakkori and Teddlie (1998), in this type of interview *"the researcher starts from broad questions and gradually limits the scope of the questions to a few focused issues"* *(p. 102)* as shown in the Topic Guide in Appendix 4. Interviews are a powerful method of collecting information as:

> *the flexible and responsive interaction which is possible between interviewer and respondent(s) allows meaning to be probed topics to be covered from a variety of angels and questions made clear to respondents (Sykes, 1991: 8, cited in Saunders et al., 2000)*

Moreover to complement the information collected by the survey questionnaire, I undertook three interviews with SMEs in the manufacturing sector. Furthermore, during the time I conducted the questionnaire interviews, I kept in a diary every conversation I had with entrepreneurs regarding different issues of interest to them, which stemmed from the questions in the survey. This process was very helpful in terms of obtaining some insights into more accurate perceptions of entrepreneurs regarding their business activities. The table below summarises all the interviews that I conducted as part of my qualitative research:

Table 4.5: Qualitative interviews

Face to face interviews	Total
Public officials • Department of Business Promotion (Ministry of Economy) • Small and Medium Enterprise Development Agency	3
Business Agencies/Associations • Regional Development Agencies • Agro-Business Council • Albanian Industrialists and Investors Association	3
Donor programmes • Southeast Europe Enterprise Development (World Bank) • Small Business Credit and Assistance (USAID) • German Agency for Technical Cooperation (GTZ)	3
Financial institutions • National Commercial Bank of Albania	1
Manufacturing businesses	3

Apart from state officials, all interviewees agreed immediately to participate in the study. Some of them, instead of participating in the study suggested that I interview other officials within the same institution. However, I noticed that some interviewees did not feel free to say their real opinion but instead, they would repeat already written and approved documents, laws or strategies. This could be considered as a legacy of the communist period namely, deference to authority.

4.5.1 Issues and practicalities related to interviews

Logistical and resource issues. Interviews as a research technique are time consuming and expensive. However, for the purposes of my research, access to the interviewees was easy, as they were mainly located in Tirana. This fact was a signal that the SME development infrastructure is more consolidated in a central level with local deficiencies, as my further research found out. One positive aspect of my interviews was that I had pre-contacted a number of people to be interviewed and these people I had collaborated with were part of my snowballing approach to interviews. In contexts like Albania, things change fast and I was not aware at the time that I designed my qualitative piece of research to involve the most influential programmes in SME development and assistance in Albania.

The duration of an interview is another issue that might have adverse effects on the willingness of the participants. However, the participants in my study were made aware in the consent letter that the interview would not last more than an hour. In fact, the interviews lasted from 45-60 minutes, with the exception of one interview that exceeded one hour. Moreover, the fact that I

was very flexible with the dates and times for the interviews, since I was going to be there for five months, was helpful. One very important lesson while doing interviews was the following up of the interviewees. In the consent letter I sent to participants, I clearly stated that I would have to re-contact them to arrange a date and time, if they consented to participate. However, I had to call several of the people that consented to participate in my research many times. They were often busy and their commitments did not give them the time to think of my research. Thus, I was the one to follow up all the interviewees, which in some cases took months.

Another valuable lesson from conducting the interviews was the choice of the people in one particular organisation. Aiming for the most important people in an organisation was not always helpful. People in lower levels in the organisational hierarchy often knew much better the problems I was interested in and were more in touch with the situation of businesses because of their regular contacts with them.

Questioning and Recording. As I mentioned above, the relevant themes were designed prior to the interview. I ensured that three types of questions were included in the interview: open questions, probing questions and specific or closed questions in order to collect all the necessary information to answer my research questions. The interviews were tape-recorded after taking the consent of the interviewee. In the only case the interviewee did not consent to be tape-recorded, I took notes immediately after the interview in order to be able to recollect the data.

4.5.2 Data analysis

Huberman and Miles (1994) see the analysis of qualitative data as a process of transforming the raw data from the fieldwork, such as partially processed data (transcripts), which then will be coded and be the subject of analysis. The qualitative analysis consists on developing a *typology of themes or categories*. Although there are some controversies among qualitative researchers, as to how the researcher should identify these themes (deductively or inductively), they are both accepted types of analysis in the qualitative research. For my study, the analysis of the qualitative data was made based on pre-defined and emerging themes, combining both inductive and deductive logic to data analysis. I was careful to analyse these themes using latent content analysis which looks at the underlying meanings of the narratives (Tashakkori and Teddlie, 1998), rather than superficial meanings that might be misleading.

Conclusions

In this Chapter, I have summarised my methodological and epistemological considerations. I showed that my research is informed by a pragmatic philosophy, which is concerned with the research question rather than philosophical underpinnings. I discussed my conceptual framework and also the choice of a multi-method design for my research. In sum, looking at the phenomenon of interest from the diverse standpoints of different actors in the process of SME development is my main reason for using this research design as it ensures that I have a good balance of breadth and depth.

In this Chapter, I also discussed my main variables of interest, dependent and independent, and the rationale of my choices, the data collection process from the sampling frame to the actual collection of data. I also discussed the practicalities of different issues in each of these stages by trying to highlight the particularities of doing fieldwork in a context like Albania. I also drew some lessons for future research from my experience dealing with many research issues.

CHAPTER 5

THE PREVAILING FORMAL AND SOCIAL INSTITUTIONS IN THE ALBANIAN BUSINESS CONTEXT- SME CHARACTERISTICS, TRENDS AND BEHAVIOURS FROM SURVEY EVIDENCE

First are perceptions about the reality, then are formed belief systems and ideologies that explain the reality and the way people behave.

(North, 1997)

Introduction

In my theoretical chapters I discussed the role that entrepreneurship and SMEs can play in economic and social development. I argued that entrepreneurship and SME development do not lead *a priori* to economic development. I gave examples of other forms that entrepreneurship can take that are unproductive or destructive, unless a bundle of formal and social institutions are in place that channel entrepreneurial behaviour toward productive uses or toward wealth creation. In the theoretical chapters, I discussed the institutions that are relevant for successful and productive entrepreneurship and I divided them in formal institutions (such as property rights and rule of law, competition-related regulations and, their enforcement characteristics) and informal institutions (such as societal cultures, trust and social relations and internally enforced codes of conduct). I discussed how the intentions and abilities of entrepreneurs influence the way they regard the opportunities that particular institutional settings offer. I showed the importance of these different institutional arrangements and the entrepreneurial characteristics needed to open the way to processes such as innovation, arbitrage and accumulation of knowledge.

Based on these theoretical observations, I move the discussion in this chapter on to the formal and social institutions that are present in Albania and investigate how they shape opportunity structures from a quantitative research point of view. I also discuss the prevailing enterprise behaviours which result from this bundle of formal and social institutions, based on my survey data and on comments that entrepreneurs made during the questionnaire interviews. In this chapter, I focus on the main trends and behaviours present in the Albanian business environment. This analysis will form the basis for the discussion of business growth in Chapter 6. I present my sample characteristics in Appendix 5.

I proceed in this chapter by exploring some of the issues in the literature with regard to the quantity and direction of entrepreneurial effort, and also the institutional arrangements that have an impact on them. I discuss these issues with regards to various parts of the conceptual framework I presented in Chapter 4. More specifically, in Sections 1 and 2, I discuss the intentions of the entrepreneurs. I look at motivations for start-up and willingness towards external finance. In Section 3, I discuss the abilities of the entrepreneurs. I consider whether the support environment has facilitated the transmission of knowledge to them. In Sections 4 and 5, I go on to consider what the institutional environment offers to entrepreneurs through the discussion of businesses' perceptions about the government and its laws and enforcement characteristics as well as the use of social networks in doing business. I also discuss non-compliant behaviours that businesses have adopted to deal with the institutional framework currently in place in Albania in Section 6. I contrast evasive behaviours with other business values that enterprises have adopted and that are indicators of a learning process taking place in the Albanian society. I conclude this chapter with a summary of the prevailing enterprise behaviours and perceptions regarding the formal and informal institutions in place in Albania.

5.1 Why is an Albanian entrepreneur in business? - Exploring "pull" and "push" factors.

Behavioural theories of entrepreneurship consider the motivations and intentions of entrepreneurs to be among the main determinants in analysing the patterns of business behaviour with regards to growth. The motivations of owners have been considered to be *"causal factors for or against growth oriented achievement"* (Bridge et al., 2003). Based on my definition of opportunities, I discussed intentions as crucial in *seeing* the entrepreneurial opportunities. It is worthwhile to investigate the different triggers for starting-up for two main reasons: *first,* to create a more informed judgement on the type of entrepreneurs that operate in the Albanian context and; *second,* to understand better the growth patterns of businesses in the sample by starting with their aspirations and reasons to be in business.

I base the discussion in this section in Question 12 in the survey that was designed to capture the motives behind the decision of Albanian entrepreneurs to start up a business activity[13]. The graph below summarises the answers to this question.

Chart 5.1: Motivations for starting up a business activity
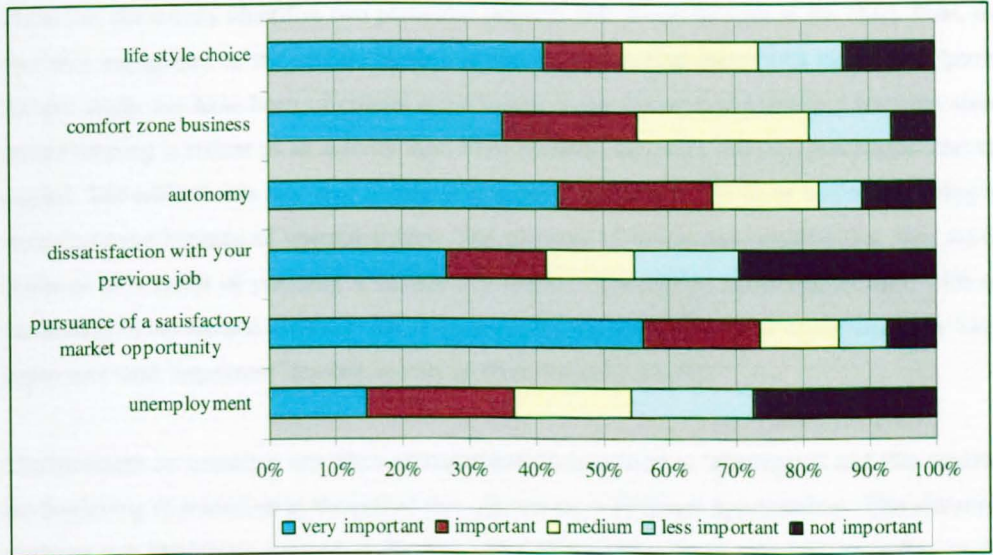
The graph shows that businesses start up for a variety of reasons. The literature on small business recognises different types of businesses based on the intentions of the entrepreneurs. I discussed in Chapter 3 that *'push'* and *'pull'* factors (Storey, 1994) or *'necessity'* and *'opportunity'* reasons can prompt the creation of an enterprise. In this respect, a strong expectation in a post-communist context, including Albania, is that *'push'* factors would be a strong motivation for starting-up an enterprise. The fall of industrial production at the start of transition was accompanied by a large number of dismissals from the state sector that were partly absorbed by the SME sector. Creating an enterprise was not just a choice but was often a necessity for those people who had lost their jobs and found this option to be the only way of generating income to maintain their families.

The liberalisation of entry conditions led to the establishment of a great number of new enterprises. The lack of regulations, created a context that acted as a *'pull'* factor in increasing the number of start-ups based on pure arbitrage reasons. In addition, a common feature of

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[13] Entrepreneurs were asked to rate all the possible alternatives on a Likert scale, which ranges from "very important" as a reason to start a business activity to "not important".

socialist economies was the shortage phenomenon, which at the first years of transition meant that there was a market for many goods, and services. This proved to be very profitable for the *would-be* entrepreneurs that in this stage of transition showed very strong Kirznerian entrepreneurial skills.

However, the survey identifies two particular patterns, which can be seen in the chart. First, the fact that enterprises in the sample operate in the manufacturing sector is a signal that *'push'* factors might not have been of crucial significance in the decision to start-up a business since manufacturing is riskier as an activity than other business activities and requires higher start-up capital. The table shows this very clearly with a small percentage (37%) of businesses being in manufacturing because of unemployment. The majority of businesses respond that they are in business as a result of pursuing a satisfactory market opportunity. More specifically, 74% of businesses in the sample consider *'the pursuance of a satisfactory market opportunity'* as *'very important'* and *'important'* reasons to start up their business activity.

The literature on transition considers entrepreneurs in transition as arbitrageurs and also regards the beginning of transition as the period that offered more arbitrage opportunities. This situation suggests that businesses created at the first stage of transition were attracted by higher profit opportunities. Table 5.1 shows that while the number of businesses created for opportunity pursuance reasons is higher than the number of businesses created for other reasons, it can be noticed a slightly higher number of businesses (62%) created before the year 1996 for pursuance of opportunities, compared to 38% created after 1996. These figures, however, might reflect *first*, the general decrease in the numbers of businesses created after the first years of transition; and, *second*, the always present alertness to opportunities in the manufacturing sector.

Table 5.1: Pursuance of market opportunities by year of start-up

	Pursuance of satisfactory market opportunities (Strong reason to be in business)		Pursuance of satisfactory market opportunities (Weak reason to be in business)		Total	
Start up year	Count	Percentage	Count	Percentage	Count	Percentage
Before 1996	48	61.5%	16	55.2%	64	59.8%
After 1996	30	38.5%	13	44.8%	43	40.2%
Total	78	100%	29	100%	107	100%

Note: *"Strong reason to be in business"* is a variable created by answers *"very important"* and *"important"* to the alternative of pursuance of a satisfactory market opportunity and *"weak reason to be in business"* includes all other answers to this.

The data suggest that different types of entrepreneurial behaviour are present in the sample. The first years of transition offered Kirznerian arbitrage opportunities. The years that follow with the introduction of rules and regulations and the increase in competition offer more scope for routine or imitative entrepreneurship, which means that entrepreneurs start using the knowledge accumulated in the market to make it more dynamic.

In addition, another strong reason to be in business evident in my sample was a need for autonomy. Over 66% responded that they are in business because they like to be autonomous. Combined with 42% answering that they were dissatisfied with their previous jobs, gives more explanatory value to this factor. The collectivist culture of communism allowed little space for initiative, self-responsibility and autonomy in work. Individuals were required to learn those skills that would ensure conformity to centrally determined goals rather than the skills required to handle by themselves different uncertain situations (Hofstede, 1991). This situation is a reason why people might consider a small business as a means to be autonomous or to pursue activities that are of more interest to them. The businesses in the sample fulfil this expectation.

Furthermore, the literature on small businesses makes a distinction between those businesses that are created for lifestyle reasons and those that are created as comfort-zone businesses (Bridge et al., 2003). The former is defined as a kind of business which not only facilitates, but also is part of, the lifestyle of the owner. The latter is more associated with those businesses that are in operation to enable the entrepreneur to achieve a certain standard of living with which he is happy and all the decisions related to business growth are linked to this. In the theoretical chapters of this thesis, I made reference to a number of authors (i.e. Scase, 1997; 2002) who consider the majority of businesses in transition economies as being comfort-zone businesses or proprietors. Chart 5.1 shows that this reason is also an important motivator for starting-up a business. 55% of the businesses in the sample consider it to be a 'very important' or 'important' motivator to start up their business activity. To a degree, this can be related to legacies of the communist regimes where the standard of living deteriorated and people were struggling through their connections to achieve a better distribution of goods and power in the society. Now, they have the opportunity to fulfil these materialistic needs.

Nevertheless, it is important that these results are viewed with caution since the factors that motivate businesses' decisions cannot be considered to remain constant over time. Entrepreneurs' attitudes are, to a large extent, affected by the changes in their external and internal environment. Moreover, as this study is a cross-sectional survey, many of the answers

that require businesses to look back at the past might suffer from some inconsistency with the perceptions that businesses had at the previous time.

Another feature of entrepreneurship in transition, as discussed in Chapter 3, has been a lack of interest in capital accumulation and the use of business activities to achieve certain standards of living. To explore this aspect a good indicator of businesses' intentions to grow is how an enterprise makes use of the profits it generates. Enterprises in the survey were asked about how they planned to make use of their profits. Chart 5.2 shows the proportion of enterprises that planned to use their profits for investing in assets for the firm. I have categorised their answers in 4 groups. Group 1 includes businesses that would spend less than 25% of their profits on investment, group 2, those that would spend 25-50%, group 3, 50-75% and group 4, 75-100% of the profits in firms' assets.

Chart 5.2: Use of profits for investment in firms' assets by number of enterprises
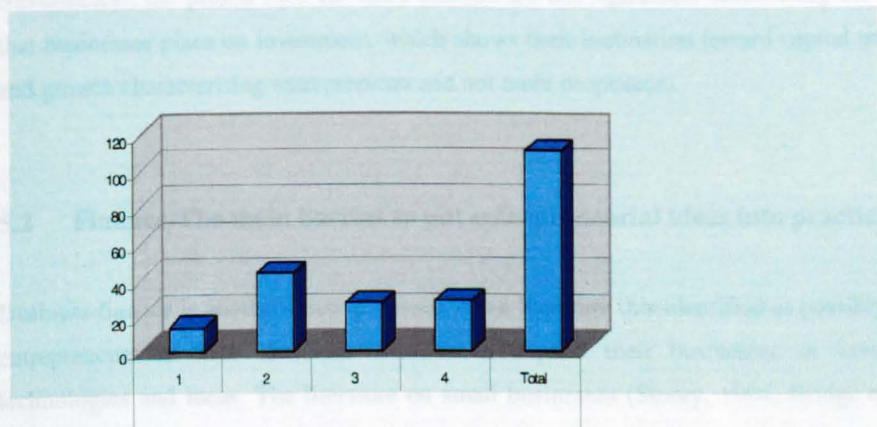
The number of enterprises that would use only 0-25% of their profits for investment is really low, at only 13 enterprises, while 49% of the businesses report that they would use 50-100% of their profits for investment. These results are a good sign that manufacturing businesses in the Albanian context are accumulating knowledge in the market and are trying to improve their businesses. And consequently shows that a process of learning is taking place in Albania. Moreover, businesses located in districts other than Tirana are more likely to invest in their firm assets, because these businesses may be starting to face fiercer competition.

With regard to the other answers businesses gave in terms of the use of their profits, as shown in Table 5.2, it is interesting to notice that 90% of enterprises would use some profit for training activities, which shows that businesses intend to upgrade their capabilities in order to compete better in the market. This factor is another positive sign of the accumulation of knowledge and skills discussed above. The data also show that businesses would use a small percentage of their profits for consumption and savings.

Table 5.2: Other uses of profits by number of enterprises

Categories	Use of profits to repay a loan		Use of profits on training		Use of profits on consumption		Use of profits on savings	
	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
1 (0-25%)	80	73%	100	91%	78	71%	48	44%
2 (26%-50%)	13	12%	4	4%	27	25%	9	8%
3 (51%-75%)	0	0%	0	0%	2	2%	2	2%
4 (76%-100%)	1	0%	0	0%	2	2%	0	0%
Total answers	94	85%	104	95%	109	99%	59	54%
Missing answers	16	15%	6	5%	1	1%	51	46%
Total	110	100	110	100%	110	100%	110	100%

Nevertheless, the profits used for these reasons are not significant considering the importance that businesses place on investment, which shows their inclination toward capital accumulation and growth characterising entrepreneurs and not mere proprietors.

5.2 Finance-The main barrier to put entrepreneurial ideas into practice?

Business finance is another issue discussed in the literature that identified as possibly restricting entrepreneurs in their decisions whether to expand their businesses or invest in new technologies and ideas. The literature on small businesses (Storey, 1994; Bridge et al., 2003) considers them to be under-financed due to the risk and uncertainty related to financing this sector and also due to the collateral based approaches of the banks. Moreover, small businesses prefer not to deal with the issues of control and ownership that come with business growth, which is another reason for their reluctance to use external finance. For this reason, a willingness to accept external finance has been cited (Bridge et al., 2003) as among the characteristics of entrepreneurs that indicates whether the entrepreneur has aspirations to grow his/her business, as accepting equity involvement and sharing ownership eliminate one of the constraints to growth. However, small businesses are mostly financed by their own funds. Otherwise, entrepreneurs may use friends and family as sources of informal finance. In transition economies, this move has also been a trend. The reluctance of banks to take risks

associated with financing this sector and also the tight monetary policies pursued in these countries have contributed to the self-financing of this sector.

In recent years, banks' have become more willing to finance the SME sector in comparison to their reluctance some years ago. Most studies on SMEs in Albania (Muent et al., 2000; Hashi, 2001), do not point to finance as one of the barriers to business growth, due to the use of informal means of finance such as remittances. However, since manufacturing businesses need a large amount of capital to finance their investments and, as I discuss in Chapters 7 and 8, they have been typically starved of capital in transition economies, I discuss business finance as part of my questionnaire. The demand for investment capital is also stimulated by the growth aspirations of the entrepreneurs.

The survey results indicate that Albanian manufacturing enterprises are financed mainly by their own funds. In 2004, the year the survey was conducted, 83 out of 110 manufacturing businesses participating in the survey were financed 100% by their own funds. At the start-up year only 48 businesses were 100% self-funded. These businesses had also made use of other sources, mainly friends and credit lines. Table 5.3 summarises the sources of finance businesses use in six different categories:

Table 5.3: Distribution of enterprises by sources of finance

	Own Funds		Friends		Banks		Credit Lines		Local government	
Finance in categories	*Start up year*	*Now*	*Start up year*	*Now*	*Start up year*	*Now*	*Start up year*	*Now*	*Start up year*	*Now*
1 (0%)	8	1	68	103	93	94	97	101	106	107
2 (1-25%)	4	2	11	3	8	11	3	2	0	0
3 (26-50%)	27	7	23	2	5	3	6	5	0	0
4 (51-75%)	13	6	1	0	1	0	1	0	1	0
5 (76-99%)	8	9	0	0	0	0	0	0	1	1
6 (100%)	48	83	5	0	1	0	1	0	0	0

While the majority of enterprises are financed by their own funds, there is a slight reduction in the number of businesses that rely on friends. Most enterprises have used friends and family as a source of finance only at the beginning of their activities and thereafter mainly rely on their own funds, which suggest their need to have control over their business. Also, there is a slight increase in the number of businesses that have turned to banks for finance. This situation

reflects the gradual change in bank policies toward businesses and also the increasing confidence placed in the banking sector.

For this reason, relationships with banks were another aspect of SME development that my questionnaire explored. One of the questions I asked regarded bank loans and reasons why enterprises would need a loan. Asked if the enterprise is in need of a loan, 53 businesses said that they do not need any loan and 46 of these are businesses funded 100% by their own funds. Not surprisingly, since businesses are in manufacturing, they would like to use the loan for making investments in their businesses. As the graph below shows, 70% of the businesses consider investment in equipment and 64% investment in know how as '*very important*'.

Chart 5.3: Reasons for the need for loans
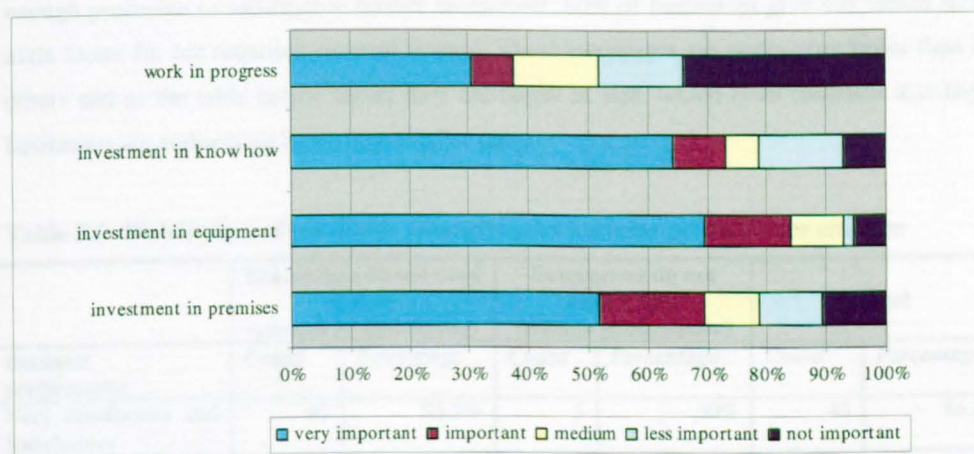
These needs for loans bring forward already known arguments related to technology and knowledge transfer in the manufacturing sector. According to various evaluations, the manufacturing sector is still very weak, obsolete and far from being sustainable in the future.

Exploring this issue of loans further, Table 5.4 below shows that those businesses that have a better performance do not need any further loans. 54% of enterprises in the group of those that report '*very satisfactory*' and '*satisfactory*' business performance do not need any further loans. Within the group of enterprises that report a '*less than satisfactory*' business performance, 70% require a loan for their business activities. This finding suggests that businesses that have strong business performance rely more on internal finance. Besides, entrepreneurs consider finance to

be an important factor in improving their business performance, since those that are performing poorly regard finance as a mean to increase their business performance.

Table 5.4: Relationship between business performance and need for loan

	Business Performance				Total	
	Very satisfactory and Satisfactory		Less than satisfactory			
	Count	Percentage	Count	Percentage	Count	Percentage
Need for loan (Yes)	40	46.5%	16	69.6%	56	51.4%
Need for loan (No)	46	53.5%	7	30.4%	53	48.6%
Total	86	100%	23	100%	109	100%

Note: Results are significant at 0.05 level (Chi square tests)

Looking at table 5.5, businesses that do not need a loan explain this by the fact that they are enough profitable to self-finance further investment. 80% of businesses give this reason as the main factor for not requiring external finance. These businesses are performing better than the others and as the table below shows they are larger in size, which is an indicator that larger businesses are performing better than smaller ones.

Table 5.5: Distribution of profitable enterprises by business performance and size

	Enterprises do not need a loan (enough profits-strong)		Enterprises do not need a loan (enough profits-poor)		Total	
Business performance	Count	Percentage	Count	Percentage	Count	Percentage
Very satisfactory and Satisfactory	41	95.3%	5	50%	46	86.8%
Less than satisfactory	2	4.7%	5	50%	7	13.2%
Total	43	100%	10	100%	53	100%
Size	Count	Percentage	Count	Percentage	Count	Percentage
Less than 50	31	72.1%	60	89.6%	91	82.7%
More than 50	12	27.9%	7	10.4%	19	17.3%
Total	43	100%	67	100%	110	100%

Note: Results are significant at 0.01 for "business performance" and 0.05 level for "size" (Chi square tests)

Whilst many banks and other financial organisations have started to relax some of their criteria with regard to crediting small businesses, they need to see good business plans to process the loan applications any further. Entrepreneurs have often approached banks in an informal way. Attitudes such as "*all I need is the money and I don't need any other form of assistance*" or "*you know me personally why don't you give me a loan*" (NCB) have been very common according to representatives of the NCB of Albania.

However, the perceptions of businesses on the chances of getting a loan on the basis of producing good business plans have changed over time. Asked to comment on the frequency of getting a loan providing they present good business plans, 37 businesses say that 'always' or 'mostly' this is the case and 18 businesses say the same when referring to the year they started their business operations. Nevertheless, start-ups are considered to be greater risks even when they provide good business plans. Businesses that do not have a track record are considered to be high risk. I look at this subject in more detail in Chapter 8, when I discuss the perspectives of donor programmes. Still, Table 5.6 below shows that entrepreneurs feel this issue is a concern and their perceptions on the issue vary according to the age of their businesses.

Table 5.6 shows that in the group of businesses created after 1996, 79% of businesses appear to be rather pessimistic in comparison to 21% that appear to be optimistic about the possibility of getting a loan in the basis of a good business plan. On the other hand, in the group of businesses created before 1996, the proportion of optimists to pessimists is higher (39% towards 61%). This finding shows that businesses that have been in operation longer have already created a track record and find it easier to get external finance on the basis of good business plans.

Table 5.6: Difficulty to get a loan by start up year

	Start up year				Total	
	Before 1996		After 1996			
	Count	*Percentage*	*Count*	*Percentage*	*Count*	*Percentage*
Difficulty to get a loan on the basis of a good business plan (optimistic)	25	39.1%	9	20.9%	34	31.8%
Difficulty to get a loan on the basis of a good business plan (pessimistic)	39	60.9%	34	79.1%	73	68.2%
Total	64	100%	43	100%	107	100%

Note: Results are significant at 0.10 level (Chi square tests)

Taking into consideration the risks associated with SME crediting, it is not surprising that in Chart 5.4 the majority of businesses, 85%, consider the most serious barrier to get a loan to be the high interest rate charged by the banks. As mentioned above, banks have been very cautious in financing the private sector due to problems with bad loans in the past. Also, the commercial rates of interest introduced by them have made the manufacturing sector an unattractive and risky client. The unattractiveness is related to the fact that businesses in the manufacturing sector do not have high rates of return very soon after starting their activities, compared with activities in the sectors of services and trade.

Chart 5.4 Barriers to get a loan
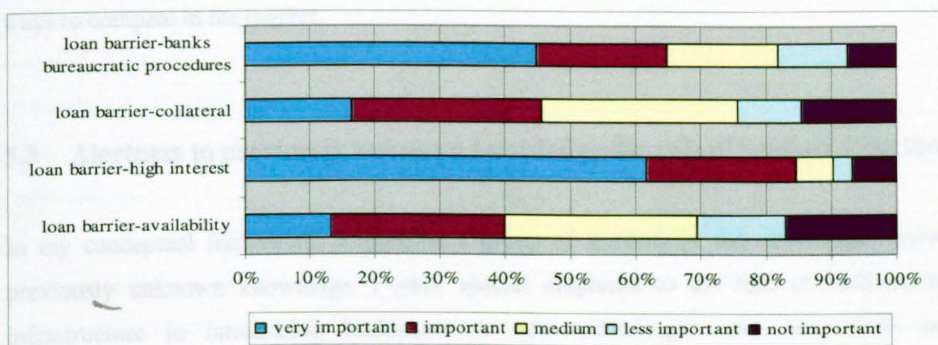
The over cautiousness of banks is sometimes accompanied by lengthy bureaucratic procedures, another major issue mentioned by 65% of businesses in the sample. Moreover, in the early stage of transition, banks in Albania were not prepared to offer a variety of services to businesses. Only in recent years have bank personnel been trained in processing credit applications. Moreover, the process is fairly centralised as one of my interviews illustrates:

> *The decision making process is centralised at the moment. Our branches do most of the job in selecting the clients and they make proposals but they do not give loans themselves. All clients' files from different branches are collected by the credit department and are subject to a deep supervision by the credit analysts. Thereafter, they are presented to the credit committee to take a decision for loans of certain amount. The board of directors takes decisions for the so-called big projects. This is relevant for those projects, which require a capital that is comparable to the bank's capital (NCB).*

This centralisation makes the process of obtaining a loan lengthier hence, the responses of the entrepreneurs who report on the high bureaucratic procedures of the banks. Nevertheless, the increasing competition in the banking sector will most likely make banks reconsider these procedures and offer services that are closer to the needs of their SME clients.

In this section, I showed that businesses rely mostly on their own funds to finance their activities. The assistance of friends and family is more evident at the start of their operations, and once they gain confidence in their business activities, they rely more on their own funds. The majority of enterprises consider themselves enough profitable to self-finance their activities instead of turning to banks for external finance. Moreover, although businesses feel more confident about the banking sector, they still perceive banks as charging high interest rates and adopting bureaucratic procedures. Enterprises perceive the introduction of new technologies and equipment as important. This suggests the dynamism of competition and also the knowledge

diffusion and accumulation that is taking place which requires that the enterprises adopt better ways to compete in the market.

5.3 Alertness to previously unknown knowledge-the role of support structures

In my conceptual framework, I included a group of institutions that encourage alertness to previously unknown knowledge. I gave special emphasis to the role of business support infrastructure in introducing businesses to new technologies and innovations and by encouraging business linkages among themselves and with other relevant organisations. I discussed entrepreneurial abilities as crucial in enabling the entrepreneur to act towards the alerted market opportunities. In this section, I discuss the main types of skills and knowledge businesses need and how the existing business support infrastructure in Albania is fulfilling their needs. My aim in this section is to get some insight on the process of knowledge transmission in the Albanian business community.

Section F of my questionnaire collects enterprises' perceptions in connection to various issues related to business services. The intensification of the competition from domestic and foreign enterprises and increased consumer demands means that enterprises need to increase their capabilities.

Chart 5.5 Business services that are most needed in the Albanian context
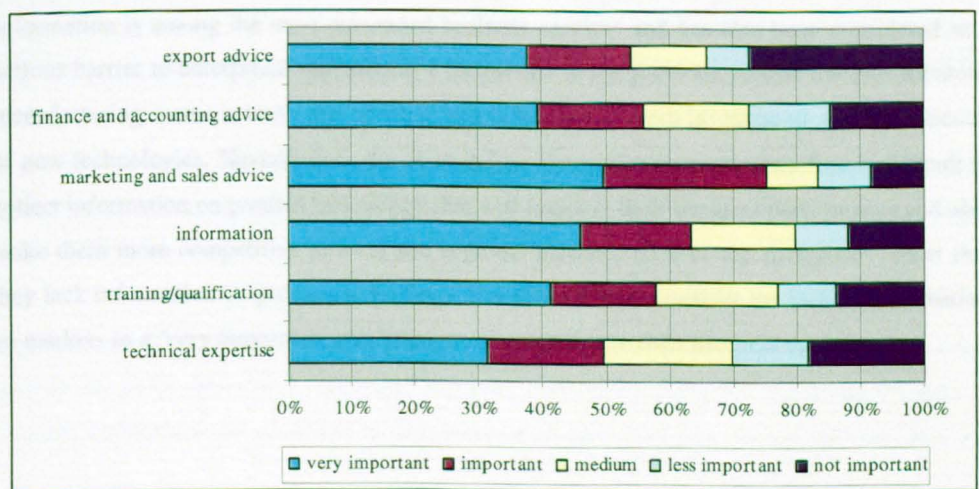
Chart 5.5 shows what business services respondents consider as needed to improve their business performance. For each of the business service alternatives, over 50% of the businesses respond that they are *'very important'* and *'important'* services in improving their business performance. Nevertheless, marketing and sales advice (75%) and information (58%) are the most important services that businesses view as necessary to improve their business performance.

Enterprises located in Tirana are more in need of marketing and sales advice compared with enterprises in other districts. As Table 5.7 below shows, within the group of businesses located in Tirana 82% consider this advice as a *'very important* and *'important'* service compared to 66% of businesses in other locations. This finding can be attributed to fiercer competition in Tirana where a larger number of businesses are located, which brings the need for a better marketing of the products in order to reach certain segments of the market.

Table 5.7 Need for marketing and sales advice by location

	Enterprises located in Tirana		*Enterprises located in all other districts*		*Total*	
	Count	**Percentage**	**Count**	**Percentage**	**Count**	**Percentage**
Marketing and sales business services (strong need)	49	81.7%	33	66%	82	74.5%
Marketing and sales business services (weak need)	11	18.3%	17	34%	28	25.5%
Total	**60**	**100%**	**50**	**100%**	**110**	**100%**

Note: Results are significant at 0.10 level (Chi square tests)

Information is among the most demanded business services and has also been considered as a serious barrier to enterprises' operations. I mentioned in the previous section that the Albanian manufacturing sector is weak and obsolete and is in need of fresh investments and introduction of new technologies. Nevertheless, the chart below shows that entrepreneurs find it difficult to collect information on product technology that will improve their business performance and also make them more competitive in local and regional markets. 65% of the enterprises report that they lack information on product technology and 45% of them consider the lack of information on markets as a *'very important'* and *'important'* constraint to their business operations.

Chart 5.6 Information related barriers by an enterprise perspective
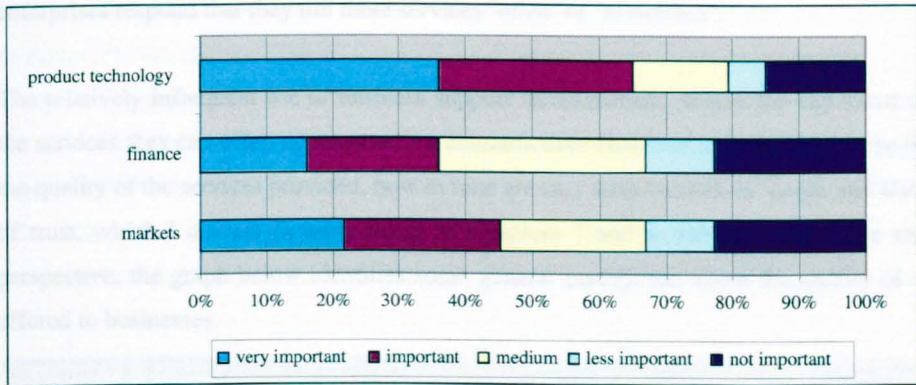
Not surprisingly, businesses that consider lack of information on product technology to be a barrier to their business performance are the ones that use sophisticated technology as a basis for competing in the markets as shown in Table 5.8.

Table 5.8 Relationship between businesses competing on the basis of sophisticated technology and those that consider lack of information on product technology as a barrier to growth

Lack of information on product technology	Sophisticated technology as a basis for competing in the market				Total	
	Strong		Weak			
	Count	Percentage	Count	Percentage	Count	Percentage
Strong constraint	53	68.8%	16	48.5%	69	62.3%
Weak constraint	24	31.2%	17	51.5%	41	37.3%
Total	77	100%	33	100%	110	100%

Note: Results are significant at 0.05 level (Chi square tests)

Thus, 69% of enterprises that compete on the basis of sophisticated technology consider the lack of information on product technology as a serious barrier to their business operations compared to 31% which do not.

So far, I have shown that businesses need a variety of services and that the lack of services is a burden on their operations. However, although businesses recognise the need for various business services, when asked if they use business support structures to receive these services

61 out of 110 enterprises in the sample report that they do not use their services. Only 28 enterprises respond that they use these services *'often'* or *'sometimes'*.

The relatively infrequent use of business support infrastructure, despite the expressed need for the services they can offer, appears to be a contradiction. However, this finding can be linked to the quality of the services provided, how in tune are they with businesses' needs and also, issues of trust, which I discuss in more detail in Chapters 7 and 8. However, from the enterprise perspective, the graph below identifies some general perceptions about the quality of services offered to businesses.

Chart 5.7: Quality of services offered by business support structures
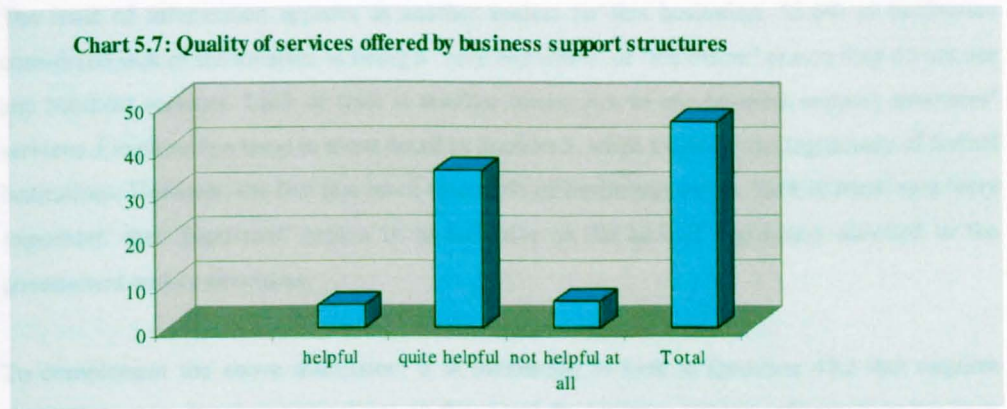
Chart 5.7 shows that 87% of businesses that use business support services consider them to be *'helpful'* and *'quite helpful'*. Those that do not use business support structures' services do it for the reasons outlined in Chart 5.8.

Chart 5.8 Reasons for not using services by business support structures
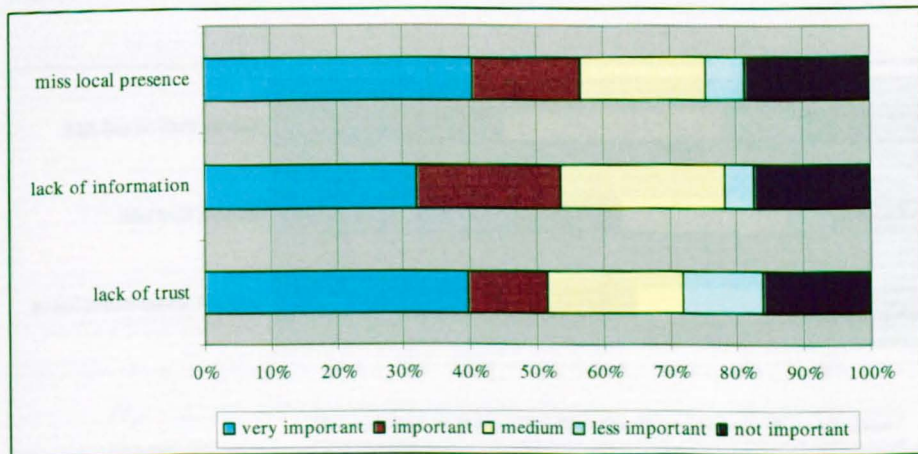
Although the answers for each of the alternatives concerning the use of the business support infrastructure do not differ very much from each other, businesses report that they do not use business services mainly because they lack local presence in the areas these enterprises operate. Many studies report that the business support infrastructure is located in main cities. However, my data does not support the argument that businesses will make more use of the business support infrastructure if they are located in main cities. Businesses selected for my survey are all operating in areas where the RDAs have their offices. This situation suggests other reasons for this hesitation of businesses to use the services offered by the business support infrastructure.

The issue of information appears as another reason for this hesitation. 53.6% of businesses considered lack of information as being a *'very important'* or *'important'* reason they do not use any business services. Lack of trust is another reason not to use business support structures' services. I explore this issue in more detail in Section 5, when I discuss the legitimacy of formal institutions. However, the fact that more than 50% of businesses report *'lack of trust'* as a *'very important'* and *'important'* reason is an indicator of the lack of legitimacy attached to the government and its structures.

To complement the above discussion, it is interesting to look at Question 42.2 that requires entrepreneurs to give their perceptions on the extent the business support infrastructure has been a burden on their business operations. The same concern about the lack of local presence is also reported in this question. 52% of businesses report that this presence is a *'very important'* or *'important'* barrier in improving their growth prospect.

Chart 5.9 Business support infrastructure barriers

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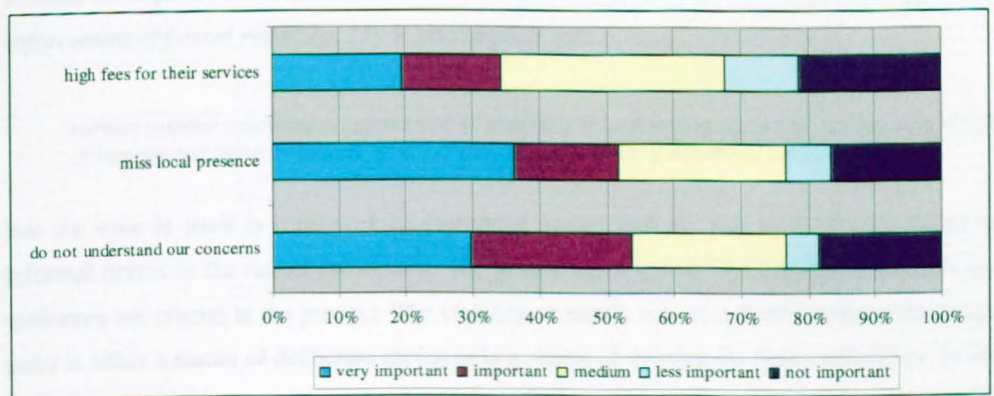
While high services' charge is not a main issue for enterprises, the quality of the services offered to them seems to be the most important concern. 54% of enterprises in the sample do not think that business support structures really understand their concerns. This finding adds to the discussions about the standardisation of businesses services and the lack of the individual entrepreneur's perspective in the process.

My aim in this section has been to show how the alertness to previously unknown knowledge in the manufacturing sector is facilitated by the business support infrastructure. I showed, from an enterprise perspective, that the process of trial and error learning, and thus of knowledge accumulation, is not being well facilitated by the support infrastructure that is currently in place. Although businesses recognised a need for various types of business services, they think that the business support structures miss local presence and also do not understand their concerns. A major difficulty that enterprises expressed was the lack of information on product technology and markets. Enterprises' perceptions are a first indicator about the problems that exist with regard to the support structures that are in place. I discuss these issues in more detail in Chapters 7 and 8, with particular attention to government policies and the features of the support infrastructure that are created in order to implement these policies.

5.4 Mistrust versus the legitimacy of institutions-enforcement characteristics

...if self interested entities are to realise mutual profit in a non-zero-sum game situation, two problems typically must be solved: communication and trust (Wright, 2000; 328)

North (1997) argues that the single most important determinant of economic performance is the effectiveness in enforcing agreements across time and space. Whilst a simple process on the surface, it requires the state to create *"an impartial system of laws and courts for the enforcement of formal rules" (p. 15)*. It also requires the:

> *correct societal sanctions to enforce norms of behaviour and strong normative personal standards of honesty and integrity to undergird self imposed standards of behaviour (North, 1990: 56)*

But the state in itself is a network of embedded agents that are just as much influenced by informal norms as the rest of the society. The behaviour of agents like lawyers, arbitrators and mediators are crucial in the process. The viability of state's role as a third neutral enforcement party is either a matter of deliberate choice or is a matter of missing the right capabilities. In this section I consider the use of formal and social institutions and the degree of legitimacy Albanian

businesses attach to them. I also discuss the behaviour that this mixture of formal and informal institutions induces in the Albanian business context. As I argued in Chapters 2 and 3, in every society there is a bundle of formal and informal rules that coexist with each other but do not necessarily complement each other for a wealth creating game in the society. Whether people choose to use one or the other set of rules is a matter of the reliability and credibility of formal rules as well as of the costs of transactions involved. I discuss these issues based on the perspective and perceptions of Albanian businesses revealed through my survey data.

For this analysis, I distinguish between formal institutional enforcement and self-enforcement as a result of social norms and trust. I start with the latter and build from that on to the non-usage or mistrust of the other. Section H of my questionnaire deals with relationships with business partners and other informal networks that are considered to be important in doing business in Albania. Referring to the survey data, businesses in Albania prefer long-term partners rather than short-term partners. Thus, 56% of respondents say that long-term partners are very important for their business activity. Based on game theory perspectives (Axelrod, 1984), which I discussed in Chapter 2, Section 5.1 repeated exchanges in the market are very important for achieving the self-enforcement of contracts because repeated cooperative exchanges have benefits that exceed the costs of defection. Thus, by dealing with a partner on repeated occasions, the individual can better predict the behaviour of the other party in the exchange process. Taking these arguments into account, it seems that this reason is a good rationale for Albanian businesses to prefer long term partners.

Chart 5.10 Selection of business partners
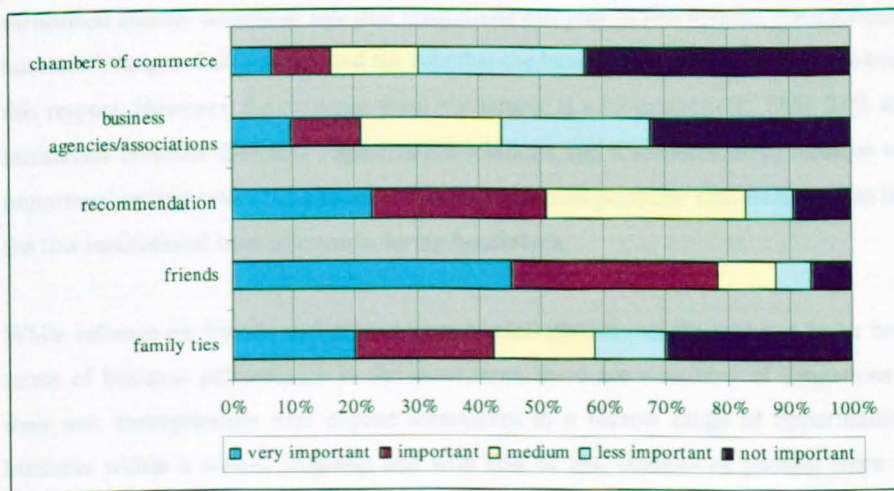
When discussing the work of Axelrod (1984), I pointed out that in order for cooperation to emerge in purely based economic reasoning that yields lower transaction costs, some kind of *'past behaviour'* research was needed especially in terms of making the first decision about with whom to cooperate. I therefore designed a question whose aim was to capture businesses' proclivity toward different possible alternative groups with which they could start cooperation.

An obvious feature, that originates from enterprises being asked, *"On what basis would you choose a business partner?"* (Question 56) is the reliance upon *'personal'* networks when doing business. Chart 10 reinforces the argument of Granovetter (1985; 2002) on the embeddedness of economic objectives in a web of social and cultural factors. 87 % of enterprises in the sample report friends as the most important group from which they would choose their business partners. By choosing friends, they avoid the problems that come with the lack of knowledge and information about the parties in the exchange that are crucial in starting cooperation with a partner. This knowledge creates some confidence in the other person's behaviour based on the life experiences of the individual and on certain positive experiences that facilitate decisions about a potential business partner.

Rather than a calculative decision, the decision to choose a friend can be interpreted as a trust-based decision. The evidence on the issue of collective trust reinforces this assumption. 51% of the enterprises in the sample can be considered as having collective trust, since they consider it to be very important to choose a business partner through recommendations. This activity means that they do not rely only on their personal knowledge about somebody, but also on a broader social network. When I discussed alertness to previously unknown knowledge, I mentioned another important role that institutions can play in this respect, the encouragement of business linkages. I also mentioned the role that the business support infrastructure could play in this respect. However, the evidence from my sample is a bit pessimistic. Only 21% and 16% of businesses consider Business Agencies/Associations and Chambers of Commerce to be *'very important'* or *'important'* as a means of finding business partners. This finding is an indicator of the low institutional trust of manufacturing businesses.

While reliance on friends and other recommended partners might turn out to be beneficial in terms of business performance in the short term, there are a number of limitations related to their use. Entrepreneurs who expose themselves to a narrow range of opportunities conduct business within a narrow in-group and with risk of low chances of gaining more innovative knowledge. Nevertheless, only 41% of businesses would rely upon family ties to find business

partners. Business with family members very often is accompanied by problems not only in terms of skills, but also in terms of other obligations that are linked to doing business with family members.

Going back to the issue of low institutional or systemic trust of Albanian entrepreneurs, another strong indicator that the survey reveals are the agreements they use with their partners. Asked whether they use oral or written agreements, businesses answer as following:

How do you connect to your partners?	
through written agreements	19%
through oral agreements	52%
one or the other depending on the partner	29%

The fact that the majority of the businesses rely on oral agreements means that either businesses have total faith in the partners they do business with, as it could be the case with friends or relatives, or that businesses do not have any confidence that the third party enforcement in place is impartial, fair and efficient. Moreover, I tested the data for any possible significant patterns on the choice of oral or written agreements based on the year of starting up the activity, the size of the businesses, location as well as trust in business partners. In terms of years of starting the activity, the beginning of transition was more characterised by a lack of formal rules.

Thus, one assumption might be that the stability in rules and their concurrent higher predictability might lead one to expect that businesses that were created in a later period might have more incentives to rely on formal contractual agreements with their partners. Alternatively, businesses that have been in operation longer have developed their business partnerships and might be more trustworthy.

In terms of stages of development of a business, one assumption is that as the enterprise gets larger, the number of partners or suppliers might increase, and they are not always part of personal contacts, which might lead one to think that larger businesses would be more interested in working on a formal contractual basis. Location was another variable of interest, since different cities offer different opportunities for doing business.

Table 5.9 Relationship between contractual agreements and firm characteristics

	Connection to business partners							
	Written agreements		Oral agreements		One or the other		Total	
Start up year	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Before 1996	12	57.1%	22	40.7%	19	63.3%	63	60%
After 1996	9	42.9%	32	59.3%	11	36.7%	42	40%
Total	21	100%	54	100%	30	100%	105	100%
Size	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Small Business	13	68.4%	26	52%	17	58.6%	56	57.1%
Medium Business	6	31.6%	24	48%	12	41.4%	42	46.4%
Total	19	100%	50	100%	29	100%	98	100%
Location	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Tirana	9	42.9%	36	63.2%	13	43.3%	58	53.7%
Other districts	12	57.1%	21	36.8%	17	56.7%	50	46.3%
Total	21	100%	57	100%	30	100%	108	100%
Trust in business partners	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Strong	19	90.5%	44	77.2%	26	86.7%	89	82.4%
Weak	2	9.5%	13	22.8%	4	13.3%	19	17.6%
Total	21	100%%	57	100%	30	100%	108	100%

In Table 5.9, I show the distribution of businesses by the variables I discussed above. None of the relationships presented above are significant which means that it is difficult to establish a pattern on the decisions of enterprises to rely on various forms of contractual agreements based on these firm characteristics. However, one conclusion is evident. Enterprises in the sample rely mostly on personal trust, which is not only obvious by the large number of those relying on oral agreements, but also because of the trust they place in business partners. As the table shows, 82% of businesses have strong trust on their partners. In this group, 17% respond they 'always' trust their business partners, whilst respectively 34% and 31% of them say they trust them 'mostly' or 'frequently'. Thus, this finding is a good indicator of personalised or collective trust in business partners providing that the majority of the businesses in the sample work on the basis of oral agreements.

However, as I mentioned before, if businesses need to pass from social networks to broader networks of impersonal exchange that are real world cases, where individuals have incomplete information and the exchange is not repeated, the third party enforcement is indispensable. In this regard, I discuss third party enforcement in Albania. Section G of my questionnaire deals with the perceptions of businesses about formal institutions. Being asked about the judiciary system and the courts, the answers of businesses give some insights in the perceptions of entrepreneurs and their consequent behaviours. 73% of businesses in the sample agree that the unpredictability of the judiciary is a problem for their business operation.

Moreover, when asked if they would go to court to resolve any disputes they might have with their partners, only 18% of businesses respond that they would *'always'* or *'mostly'* go to the court in case of business disputes. However, the data do not show any significant associations between the fact that businesses are using oral or written agreements or, the trust in their business partners, which means that the general perception of the courts is negative. Enterprises do not trust the institution of the contract and its enforcement characteristics, so they use it only in very rare cases, reflecting the inefficiency of formal institutions in Albania.

This prevailing perception of the Albanian enterprises about courts is given in the answers below, with a majority of businesses agreeing on the lack of fairness, honesty and affordability of the courts:

	fully agree	agree in most cases	tend to agree	tend to disagree	disagree in most cases	strongly disagree
Courts are fair and honest and this has facilitated my business operation	2%	7%	13%	38%	18%	22%
Courts are quick and affordable in resolving business disputes	0%	4%	8%	41%	20%	27%

These same results are complemented by other studies conducted in Albania such as FIAS (2003) that concluded that one of the worries businesses have is the long time and the high costs they have to endure in the process of judicial dispute resolution, including the difficulties presented by the execution of court decisions.

Thus, it seems that the general perception is that the reliance of agents on the court is uncertain and that they would act in their own interests rather than those of society in general. These answers put in doubt the integrity and honesty of the judges, which reflects the immorality of transition. This situation is multiplied by the ambiguity of the laws concerning business operations. Not only have these laws been continuously changed, but also at the same time they have not been very clear in their aims. Businesses report that during the time they have been in operation, they have had to deal with unexpected changes in rules, laws or policies that have affected their businesses. In this context, only 33% of businesses respond that these changes have been predictable which suggests that these formal institutions do not reduce uncertainty, which is one of the functions of the institutional framework.

Moreover, businesses do not seem to have a voice in the decisions taken by the government.

	Always	Mostly	Frequently	Sometimes	Seldom	Never
Governments have ensured to inform the businesses affected by new rules or policies	3%	10%	7%	17%	39%	24%
Businesses are not only informed about changes in laws or policies that affect the business operation but their concerns voiced directly by them or business associations are taken into account.	0	1%	4%	25%	30%	40%

13% of businesses think that the government *'always'* or *'mostly'* ensures that the business community is informed about changes in legislation or policies. The figures enterprises report, are low when they are asked if there is any voice for the business community or the associations they are represented by, in designing laws and policies that will affect businesses. As shown in the table, only 5% of businesses think that their concerns are taken into consideration *'mostly'* or *'frequently'*. I discuss this issue in more detail in Chapter 7 that deals with the government policy on SMEs and its policy initiatives.

In addition, to complement my discussion in Sections 2 and 3 about businesses' tendency toward capital accumulation, I will refer to the answers that businesses gave in terms of the role that costs of compliance with rules and regulations play in their decision whether to carry out an investment or not.

	Yes	No
Have you ever decided not to make a major investment because of government regulations?	38%	62%

Businesses that responded *'yes'* to the above question say that it is because costs of compliance are too uncertain for investment planning, which reflects my theoretical discussion that institutions should reduce the uncertainty of entrepreneurs.

Another issue explored in the questionnaire that can give some insight in the sophistication of the exchange process in the Albanian context is that of assistance. Businesses were asked to rank some possible sources of assistance they would rely upon in times of need. Unsurprisingly,

the answers show that businesses in Albania are more prone to personal and collective forms of assistance rather than institutional forms.

Friends are ranked highest (94%) in terms of businesses assistance in case of need by the Albanian entrepreneurs. This finding may reflect the assurance, the information or knowledge, that the business has about friends or family ties. Considering the insecure environment in which businesses operate in Albania and the weak enforcement, forms of personal exchange are often safer than impersonal exchange. Business agencies and Chambers of Commerce are rated very low by Albanian businesses. This finding is consistent with the previous answers about the use of their services, their helpfulness and also the lack of information on their services.

Chart 5.11 Possible sources of assistance of Albanian businesses
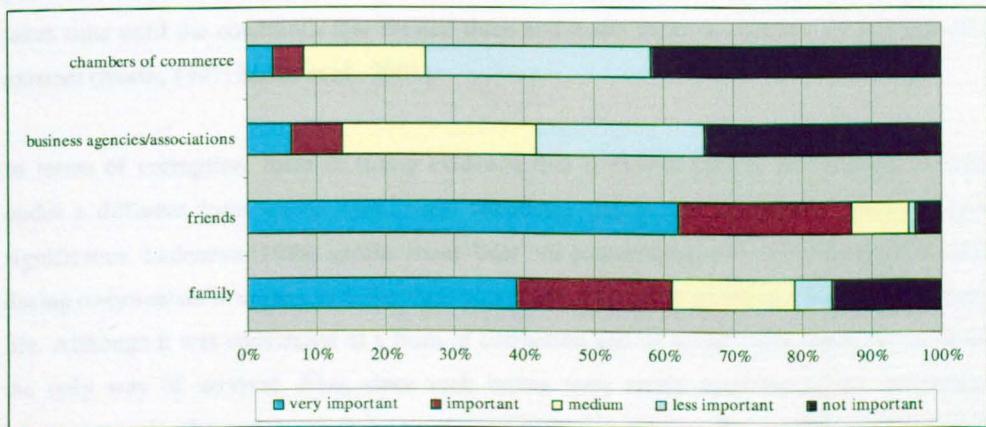
In this section, I showed that enterprises are hesitant about using formal institutions. They think that the government does not take their concerns into account and the government regulations have been a major determinant of how they make their investment decisions. It is interesting to observe that the way of doing business is quite informal since the formal institutions are hardly given any credibility. The majority of enterprises in the sample rely on oral agreements and they think that courts are unfair, partial and inefficient. In general terms, enterprises have more personalised trust than systemic trust which was made clear regarding the use of friends for doing business as well as for assistance, instead of state or other formal structures. In the next section, I focus on the different behaviours that enterprises have adopted in order to cope with the inefficiencies of institutions. I give a special emphasis to corruption and moral attitudes of enterprises.

5.5   Nothing is legal but everything is possible-Exploring the non-compliance behaviours of Albanian entrepreneurs

Law is like a door in the middle of the field. You can go through it if you want to, but you don't have to. (Rose, 2002: 44)

The economic and moral chaos that accompanied transition to a market economy had among its features an increase in the levels of corruption. The most mentioned argument for the increase of corruption is that based on institutional perspective and path dependency. According to that argument, people in the post-communist countries experience the present whilst carrying the baggage of the past with them and do not often adopt new behaviours and new thinking. The legacies of the communist past such as the interventionist state and the inherited discretionary power of officials do not just fade away. These legacies adjust to current conditions but this takes time until the conditions that created them and made them sustainable are not any more existent (North, 1997; Miller et al., 2001).

In terms of corruption, there is strong evidence that it existed during communism although under a different form where kinship and friendship ties were considered to have a higher significance. Ledeneva (1998) speaks about *'blat'*, or connections, as a very important element during communism in coping with the shortages or the scarcity of goods and the uncertainties of life. Although it was considered as a form of corruption and its social costs were known, it was the only way of survival. Also, since cash bribes were rarely involved in the transactions between people, the social acceptability of corruption was greater. But, in the post-communist world, the perception of corruption has changed very much and its social acceptability has decreased. Corruption has been monetarised during the period of transition with *'blat'* being substituted by bribes.

Transition brought high rates of unemployment, poverty and social inequalities. Also, the lack of the rule of law, the deficiency of the public officials, and the lack of motivation and clear responsibilities has further increased the incentives for corruption. The inequalities of wealth during transition have created the means to pay bribes and the inequalities of power have created the means to extort them. I discuss these issues in this section with an emphasis on the business community. The questionnaire data show that businesses in Albania have to make additional extra payments to public officials in order to get things done and 66% of the enterprises consider this as being common in their day-to-day activities. Also, 82% of the

businesses respond that this payment ensures that the service gets done, as shown in the answers of enterprises about the frequency of the activity referred in the statements given to them.

This is true:	Always	Mostly	Frequently	Sometimes	Seldom	Never
"It is common for firms in my line of business to have to pay "additional payments" to get things done."	15.5%	18.2%	26.4%	23.6%	10.9%	5.5%
The "additional payment" ensures the delivery of service as agreed."	17.3%	24.5%	40%	11.8%	2.7%	2.7%

While during communism corruption was a centralised phenomenon, in post-communist Albania is order to get things done one has to bribe the entire chain. It seems as if everybody wants to have *a piece of the cake* and moral values are disregarded considering the circumstances. According to businesses in my sample, all the officials are the same; their personal interests have become business interests so, in order to get things done businesses have to bribe them all. My 2004 survey data show that businesses do not perceive a single official as giving them the correct treatment. Only 26% of the businesses think that this might be the case as evidenced in their answers below:

This is true:	Always	Mostly	Frequently	Sometimes	Seldom	Never
"If a government agent acts against the rules I can usually go to another official or to his superior and get the correct treatment."	4.5%	10.9%	10.9%	17.3%	34.5%	20.9%

In this context, this process of bribing the whole chain has become very costly. One entrepreneur in Korca said:

> *I can't pass my goods through the customs unless I pay each of the customs' inspectors individually. They say that it is better to pay them than to stay there for a whole week and to pay for accommodation, food etc... (Entrepreneur in Korca)*

The uncertainty and instability that has characterised transition in most post-communist countries have contributed to the short-term horizons of the individuals. This finding is most notable in the public administration due to the lack of clear responsibilities and motivation as mentioned previously. According to Baumol (1990) this situation dates back to Medieval China or to the Romans.

> *Corruption, which is widespread in all impoverished and backward countries, was endemic in a country where the servants of the state often had nothing to live on but their meagre salaries (p. 902).*

Moreover, in Albania each time a party comes into power, it fires all the previous employees and hires its supporters. Although there is a law on civil service, the truth is that it is interpreted subjectively, as randomly happens with other laws, and rarely the brightest people are appointed in these posts.

This situation has created certain attitudes in public officials that *today's goose is seen more clearly than tomorrows' golden eggs*. Thus, as they see themselves as being only temporarily in a job, they try to use the post as an opportunity to gain personal benefits. Moreover, businesses report that from the time they have started their business operation, the difficulties in dealing with government officials have increased. 51% of businesses in the sample say that difficulties dealing with them have increased. Table 5.10 below shows a very interesting relationship of the difficulties reported by enterprises and the year they have started their operations.

Table 5.10 Difficulties in dealing with government officials by the year of start up

	Start up year				Total	
	Before 1996		After 1996			
	Count	Percentage	Count	Percentage	Count	Percentage
Difficulties with government officials (Major Problem)	38	59.4%	17	39.5%	55	51.4%
Difficulties with government officials (Not a problem)	26	40.6%	26	60.5%	52	48.6%
Total	64	100%	43	100%	107	100%

Note: Results are significant at 0.05 level (Chi square tests)

Table 5.10 shows that among enterprises established before 1996, there is a higher percentage of businesses that report that difficulties with government officials have increased (59%) compared to the respondents from the group of enterprises created after the year 1996 (40%). One possible explanation can be related to the range of laws and regulations introduced after 1996 that have not been accompanied by the right and clear responsibilities of public officials, which can be reflected on the public's administration attitudes towards businesses.

Thus, to take only one example, the fiscal legislation that is a large concern of enterprises in Albania contributes to this problem, as it gives much power to the Tax Directorate, in terms of

developing fiscal policies instead of only implementing them. In this way a conflict of interests is created. Also, the laws leave space for various subjective interpretations as I discuss in more detail in Chapter 7. This finding can explain the rather lengthy comments of entrepreneurs regarding the arbitrariness and arrogance of customs or tax authorities. One entrepreneur in Elbasan mentions:

> *I am not able to pay tax inspectors a monthly salary as many of my competitors do, so that they won't disturb me with controls or that notify me when other inspectors are coming over (Entrepreneur in Elbasan).*

All these features make businesses very cynical toward not only the state structures, but also the new rules of the game. They have contributed to the creation of mischief, distrust and inequality of opportunities.

Entrepreneurs' Real Life Experiences

A beverage manufacturer told this story:

The fiscal inspector found me some alcoholic drinks; I had produced without the excise stamp. This was a good reason for both of us to compromise on the issue. So, we agreed that I (the producer) would pay him 10.000 Lek a month in order for the tax inspector not to be a burden for my activity and to sell my alcoholic drinks without the excise stamp.

However the story became complicated when another tax inspector that had a similar deal with another beverage producer, competitor of mine, put pressure on the other inspector I had a deal with, about me, the producer he had "under protection". Since the situation was very difficult I find myself taking the decision to go to court. I had some witnesses that had seen the tax inspector getting money from me, so I won the court case. However, since that time I am being subject to continuous tax inspections, which have made my activity even more difficult than before.

It is impossible to survive in this environment if you do not try to avoid certain business obligations because there are many other producers that do the same or falsify their products.

5.5.1 The other side of the coin. Are businesses immoral or victims of circumstances?

Disrespect of formal regulations is a very common phenomenon in transition economies. In societies where new rules and regulations coexist with informal ones and when the circumstances, conditions and, the perceptions and belief systems to replace them are not yet viable, people feel more comfortable in using the older ways of behaviour. In societies where there is over-regulation and little effective enforcement of regulations, the tendency to use informal means is even higher.

I mentioned in Chapter 1 that the informal economy in Albania makes up one third of all economic activities. In addition, the collection of taxes is very low. Does this mean that businesses are immoral in Albania? The (im)morality of transition is a very interesting issue, which I try to explore with reference to the business community through one section of my questionnaire. In this regard, questions 45-49 capture some of businesses perceptions on this issue and also how they understand their role and that of the government in the process. I discussed before that businesses in the sample use informal ways such as additional payments or bribes to get away with things. At the same time, they were asked if they would use the opportunities presented to them in avoiding different regulations. Chart 13 shows that the percentages of those businesses that say they would do this *'seldom'* or *'never'* is quite high in comparison to other responses on the frequency of evasion happening. While answers to these questions might be taken cautiously due to the sensitive nature of the question, it is interesting to see that businesses have a higher incentive in cheating on profit (44%) or social security taxes (46%) than cheating on any other type of regulations, which highlights the problems that exist in the fiscal legislation.

Chart 5.12 Commonality of exploiting opportunities to cheat on formal regulations
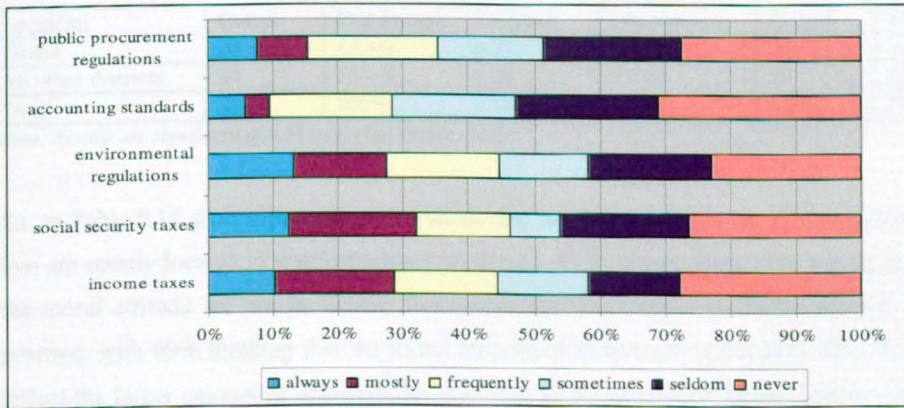
Moreover, due to the legacies of the communist period, entrepreneurs in transition economies are greatly associated with speculators. The rising social inequalities in a society where people shared communistic values and feelings of security, have also contributed in viewing entrepreneurs through immoral lenses. Entrepreneurs themselves do not think that immorality or regulations' evasion are the norms for business success, although they do accept that Albanian businesses do not have a high moral attitude.

"The moral attitude of Albanian businesses toward formal institutions is low"	fully agree	agree in most cases	Tend to agree	tend to disagree	disagree in most cases	strongly disagree
Current year	12%	11%	31%	30%	15%	1%
Five years ago	19%	13%	24%	28%	15%	1%

As it can be seen in the answers above, 54% of Albanian businesses in the sample agree that the moral attitude of Albanian entrepreneurs is low. The table also shows that the number of businesses that are at some sort of agreement with the statement it is the same when the question is asked for the year of the survey and for five years ago. What seems to differ is that the number of businesses that fully agree with the statement has dropped, which could be a positive sign that businesses see a difference in the way they operate. Another interesting result is that enterprises that agree that Albanian businesses are immoral tended to be in districts other than Tirana. I show in Table 5.11 below the relationship between businesses that say that the moral attitude is low and the district they are located.

Table 5.11 Perceptions about moral attitude by location

	Perceptions about moral attitudes (negative)		Perceptions about moral attitude (positive)		Total	
Location	Count	Percentage	Count	Percentage	Count	Percentage
Tirana	25	42.4%	35	68.6%	60	54.5%
All other districts	34	57.6%	16	31.4%	50	45.9%
Total	59	100%	51	100%	110	100%

Note: Results are significant at 0.01 level (Chi square tests)

So, as Table 5.11 shows, businesses that think that the moral attitude of Albanian enterprises is low are mostly located in districts other than Tirana. 58% of businesses that are negative about the moral attitude are not in Tirana. Businesses that are located in Tirana seem to be more positive, with 69% thinking that the moral attitude of businesses is not low. This finding may reflect the larger amount of opportunities that exist in the district of Tirana, fiercer competition and thus a greater need to operate by the rules of the game.

However, when asked if the objective of profit maximisation is enough in order to evade the formal regulations, only 4% of them 'fully agreed' with the statement and 9% and 13% of them said respectively that they 'agreed in most cases' or 'tended to agree'. So, the majority of the businesses in the sample do not think that it is a legitimate action. However, they do not give legitimacy to these formal institutions and legitimacy is the core for the credibility and stability of institutions as I have discussed throughout this thesis. When asked if they evade because of

mistrust in the government, 78% of them respond that it *'frequently'*, *'mostly'* or *'always'* happens because of mistrust toward government and its structures. This finding reflects what Miller et al. (2001) call *"victims of circumstances"* model of corruption.

During communism, the state removed any kind of responsibility from the individuals so they had a pre-ordained way of life and did not decide for themselves. In a market economy, the state is a partner that makes sure to create the necessary framework or environment for people to make their decisions and to operationalise them. However, the legacies of the past and the experiences of transition have created a kind of relationship between the state and businesses where the latter think *"state sees them as cows to milk"* (Entrepreneur in Tirana). The manufacturing businesses in my sample when asked about the government and bureaucracy responded as follows:

"In general how would you consider state and bureaucracy in doing business?"	Helping hand	Neutral agent	Grabbing hand
Now	6%	35%	59%
Year of start up	12%	43%	45%

Enterprises' responses show that 59% of the enterprises in the sample have a considerable mistrust in the government and its ability to help businesses in their activities at the time the survey was carried out. These figures are slightly higher than those about businesses' perceptions on the government at the year they started their business activity. Looking further at perceptions about the state, it seems that current perceptions are influenced by the year the enterprise started its business operations. As Table 12 makes clear, those businesses that are created before the year 1996 have an inclination toward thinking that state is a *"grabbing hand"* (66%), which is also consistent with the answers that businesses gave in terms of difficulties with government officials.

Table 5.12 Businesses' perception on the state by the year of starting up a business activity

	Location				Total	
	Before 1996		After 1996			
	Count	Percentage	Count	Percentage	Count	Percentage
Business Perceptions on the state (Grabbing hand)	41	66.1%	20	46.5%	61	58.1%
Business perceptions on the state (Neutral or helping hand)	21	33.9%	23	53.5%	44	41.9%
Total	62	100%	43	100%	105	100%

Note: Results are significant at 0.05 level (Chi square tests)

Furthermore, it is widely argued (Colombatto, 2002) that it cannot be taken for granted that individuals in Central and South East Europe have the willingness to accept the principles of the market economy, such as self determination and individual responsibility, because they still like certainty and stability in their lives which the previous system would offer them. However, the inertia of informal institutions is somewhat exaggerated, because individuals would use behaviours that are path dependent, but at the same time will embrace innovative behaviours that prove to give more desirable results than the old and familiar informal norms of behaviour. The experience of transition economies so far has shown that there are many entrepreneurial people, but their activities are often not productive or are adapted to very simple market conditions.

This situation means that the system of incentives in the society is not the right one for channelling resources in productive uses that add value to the economy. North (1990) argues that the kind of behaviours, information and knowledge required by an entrepreneur are very much influenced by the institutional context. In these terms, the behaviour one sees at firms is the one deemed more appropriate in the environment they are operating.

Chart 5.13 Factors for business success
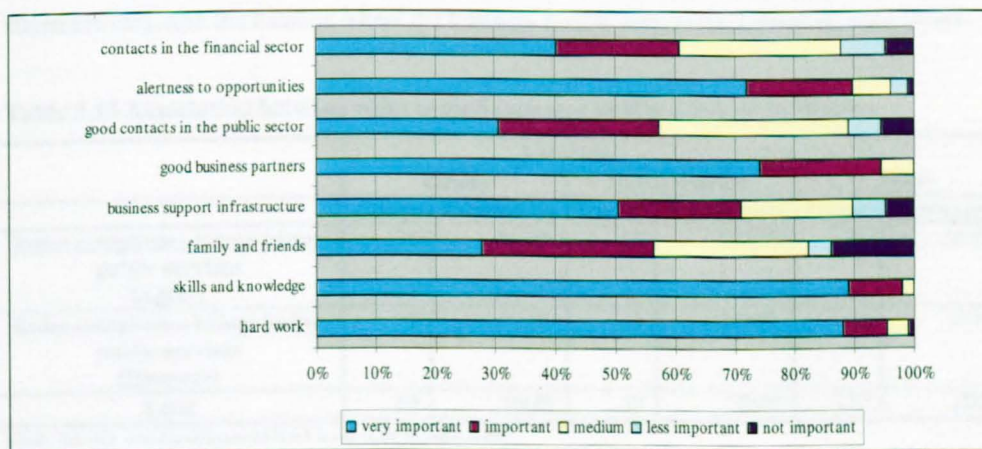
Chart 5.13 above shows that Albanian businesses know that to be successful they need to work hard. 95% of them think this factor is a '*very important*' or '*important*', 98% of them think that 'skills and knowledge' is a '*very important*' or '*important*' factor, 94% of them think that 'good business partners' is a '*very important*' or '*important*' factor and also they need to be alert to opportunities, with 90% of them thinking that this is a '*very important*' or '*important*' factor.

These answers provide evidence that businesses have embraced the values of capitalism and understand what are the available resources and, if there were signals of accountability or willingness to set the game right by the government and its structures, they would play by the rules instead of using informal means that do not prove productive in the longer run.

In addition, another way the government shows its commitment and also builds credibility is through the use it makes of tax revenues. Enterprises need to see that the government is making efforts to create the necessary infrastructure for entrepreneurship. Question 49 asks enterprises to comment on the relationship between government spending on public services and enterprises' compliance with rules. Enterprises in the sample seem to agree that compliance with formal institutions means better public services offered by the government.

In simple numbers of enterprises, it can be seen that 61% of enterprises agree that if businesses comply with formal regulations they will benefit from better public services. Yet, it is interesting to see that this number has increased compared with what businesses' perceptions were about the same issue five years ago. Asked about the same statement five years ago, 51% of enterprises are in agreement with it, but only 15% of enterprises *fully agree'* with the statement compared to 22% in the year of the survey. Nevertheless, these perceptions about this statement vary with the location where the business is operating as the following table shows.

Table 5.13 Association between rules compliance and public services by district

	Location				Total	
	Tirana		Other districts			
	Count	Percentage	Count	Percentage	Count	Percentage
Rules compliance brings better public services (Agree)	31	51.7%	36	72.0%	67	60.9%
Rules compliance brings better public services (Disagree)	29	48.3%	14	28.0%	43	39.1%
Total	60	100%	50	100%	110	100%

Note: Results are significant at 0.05 level (Chi square tests)

Table 5.13 shows that 52% of businesses located in Tirana agree with the statement compared to 72% that agree with the statement in other districts. The disparity in terms of public services in Tirana and other cities it is noticeable with a better infrastructure in Tirana. However, this disagreement by businesses with the statement can be based on two possible explanations. *First of all,* businesses in districts other than Tirana might evade more which is why they tend to

believe that in case they would contribute more to the government's budget they would receive better public services. *Second,* although businesses in Tirana operate in an apparently better environment they face higher competition and are more demanding of the government in terms of the services that would facilitate their business activities.

In this section I showed that corruption is a phenomenon that enterprises encounter often. However, it seems that they have learned how to cope with this problem by bribing officials or by cheating on a range of formal regulations. Nevertheless, I also discussed that businesses have embraced various business values and they know that these are the prerequisites to be successful rather than corruption. Moreover, they have mainly adopted these behaviours because of mistrust in formal institutions and difficulties in coping with government officials.

Conclusions

In this chapter, I discussed the prevailing formal and social institutions in Albania and the kind of behaviours that they induce in entrepreneurs from enterprise survey evidence. I showed that Albanian manufacturers enter business in order to pursue satisfactory opportunities in the market. Enterprises show their inclination toward capital accumulation and, new skills and knowledge. Also their attitude toward external finance, such as banks, is more positive compared with the period when they started their activities, which is another indicator of businesses willingness to grow.

However, as I showed in the course of the chapter, businesses face difficulties in using new technologies and gaining information on products and markets. These difficulties are further multiplied by a system of formal institutions to which they give little legitimacy, by government and public officials that have negative attitudes towards them, and who operate under a poorly defined set of responsibilities. I also showed that businesses have adopted various strategies to cope with the deficiencies of the formal institutional system. One strategy is to rely upon personal contacts rather than institutional contacts. This strategy is demonstrated through the choice of contractual agreements, business partners and sources of assistance. The other strategy is the use of corruption and through cheating formal institutions.

However, two different types of attitude are found in the Albanian environment. The *can do it on my own* attitude, which to a degree explains the reluctance of businesses to use other forms

of help apart from those given by families or friends and the *outward looking* attitude that is related to more entrepreneurial people whose perception of opportunities is more progressive and have other intentions toward their businesses and have adopted new behaviours more quickly. It seems from the findings of this survey that Albanian businesses know what real business values are. They realise that they cannot build their reputation by evading formal institutions. This finding suggests that their behaviour is not just a legacy of the communist past, but a response to the problems that exist in the formal institutional infrastructure in Albania.

In the next chapter, I utilise the business behaviour and perceptions from the survey to explain patterns of business growth. Many variables combine to create their overall impact on growth. In the next chapter I show the simultaneous effect of these different variables on business growth through an econometric analysis of the survey data.

CHAPTER 6

AN EXPLANATORY ANALYSIS OF BARRIERS THAT AFFECT SME GROWTH: EVIDENCE FROM AN ENTERPRISE SURVEY

Proleptically, I would say that whether we can measure something depends, not on that thing, but on how we conceptualise it, on our knowledge of it, above all on the skill and ingenuity, which we bring to bear in the process of measurement, which our enquiry can put to use.

(Kaplan, 1964)

Introduction

In Chapter 5, I identified some of the main behaviours and perceptions that exist in the Albanian business context with regards to the institutional environment, both formal and informal, and the opportunities for entrepreneurship they offer. I showed that in a post-communist setting there is space for productive entrepreneurship and for entrepreneurs who pursue business opportunities from choice rather than necessity. During more than fifty years of communism, private activities were banned. However, the way is now open for entrepreneurs to fulfil their needs for accomplishment and autonomy. Nevertheless, in Chapter 5 I showed how Albanian entrepreneurs operate within a hostile institutional environment which creates incentives for the substitution of formal ways of doing business with informal ways, based on a reliance on trust and social capital. It often happens that unproductive behaviours are amongst the best strategies entrepreneurs have adopted to cope with the deficiencies of the system.

Furthermore, in Chapter 5 I also focused on general trends and characteristics of the institutional environment and identified the main characteristics of Albanian businesses and the perceived barriers that they face. In this chapter I go on to discuss the influence of these perceived barriers and characteristics on business performance, in particular on business growth. In this respect, in this chapter I provide two main contributions to existing research. *First,* by using the institutional theory (North, 1990), I outline a model, which I introduced in the methodology chapter, that conceptualises the effect that institutions have on entrepreneurial behaviours that are translated into decisions about business growth. *Second,* based on the survey data, I test in this chapter the effect of different sets of determining factors on business growth. In this chapter, I employ regression analysis to answer the main question:

Which perceived institutional barriers to business operation most affect business growth? How do the intentions and abilities of entrepreneurs moderate this effect?

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I start this chapter with a brief review of my theoretical conceptualisation, emphasising my model of entrepreneurial behaviour under a particular institutional environment. I also present a brief discussion of other similar studies and the variables they have used to explain growth. The aim of this section is to also show what novelties my model brings in explaining entrepreneurial behaviour and business growth. In Section 2, I move on to a discussion of my growth variables. In Section 3, my discussion becomes more technical, explaining some of my decisions about barrier variables in my questionnaire and the statistical analysis I used for my sample. I discuss principle component analysis, which I use to avoid multicollinearity problems in the regression analysis and, subsequently, I put forward the hypothesis that different regression models test.

I conclude this chapter by emphasising that business growth is a function of various determinants, including institutional variables as well as the characteristics of the entrepreneurs. My analysis in this chapter also supports the proposition I put forward in Chapter 3 on context, as one of the main explanatory factors of entrepreneurial behaviour.

6.1 Theoretical conceptualisation

My conceptual framework is a multidimensional presentation of enterprise behaviour and consequent decisions about business growth. My framework is based on the new institutional theories and also on the small business growth theories (Baumol, 1990; Davidsson, 1991; North, 1999; Morrison et al., 2003). I presented growth as a function of three main determinants: opportunities to growth, which I have mainly discussed in terms of the institutional environment, growth intentions and growth abilities. In Chapter 5, I discussed the kind of behaviours that each of these variables induces in entrepreneurs. However, I believe that none of these variables can be discussed in isolation from each other when analysing entrepreneurial behaviour. For this reason, in this Chapter, I look at the simultaneous effect of all these variables on business behaviour and afterwards in the decisions about business growth, the main focus of this thesis.

Moreover, I consider variables related to businesses' or entrepreneurs' characteristics among the main determinants of growth and not as just control variables, thus I include them under the headings of abilities and intentions of entrepreneurs. Among these variables, I discuss time throughout my analysis. Since I am concerned with institutions and with the transformation of post communist societies, I consider time to be a very important element in the design of formal

rules and regulations and in the changes that take place in individuals' perceptions and in their interpretations of the new rules of the game and therefore, in the strategies they adopt.

Transition studies have often looked at the effects of different periods of transition (Smallbone and Welter, 2001b; Aidis, 2003). In my research, I have distinguished between two different periods of transition in Albania, before and after the year 1996, with the second being characterised by a broader introduction of laws and regulations, as well as by an unclear distribution of duties and responsibilities of public officials.

Before discussing my data, I briefly review some of the variables that have been used in transitional business surveys. These studies report different findings, which as Smallbone (2001b) argues may be related to the transition stage in which a country finds itself. While countries that have been slower in this process report more problems in terms of the broad institutional framework, the more advanced countries are more concerned with issues of technology, finance and more sophisticated business support services, as I show in the following account of the literature.

Transition studies focusing on SMEs can be divided into two main groups. Those that regard finance as one of the main impediments to business development, and those that take a more institutionalist perspective and emphasise the institutional environment as determinant to business development. Studies undertaken by Pissarides (1999), Pissarides et al. (2000), Falcetti et al. (2003) in SEE, by Hashi (2001) in Albania, Bartlett and Bukvic (2001) in Slovenia, and Bartlett (2003) in Slovenia, FYROM and Bosnia and Herzegovina, report access to external finance and the high cost of finance as major constraints to business development. Alternatively, studies of a more institutional nature such as Johnson et al., (1999) report weak property rights as constraints on reinvesting profits in manufacturing activities. The regulatory environment has very often been found to be a barrier to business development. Smallbone and Welter (2001b) studying the case of Belarus, Ukraine and Moldova, report business legislation as one of the main constraints on SME development. The tax system is also one of the most cited impediments to growth that transition studies report. In this respect, studies in Albania, Czech Republic, Hungary, Poland and Lithuania by Hashi and Mladek (2000), in Slovenia by Bartlett and Bukvic (2001), in SEE by EBRD (1999, 2002) report tax regulations as a major barrier to SME development.

Recently, there has been greater emphasis on the institutional environment especially with regard to problems related to market competition. Aidis (2003) and Aidis and Mickiewicz

(2004) discuss the institutional barriers to doing business in Lithuania. The former concludes that perceptions about one group of institutional barriers influence perceptions about others and emphasises the strong interaction effects of different institutional barriers. The latter focuses on aspirations to business growth and barriers constraining it, showing that taxes and corruption have a negative effect on growth. Studies by Hellman et al. (2000a; 2000b), on a global level, look at another feature of transition that hinders competition in the market. They discuss different forms of corruption and develop the concept of 'state capture' that has become more evident in these economies. They suggest transparency in reform, political accountability and more active competition policies as the key against this phenomenon.

These studies strengthen the proposition, put forward in Chapter 2, with regard to the differing features of entrepreneurship across time and space. Moreover, with regard to determinants to business growth, different factors exert simultaneous effects on growth rather than barriers themselves in isolation from each other. Moreover, those constraints that are influential in a certain period of time might not have the same impact once changes in the business environment have taken place. In the rest of this chapter I discuss these issues on the basis of my survey evidence.

6.2 Growth variables

In the methodology chapter, I discussed the different measures of business growth that are used in the literature on SMEs, and the rationale for their use. I included in my questionnaire a number of questions whose answers are indicators of business growth and which I use in this chapter to discuss barriers to business growth. I included a question (Q.13) that asked businesses to rate their business performance. I summarise their answers in the table below:

Table 6.1: Perceptions of businesses about their performance

	Business performance	
	Count	Percentage
Very satisfactorily	12	11.0%
Satisfactory	74	67.9%
Less than satisfactory	23	21.1%
Total	109	100%

Table 6.1 shows that the majority of businesses (68%) consider their performance as satisfactory. This might appear to be a rather subjective indicator of business performance, as it measures performance based on the entrepreneurs' own definition of success. It might result in

an upward bias since entrepreneurs typically do not want to appear to be unsuccessful. Nevertheless, when asked to specify their answers in terms of a list of performance indicators such as turnover, employment, assets and profits, the entrepreneurs gave responses that reflected the answers to the above question. This finding provides some evidence of consistency and honesty in the answers of the entrepreneurs to the questionnaire.

Moreover, another growth indicator, based on economic approaches on entrepreneurship and its contributions to job generation, is the growth in employment. Enterprises were asked to report the number of employees at two moments in time: the start-up year and the current year[14]. Recently, some studies (Aidis and Mickiewicz, 2004) consider these objective measures used in cross-sectional surveys as carrying substantial measurement errors since they look at data in the past. In this respect, they agree with Davidsson (1991); Wiklund et al., (2003) that attitudes can be used to predict future behaviour.

Furthermore, they agree with the part of the literature that looks at perceptions as important since they capture insider's knowledge. However, while I agree that expectations and perceptions are very important, entrepreneurs form them based on their past and present experiences, which directs the discussion towards perceptions and accounts of the past. Moreover, these studies were conducted in countries with stable institutions and where entrepreneurs' choices were arguably less influenced by the post-communist setting. In that context, insiders' knowledge does not capture changes in the business environment that happen as a result of the institutional change these countries are undergoing.

The enterprises in my sample had an average of 15 employees in the start-up year and 28 in the survey year, so that on average, employment almost doubled in the surveyed firms.

Table 6.2: Distribution of enterprises by annual growth in employment

	Frequency	Percent
Enterprises that did not grow or shrank (<=0)	34	30.6
Enterprises that grew less than 20% per year (>0)	34	30.6
Enterprises that grew more than 20% per year	43	38.7
Total	**111**	**100.0**

On average, employment in the sample enterprises increased by 19% per annum. The annual rate of employment growth (decrease) ranged from a decrease of 24% per annum to a maximum

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[14] I refer here to the year the survey was carried out.

increase of 167% per annum. Table 6.2 shows the distribution of enterprises by employment growth, distinguishing between firms which did not grow or shrank, firms which grew by up to 20% per annum, and firms which grew by more than 20% per annum. Half the enterprises that grew below average in terms of employment experienced negative growth, which could be an indicator that businesses are facing barriers of various types.

6.3 Barrier variables

In the previous chapter, I drew attention to a number of behaviours that were predominant in the Albanian business context and to a number of difficulties that entrepreneurs face in their environment with regard to institutions. I also discussed questions related to information and support infrastructure barriers. I now discuss the *'government-business interface'* type of barriers and I provide a table that groups the latter and *'information'* and *'support'*[15] barriers based on their significance.

Chart 6.1: Perceived importance of different barriers by enterprises
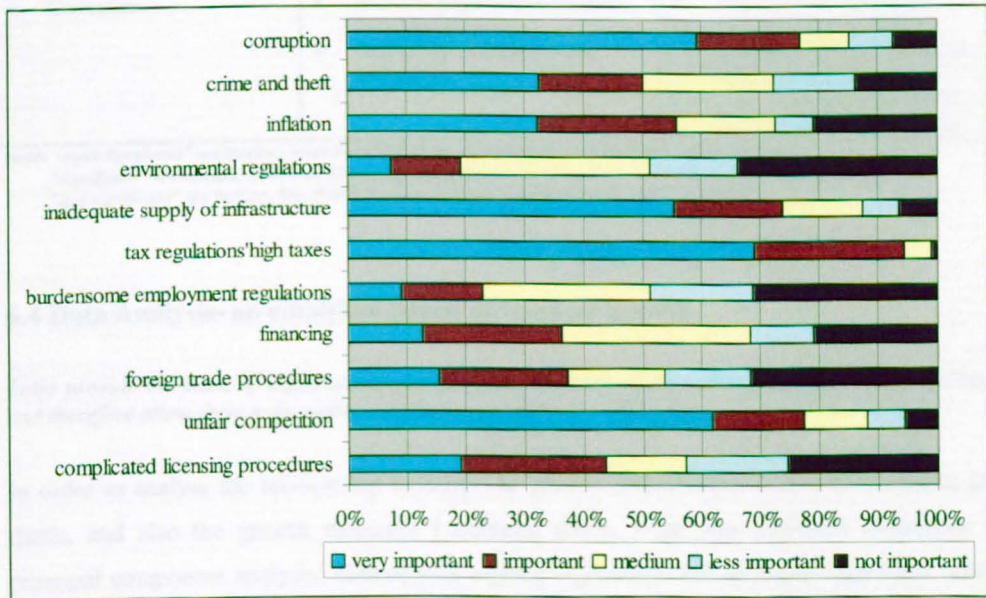
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[15] I discussed *'information'* and *'support'* barriers in the previous chapter.

Chart 6.1 gives a picture of the perceived importance of different formal institutional barriers from an enterprise perspective (Question 42). It shows that there are a number of variables which entrepreneurs perceive as serious hindrances to their business operations. Taking together *'very important'* and *'important'* barriers, the most significant barriers are tax regulations/high taxes (95%), unfair competition (77%), inadequate supply of infrastructure (74%), and corruption (77%).

In Table 6.3, I group these barriers according to their perceived significance by entrepreneurs. As Table 6.3 shows, barriers related to the government and formal institutions such as taxes, supply of infrastructure, unfair competition, are the most cited as barriers to business operations. These are among the main independent variables whose effect on business growth I explore in the empirical analysis in the following sections.

Table 6.3: Perceptions of business barriers in terms of significance

Most significant	Significant	Not significant
• Unfair competition • Tax regulations/high taxes • Inadequate supply of infrastructure • Corruption	• Inflation • Crime and theft • Business support infrastructure-do not understand our concerns • Business support infrastructure-miss local presence • Lack of information-product technology	• Business complicated licensing procedures • Foreign trade procedures • Financing • Employment regulations • Environmental regulations • Business support infrastructure-high fees for their services • Lack of information-markets • Lack of information-finance

Note: *"most significant"* are barriers, more than 50% of the entrepreneurs considered as *"very important"*
"significant" are barriers, more than 50% of the entrepreneurs considered as *"very important"* and *"important"*
"less significant" are barriers, less than 50% considered as *"very important"* and *"important"*

6.4 Data Analysis- an empirical model of business growth

Laws provide the basis of explanation, permit the anticipation of phenomena, predict their occurrence and therefore allow them to be controlled (Hussey and Hussey, 1997: 52).

In order to analyse the relationship between the growth determinants I have discussed in this thesis, and also the growth measures I outlined above, I use the statistical techniques of principal component analysis, multinomial logistic regression, and multiple regression. These form the focus of the rest of this chapter and will enable me to identify the simultaneous effect of the various determinants of business growth.

6.4.1 Principal component analysis

Usually regression analysis suffers from multicollinearity. Multicollinearity is the existence of a perfect or nearly perfect linear correlation between variables. In order to avoid such problems, I tested for correlations between the institutional barrier variables that I discussed above. Often the perceptions of entrepreneurs for a set of variables are influenced by their overall perceptions of other variables (Aidis, 2003). After running a correlation analysis (See Appendix 6), I realised that the responses to various barriers' perceptions were highly correlated to each other, which prompted the use of factor analysis to avoid these problems.

In my questionnaire, I included questions on the perceptions of enterprises of the different barriers as presented in the tables above. Using principle component analysis, I summarised these perceptions about barriers in a limited number of underlying factors. I used 14 responses from the 17 I had available. I dropped from the analysis the response on the government-business interface barrier *high taxes/tax regulations*, since it measures more than one component of the tax system. The same applies to the response on the *crime and theft*. Moreover, I dropped from the analysis the response on the *financing* because of its minimal input to the analysis. Thus, the 14 responses available have been reduced to four factors that explain almost 66% of the variance. When selecting these four factors the final component matrix appears in Table 6.4. The table shows that there is a clear distribution of statements across the four factors. Thus, the principle component analysis helped me to reduce the number of these correlated independent variables to four factors that are uncorrelated to each other.

Based on the distribution of responses across these factors, as Table 6.4 indicates the first factor is a combination of the responses that are related to perceptions about the government and its regulations, so I called this factor *'regulation related barriers'*. The second factor is a combination of responses about lack of information on various issues of concern to businesses and I called this variable *'information related barriers'*. The third factor is a combination of responses about the business support infrastructure, which I called *'support related barriers'*. The fourth factor is a combination of responses for various informal ways of doing business, such as corruption in its general meaning as well as, unfair competition and complicated licensing procedures that open the way to bribing behaviour. I called this factor *'corruption related barriers'*. A higher score in each of these factors means that the barrier becomes less important for the entrepreneur.

The literature on factor analysis does not offer a clear-cut rule about the choice of scores. However, Guadagnoli and Velicer (1988) consider as the most important element in determining factor solutions the absolute sample size and the magnitude of factor loadings. In the case of relatively small samples, factor loadings in the range of 0.5 or higher can be adequate for a reliable factor analysis. This reasoning explains my choice for factors that have a loading higher than 0.5 as Table 6.4 indicates.

Table 6.4: Principal component analysis: The rotated component matrix

	Component			
	1	2	3	4
government-business interface barriers-burdensome employment regulations	.747			
government-business interface barriers-inflation	.734			
government-business interface barriers-environmental regulations	.707			
government-business interface barriers-inadequate supply of infrastructure	.645			
government-business interface barriers-foreign trade procedures	.540			
lack of information-markets		.829		
lack of information-finance		.774		
lack of information-product technology		.689		
business support infrastructure-do not understand our concerns			.861	
business support infrastructure-miss local presence			.802	
business support infrastructure-high fees for their services			.659	
government-business interface barriers-unfair competition				.843
government-business interface barriers-corruption				.817
government-business interface barriers-complicated licensing procedures				.523

Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization.
a Rotation converged in 6 iterations.

6.4.2 Determinants of business growth-Multiple regression results

I tested the effect of different variables on business growth using multiple regression analysis. The rationale behind multiple regression analysis is the fitting of the model to the data for which the sum of the squared differences between the actual data and the regression line is minimised. For multiple regression analysis, the dependent variable must be a continuous variable, and I chose the annual proportional growth in employment as the dependent variable. I use the natural logarithm for the dependent variable in order to have a normal distribution of values. My preferred regression model is shown below as it best reflects the conceptualisation of business growth I have presented in this thesis[16].

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[16] To remind the reader, I have presented all the variables categorised under each composite variable in Appendix 1.

LN (Annual Employment Growth) = β_0 + β_1 Intentions+β_2 Abilities+β_3 Opportunities +ε

Accordingly, growth is presented as a function of intentions, abilities and opportunities that the institutional environment offers to businesses. Each of them is a composite variable of different independent variables as developed in detail in the Methodology chapter. Based on my theoretical conceptualisation I test the following hypothesis in this section:

(H1) Formal institutional barriers negatively affect business prospects for growth.

I expect regulation, information, support, corruption and other state-related barriers to have a negative effect on growth. The worse they are perceived as being barriers to business operation the more they will affect entrepreneurs' behaviours and their decisions about business growth.

(H2) Informal institutions like trust and business values positively affect business growth.

I expect trust and the embrace of new business values that did not exist in the communist past to be positive factors in business behaviour toward growth.

In order to test my hypothesis I use the institutional variables derived from the principle component analysis, and the informal variables, as well as intentions and abilities of the entrepreneur. I carried out a number of exercises with different variables pertaining to each group of determinants. In the following table I report the regression model, which has the greatest explanatory power. It shows that growth can be explained by a number of independent variables that belong to the different categories identified in my theoretical model – intentions, abilities, opportunities. The high degree of statistical significance of the regression model in explaining employment growth suggests that in the process of discovering and interpreting opportunities that the institutional environment offers, the intentions and abilities of entrepreneurs all play a crucial role.

INTENTIONS.

The data shows that older businesses have grown less than younger businesses. This finding is consistent with previous work (Bridge et al., 2003) that found that business growth tends to slow down once firms reach a certain stage in their life-cycle and that consequently younger firms are typically more dynamic than older ones.

Another finding within the category of *intentions* is that businesses run by older managers grow faster than those run by younger managers, which may reflect accumulated skills and knowledge as well as well developed business and possibly also political connections, in a context in which institutional deficiencies act as a burden on business operations. Older entrepreneurs typically have a wider set of connections than younger entrepreneurs and this circumstance may ease their business activities. Also, small businesses seem to grow more than medium sized businesses. However, the size variable is not a statistically significant variable in the explanation of employment growth in this regression model.

In the previous chapter I showed that Albanian entrepreneurs are in business for a variety of reasons, the most important of which is to pursue a business opportunity rather than out of necessity or due to unemployment, as could be expected in a less developed country like Albania. The regression analysis shows that being in business to pursue a satisfactory market opportunity is positively related to business growth, at a 10% level of statistical significance. This finding indicates how important are the intentions of entrepreneurs in explaining their behaviour toward growth.

Table 6.5: Regression results[17]

Model	b[18]	Std. Error	t	Sig.
(Constant)	1.102	.647	1.703	.095
INTENTIONS				
Years in operation	-.142	.037	-3.833	.000
Old entrepreneur	.958	.365	2.622	.012
Pursuance of a satisfactory market opportunity	-.170	.097	-1.752	.086
Small business	.335	.222	1.507	.138
ABILITIES				
University education	-.590	.241	-2.445	.018
Business qualification during business operation	1.091	.345	3.164	.003
OPPORTUNITIES				
Regulation related barriers	.180	.118	1.532	.132
Information related barriers	.369	.120	3.073	.003
Corruption related barriers	-.252	.101	-2.497	.016
Business success-hard work	-.450	.177	-2.542	.014
Business success-skills and knowledge	-.594	.308	-1.926	.060

Notes
(i)   Dependent Variable: Natural logarithm of annual employment growth
(ii)   Model statistics: F (test) 4.058; R square 0.482; Sig. .000
(iii)   Number of observations 60

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[17] Appendix 7 provides the list of explanatory variables used in the survey analysis
[18] For the Likert type questions in my survey a negative sign indicates a positive relationship between the dependent variable and the rate of employment growth.

ABILITIES

In the category of *abilities*, education of the entrepreneur is a significant variable although it has a negative sign. In this respect, higher education does not seem to be a prerequisite for business growth in the Albanian context. Thus, businesses run by entrepreneurs that have university education have grown at a slower pace than those that are run by non-highly educated entrepreneurs. However, the interesting finding is that entrepreneurs that have received business related qualification during the time of their operation have grown their business faster than those that have not received such qualification before.

OPPORTUNITIES

A group of variables that I discussed in the previous chapter were the values of capitalism (Chapter 5, Section 5.5.1) and how difficult it can be for people in post-communist countries to adopt these values. In the previous chapter I showed that entrepreneurs consider these values to be very important determinants of business success. The regression results show that *hard work* and *skills and knowledge* are positively related to business growth. The variable *hard work* is statistically significant at the 5% level, while the variable *skills and knowledge* is statistically significant at the 10% level. This finding suggests that the more the businesses consider these values to be important factors for business success, the faster they have grown.

In terms of opportunities for growth that I suggest in this thesis to be provided by the institutional framework, the regression analysis shows some interesting results about the different sets of formal institutional barriers and their effect on businesses' decisions about business growth. The group of '*regulation related barriers*' negatively affects business growth, although there is no statistical significance attached to this variable. The variable '*information related barriers*' also has a negative effect on growth, and this variable is highly significant at the 1% level. This finding has important policy implications, as I elaborate in the following chapters, in terms of the institutional infrastructure that facilitates the exchange of information and of knowledge transmission in the Albanian context. I dropped from the regression analysis the other group of institutional barriers, the '*support related barriers*' because of no statistical significance to the model.

A controversial finding in the Albanian business context is the finding from the regression analysis that the variable '*corruption related barriers*' has a positive effect on growth. As the regression analysis shows, the more corruption is perceived as a barrier to growth the more businesses have grown. I mentioned at the beginning of the Chapter that the perceptions about

different groups of barriers influence each other. Other studies (i.e. Aidis, 2003) have argued the same. By this logic, the more businesses perceive formal barriers to be a burden to their operations, the better they have learned how to cope with the inefficiencies of the system and found ways to deal with corruption related barriers, despite their very negative perceptions about them in terms of being a hindrance to their business operations. However, while these barriers have a positive effect on the growth of the Albanian businesses, the regression analysis does not show anything about the degree of growth that businesses would have experienced, should these barriers not exist and they did not need to spend their time finding ways to cope with the inefficiencies of the formal institutional setting.

The regression results I have presented so far support part of my hypothesis. Various institutional barriers have affected business growth. The regulatory environment, although had a negative effect on growth, was not statistically significant to the model which enforces the finding that businesses try to find ways to deal with the inefficiencies of the system. Information related barriers were highly significant as barriers to business operations. In addition, work culture also seems to positively affect growth. This finding shows that 'real' entrepreneurs that have embraced a new work culture are present in the post-communist transition, which among other features is characterised by the mix of business values that entrepreneurs are exposed to, considering the complete lack of private activities during communism. This finding is further reinforced by the significant statistical impact on business growth of the pursuance of a satisfactory market opportunity as a reason to start up a business, which builds on the argument that entrepreneurs with intentions to commit to their enterprise growth are present in a post-communist setting.

'Corruption related barriers' although being perceived as negative in terms of businesses' operations, prove to positively affect their growth. I explained this finding in terms of entrepreneurs learning to cope with these issues. As controversial as it might sound this finding suggests that the formal institutional environment in which these businesses operate offers the entrepreneurs many opportunities to learn how to cope with the system and to find informal ways to develop their business activities. Although this situation seems to be unproductive from a theoretical point of view, the finding shows that is in fact temporarily productive since businesses that experience corruption have grown faster. In the Albanian context, this finding suggests that corruption is a way to cope with the transformational problems of transition and the rapid pace of institutional change that it creates.

Corruption can be seen therefore as an informal institutional mechanism which 'greases the wheels' of growth and is apparently an effective way to overcome many of the frictions which would otherwise inhibit business growth. Although the entrepreneurs experience it as undesirable, those that learn how to play the system in this way are apparently able to create more jobs than those who do not. The challenge for Albanian policy makers will be to develop new institutions, which bypass the need for corruption and enable growth to take place in a more normal way.

6.4.3 Factors affecting business growth -Exploring some interaction effects in multiple regression analysis

In the previous section, I explored the direct causal relationships of my three sets of determinants of growth. However, it can be argued that the impact of institutions on businesses might be very well related to the size or age of the businesses. For this reason, I decided to look for moderated relationships and more specifically to look for possible interaction effects of the severity of the institutional barriers to growth depending on the size and age of businesses. Theoretically speaking, "an interaction effect is said to exist when the effect of the independent variable on the dependent variable differs depending on the value of a third variable, called the moderator variable" (Jacard and Turrisi, 2003: 3). Based on this assertion, I test in this section two hypothesis:

(H3): The effect of institutional barriers to growth is intensified by a larger size

I expect that larger businesses find it more difficult to deal with formal institutions, since the larger size imposes a higher need for structure and certainty in their business operations compared to enterprises that are smaller in size. By this logic, I expect that these businesses would not rely as much upon informal ways of doing business. This situation means that the larger the business becomes, the less these institutions are expected to have positive impact on their growth.

(H4): The effect of institutional barriers to growth is intensified by longer years in operation

I expect that businesses that have been in operation for longer have it easier to cope with different institutional barriers, which means that institutional barriers' effect on growth will be lower in businesses that are older.

In this section, I use the same analysis and variables as before, with the main difference being the inclusion of the interaction terms by assuming that the perception of institutional barriers will vary with the size of and the years the business has been in operation. I created the institutional barriers by size based on the four factors drawn from the principal component analysis and the total number of employees that each of the enterprises have in the current year. For the second group of interaction terms, I used the years the businesses have been in operation as component part. Before including in the analysis the variables from the three groups of growth determinants I discussed earlier in this chapter, I made sure that an interaction effect really exists. I used the strategy that Cohen and Cohen (1983) suggest that checks for the difference in the R2 and F value of two equations, one for the main effect only, and the other one for the interaction effect.

In Table 6.6 below, I present the multiple regression results for two equations. The first looks at the interaction between the institutional barriers with the size of the business, while the second looks at the same interaction, but with the years that the business has been in operation. Apart from the variables that I entered in the first regression I presented, in these two regression equations I have looked at another variable that takes into account the perceptions about the state and how they influence decisions about growth.

Table 6.6: Regression results based on interaction effects by size

Model	b	Std. Error	t	Sig.
(Constant)	1.762	.646	2.727	.009
INTENTIONS				
Years in operation	-.138	.035	-3.950	.000
Old entrepreneurs	.967	.341	2.836	.007
Pursuance of a satisfactory market opportunity	-.170	.092	-1.842	.072
ABILITIES				
University education	-.579	.225	-2.572	.013
Business qualification during business operation	1.005	.313	3.213	.002
OPPORTUNITIES				
Business's perception on the state	-.535	.232	-2.301	.026
Regulation related barriers	.255	.120	2.120	.040
Corruption related barriers	-.210	.126	-1.665	.103
Regulation related barriers by size of business	-.004	.001	-3.009	.004
Information related barriers by size of business	.008	.002	4.553	.000
Corruption related barriers by size of business	-.003	.001	-2.350	.023
Business success-hard work	-.448	.172	-2.613	.012
Business success-skills and knowledge	-.705	.290	-2.432	.019

Notes
(i)   Dependent Variable: Natural logarithm of annual employment growth
(ii)   Model statistics: F (test) 4.726; R square 0.577; Sig. .000
(iii)   Number of observations 60

The regression analysis shows some interesting results. While all the other variables that I entered and discussed in the first regression table are still significant and have the 'right' signs, there are some differences in this second regression model in relation to the institutional barriers and the interaction variables I created. 'Perceptions about the state' proves to be a statistically significant variable in business decisions and growth. As Table 6.6 shows, businesses that think of state as a 'grabbing hand' have grown more slowly than other businesses. This finding suggests that perceptions about the state and the institutions it designs and enforces are very important for businesses in making decisions. If businesses do not give credibility to the state that means that they do not believe the state creates those institutions that will structure business operations and that will give certainty about investment decisions.

In terms of institutional barriers, the 'information related barriers' was dropped from the analysis as being statistically insignificant variable to business growth. 'Regulation related barriers' is still statistically significant and has the same sign as in the first equation. The same applies to 'corruption related barriers' although they are not as significant as they were in the previous equation. With regard to the product terms, Table 6.6 gives some interesting results. In terms of 'regulation related barriers' it can be noticed that an increase in the size of the business is accompanied by a less severity of these barriers to growth. This finding means that when businesses grow in size, they have better perceptions about formal regulations than when they are smaller and do not affect their growth decisions. 'Information related barriers' seem to have a higher impact on larger businesses. As Table 6.6 shows, when businesses increase their size the information barriers are more severe to the growth of the business. In fact when a business gets larger its needs for various types of information it can utilise to take different decisions with regard to a new product, new technology or markets and so on, are increased.

The other group of institutional barriers relates to the issue of corruption. The regression models I have presented in this chapter show that this group of barriers has not negatively affected growth, although it is often cited as a barrier to businesses' operations. The results from this regression model, which includes interaction effects, show that the larger a business is in size, the less the effect of these barriers on the growth decisions of businesses. This finding suggests that it is the larger businesses which benefit most from the corruption mechanism. The larger a business is, the more it is subject to lengthy regulations and procedures, which warrants the need for policies to simplify business procedures.

My findings from this regression model fully support my first hypothesis about the effect of institutional barriers by the size of businesses, since all the interaction terms are statistically significant. The findings suggest that larger businesses are less affected than smaller firms by the problems related to regulations. With regard to information barriers, my hypothesis is also supported by this regression model, which suggests that larger businesses need more information and that information gaps have a larger negative effect on their growth than in the case of smaller businesses.

Turning to the interaction effects of years of operation and their effect on growth, a few changes can be noticed concerning the category of 'opportunities for entrepreneurship'. While the variable *'reason to be in business'* has lost its statistical significance (although it has the right sign), the other variables under *intentions* and *abilities* are still significant and have the same signs as before.

Table 6.7: Regression results based on interaction effects by year

Model	b	Std. Error	t	Sig.
(Constant)	.935	.622	1.503	.139
INTENTIONS				
Years in operation	-.139	.038	-3.714	.001
Old entrepreneurs	.853	.366	2.329	.024
Pursuance of a satisfactory market opportunity	-.092	.088	-1.045	.301
ABILITIES				
University education	-.536	.245	-2.190	.033
Business qualification during business operation	.999	.337	2.963	.005
OPPORTUNITIES				
Information related barriers by years in operation	.036	.013	2.729	.009
Corruption related barriers	-.273	.102	-2.669	.010
Business success-hard work	-.370	.174	-2.133	.038
Business success-skills and knowledge	-.531	.309	-1.715	.092

Notes

(i)   Dependent Variable: Natural logarithm of annual employment growth

(ii)   Model statistics: F (test) 4.275; R square 0.435; Sig. .000

(ii)   Number of observations 60

Business values are still statistically significant in this equation, reinforcing the argument that the sooner the new behaviours are learned and adopted, the more successful a business will be. However, some of the institutional barriers have lost their significant effect on growth. The only one that proved to be significant is the information barrier by years of operations (significant at 0.01 level), which suggests that the older a business is, the more it depends on information in order to grow.

Lack of information has greater effects on the growth of those businesses that have been longer in operation. The other institutional barrier that is significant and still has the same unexpected sign is the variable *'corruption related barriers'*. As I explained above, although corruption is one of the most cited barriers to business expansion, many businesses have learned to cope with it and use it to the benefit of their business operations.

6.4.4 Logistic regression-What counts for good business performance?

At the beginning of this section, I suggested the use of another variable as an indicator of business performance. This subjective variable is based on the perceptions of entrepreneurs themselves about their businesses' performance. This variable takes the values *'very satisfactory'*, *'satisfactory'* and *'less than satisfactory'*.

I use this variable in a multinomial logistic regression model in order to test for the possible factors that influence entrepreneurs' perceptions about their business performance. The base category is the group of enterprises that report their business performance to be *"less than satisfactory"*. The interesting fact for this analysis is that entrepreneurs perceive their business performance as highly affected by entrepreneur and firm characteristics rather than variables related to the opportunities created by the institutional environment.

Table 6.8 shows that businesses that have achieved growth in employment are more likely to perceive their business performance as being good. By looking at the group of businesses that have reported a *'more than satisfactory'* business performance one can see that *'intentions'* are very important in forming entrepreneurs' perceptions about their businesses' performance. In this regard, older entrepreneurs, businesses created after 1996 and businesses located in Tirana are more likely to report a *'more than satisfactory'* business performance. Table 6.8 also shows that an increase in the size of the business increases the odds of reporting a *'more than satisfactory'* business performance.

In terms of entrepreneurs' abilities, this regression model shows that university educated entrepreneurs have a lower probability to have *'more than satisfactory'* business performance. Moreover, enterprises that report bribing as a common activity are far more likely to report *'more than satisfactory'* business performance. This finding is consistent with my finding in the multiple regression analysis about the effects of corruption on business growth. Also, Table 6.8

shows that enterprises in this group rely on indicators like turnover and annual employment growth to judge their business performance. Investment is significant as an indicator of business performance, but an increase in investment does not increase the odds of reporting a *'more than satisfactory'* business performance.

Table 6.8: Multinomial logistic regression-business performance

Group 1: Business that report *'more than satisfactory'* business performance

	Coefficient β	Standard Error.	Sig.	Relative ratio risk (Expβ)
Constant	-20.34	6.32	0.001	
Intentions				
Older entrepreneurs	6.11	2.28	0.007	448.03
Start up year (after 1996)	3.18	1.60	0.05	23.94
Business size	0.12	0.05	0.01	1.13
Location	5.32	3.08	0.08	204.71
Abilities				
University education	-6.32	3.53	0.07	0.002
Opportunities				
Bribing activity	5.32	1.82	0.096	20.60
Accumulated investment	-0.43	1.22	0.72	0.65
Turnover	2.44	1.05	0.019	11.51
Annual employment growth	10.54	3.31	0.001	37700.05

Group 2: Business that report *'satisfactory'* business performance

	Coefficient	Standard Error.	Sig.	Relative ratio risk (Expβ)
Constant	-3.20	1.78	0.001	
Intentions				
Old entrepreneurs	3.44	1.22	0.005	31.32
Start up year (after 1996)	0.07	0.68	0.92	1.08
Business size	0.12	0.05	0.01	1.13
Location	-1.50	0.88	0.09	0.22
Abilities				
University education	-0.75	0.71	0.29	0.48
Opportunities				
Bribing activity	2.11	1.07	0.05	8.21
Accumulated investment	-1.38	0.76	0.07	0.25
Turnover	1.10	0.69	0.11	3.01
Annual employment growth	5.02	2.20	0.02	151.59

Likelihood ratio test: Chi Square=80.46;Sig<0.001

Pseudo R Square=0.693

Similarly Group 2 older entrepreneurs have a significantly greater probability of reporting a *'satisfactory'* business performance, as are larger businesses. Businesses located in Tirana are less likely to perceive their business performance as *'satisfactory'* than businesses located elsewhere. The start-up year is of no explanatory value to this group. The same applies to the entrepreneur's education.

Bribing activity is significant in this group too. Thus, the odds of an entrepreneur bribing regularly and also having *'satisfactory'* business performance are eight times higher than those of an entrepreneur that does not bribe. Moreover, entrepreneurs in this group seem to associate their *'satisfactory'* business performance to a growth in employment. Investment in this group does not seem to increase the odds of having good business performance since the higher the investment businesses have made the more in risk they might feel for their future operations.

Conclusions

In this chapter, I have shown that business growth is the outcome of a number of determinants. In the case of Albania, I suggested using a model that emphasises entrepreneurial opportunities and which adopts an institutionalist perspective. I emphasised that the intentions and abilities of entrepreneurs are important elements in explaining which entrepreneurs are likely to recognise and act upon the opportunities that the environment offers.

I collected evidence through an enterprise survey, an analysis of which I presented in this chapter, focusing on business growth and its determinants. I based the analysis in this Chapter on two main indicators of growth. One is a quantitative indicator that measures annual employment growth and the other is a qualitative indicator that was based on the perceptions of businesses about their performance.

My analysis using the objective indicator of growth found that enterprises that are in business to pursue a market opportunity have grown faster than others. Also, the businesses run by older entrepreneurs, and by those without a university education grow faster than other businesses. Moreover, businesses run by entrepreneurs that have received business qualification have also grown faster than those run by entrepreneurs who have no business qualification. Turning to institutional institutional barriers to growth, the analysis showed that information barriers hinder business growth. Alternatively, businesses whose entrepreneurs perceived that corruption was an important or very important barrier to growth have grown faster than other firms. This

finding suggests that corruption, although perceived negatively, is an important informal institutional mechanism, which facilitates business growth in the Albanian context. Interestingly, the embrace of business values that were non-existent during communism had a positive effect on growth.

Furthermore, these barriers have different effects on business growth depending on the size of the business. My analysis of interaction effects showed that larger businesses suffer less from the regulatory environment but that their growth is hindered more by information barriers. The perceptions of the state are another significant barrier to growth and prove to be statistically significant in all the regression models presented in this chapter. The regression results show that the more negatively the state is perceived, the lower is the growth of the businesses.

The use of the qualitative indicator revealed that businesses associate their business performance highly with their intentions and abilities as well as with profitability and employment growth rather than with institutional variables. The only significant variable in this group was corruption that proved to increase the odds of businesses reporting favourable business performance. Moreover, the regression results show that capital accumulation does not increase the probability of 'satisfactory' or 'more than satisfactory' business performance, possibly due to the risks associated with business investments. This result provides strong evidence of the weakness of the investment climate in Albania.

To conclude, my analysis about the enterprise barriers in Albania showed business growth is influenced by a multitude of variables. My analysis adds to the large number of empirical growth studies I have discussed in this thesis that consider growth as related to a number of variables that are subject to particular periods of time and also particular characteristics of the broader environment. My regression results give much scope for government policy especially considering the problems encountered by entrepreneurs in terms of the investment climate in Albania as well as the regulatory framework, which give more incentives to cheat the system through corruption rather than follow formal institutions. Moreover, from a policy perspective my research suggests taking into account the effect of various formal and informal institutions on SMEs in designing any policies as I discuss in the following chapters with regard to the GoA SME policy framework.

CHAPTER 7
THE SME POLICY FRAMEWORK IN ALBANIA
DISTINGUISHING BETWEEN THE MEANS AND ENDS
(Documentary and interview analysis 1)

SME policy can be described as an excess of loosely connected and apparently uncoordinated policy initiatives shooting off in all directions, generating noise and interest but not commensurate light.

(Curran and Storey, 2000)

Introduction

In my discussion of the theoretical and empirical evidence on the role of entrepreneurship, especially as embodied in small and medium sized enterprises (SMEs), I outlined the particular roles that entrepreneurship can play in economic development. I also showed the difficulties that exist in the literature to establish causality between the two. In this chapter, I am concerned with the SME infrastructure in Albania. Earlier, I looked at the framework conditions for entrepreneurship and also at the barriers to SME growth from an enterprise perspective. In this chapter, on the basis of qualitative field research, I discuss the SME policy of the Albanian government. I rely on policy documents to identify the strategies that the government has designed and implemented, and on the views expressed by policy makers, public officials and other actors involved in SME policy design and implementation in Albania.

In this chapter, I discuss the SME policy framework based on a multi-level analysis, which takes into consideration the institutions designed to facilitate entrepreneurship and business development at three levels: macro, meso and micro. I start this chapter with a brief introduction to the rationale for government policies on SMEs. In section 2, I focus on the Albanian Medium Term SME strategy and other governmental initiatives that have followed on from it. I discuss a range of issues related to the objectives of the Albanian government, such as the role of entrepreneurship in Albanian society as expressed in the strategy and in other initiatives. The sectoral and regional focus of the strategy and the attitudes of different public officials and other social actors will be part of the discussion. From this macro level discussion of institutions, I move on in section 2.2 to a discussion of the formal institutions that are an indispensable means

for achieving the objectives of the government regarding SME development. In this section, I emphasise the financial, legal and regulatory framework that affects business development.

I conclude that a policy cannot be coherent and comprehensible unless it is based on clear aims and means to achieve them. Special attention to coordination in the implementation of different aims is crucial and should also have a regional focus, which I will discuss in more detail in the next chapter.

7.1 Rationale for business policy-A short reminder

Before I focus my discussion in the case of Albania, I note the broader case for SME policies. The importance of small and medium sized businesses for economic development has become an axiom of government policy worldwide. There are now few countries or governments that would disagree, hence the large number of initiatives and policies to increase or encourage the role of SMEs, especially in terms of competitiveness and job creation. Bridge et al. (2003), discussing the UK case, argue that the real or perceived needs of this sector cannot be ignored if only on account of the size of this sector in the economy. However, the fact that the SME sector is influenced by various factors often correlated to each other means that the measurement of the effectiveness of government initiatives is difficult. This suggests that policies can easily be subject to political manipulation. However, recent research on SME policies in EU and OECD countries has shown that governments have not been very comprehensive in their aims. Based on a literature review of business policies in UK and other countries, Bridge et al. (2003) argue that this lack of comprehensive aims is due to the confusion of entrepreneurship and small business policy and what each is meant to achieve.

In this view, entrepreneurship policies concern the individual and are about encouraging self-employment as a viable way of life. One way governments try to encourage self-employment is through formal education and the promotion of an entrepreneurial culture. Such policies are meant to have an impact on broader socio-economic development. Yet, small business policy is more related to existing businesses and to identifying and removing the factors that hinder their growth. These policies concern economic development in general. However, this distinction between the two has often not been fully appreciated. Storey (1994, 2003) discusses weaknesses in SME policies with regard to setting output targets and time scales for the fulfilment of policy objectives. Success in achieving the objectives of small business policies requires an in-depth knowledge of the processes involved, which, according to Storey, has seldom been achieved, mainly due to the heterogeneity of the small business sector. There are many examples in the

literature of the failure of policies based on targets, because such policies often focus solely on achieving the measurable targets and ignore the processes that are involved (Storey, 2003).

In Chapter 3, section 5, I observed that two broad approaches have been used in Europe to achieve SME policy objectives. The first is the creation of a favourable economic environment. The second is the provision of more direct measures of technical support and other forms of assistance directed to specific groups of enterprises. I discuss these issues in the following sections with a reference to my case country, Albania.

7.2 Main discourses and objectives of business development in the Albanian Medium Term SME Strategy

...strategies in Albania are just nicely written theoretical documents with no attached practical actions. One of the reasons about this, especially in the case of the strategy of SMEs, is the low participation of businesses... there are still problematic the functioning of the government institutions and, the mobilisation of all relevant factors including the business community in designing strategies (SEED)

The Albanian government has produced a number of documents that indicate the great importance it attaches to SME development. Although much attention has been directed to this sector since the beginning of transition, few policy instruments have been available, until recently, to complement what has been called a spontaneous development of the SME sector. In Chapter 3 I discussed how a well-developed institutional environment could provide incentives to entrepreneurs to develop their entrepreneurial talents in productive activities in the economy. In the course of this chapter, I discuss how the efforts to create such an environment are expressed in the government's policy documents and also consider the instruments adopted to achieve them.

In order to understand the government's institutional priorities and how they can best fit the development of entrepreneurship in Albania, I conducted a number of interviews with public officials and other social actors involved in SME policy design and implementation. I examine these issues based on a multi-level institutional analysis. Smallbone and Welter (2001a) argue that SME development depends upon the creation of institutions and organisations at three levels: macro, meso and micro. Such a multilevel analysis is needed to give a complete picture of the SME policy design and implementation and is based upon the argument that SME development requires an appropriate set of institutions and organisations and depends critically on the cross-linkages between the different levels of policy-making.

7.2.1 The macro level

In this section, I first analyse the macro level with reference to national institutions and organisations that are responsible for SME policy. The main responsibility for formulating policies on SME development in Albania is under the Ministry of Economic Cooperation and Trade (MoECT) and, more specifically, the Department of Business Promotion in this ministry. For the first time in 2001 a Medium Term Strategy was formulated for the development of the SME sector.

Although much delayed and despite the attention directed towards this sector since the beginning of transition, this strategy puts forward a number of objectives and indicates the means to achieve them. At a first glance, the objectives that the government has articulated in this strategy do not differ much from similar strategies that have been adopted in other countries and reflect some broadly accepted assumptions about SME development. These assumptions are based on economic approaches to entrepreneurship focused on the broader role of the entrepreneur in society and the particular societal interests he or she may fulfil. The legitimisation of government policy and actions in relation to SMEs is carried out through functional discourses about job generation, the number of businesses, the contribution of the SME sector to GDP, and so on, all figures that drive government agendas on SMEs. To take just one example, in the latest report on the state of the SME sector in Albania, one can read:

> SMEs play a vital role in the economy...micro and small size enterprises comprise 99% of firms' enterprise stock...SMEs provide about 75% of employment in non-agricultural sectors (SMEDA, 2005: 1).

Other important steps followed the design of this strategy. Under the framework of the SME strategy, the institutionalisation of SME development at a macro-level has been mainly associated with the efforts to establish clear responsibilities for the implementation of the national strategy. Under this strategy, the SME Law No 8957 of October 2002 was adopted to regulate the definition of SMEs, the legal framework for SME government support, and the creation of a development agency for SMEs.

The *overall objective* of the SME strategy is to create a positive business development climate to allow for sustainable SME growth. In this regard, the government considers the main aim of SME policy in Albania to be social and economic development with a focus on job creation and on a balanced sectoral development (SME strategy). This strategy's contents spell out the

commitment of the state toward start-up businesses and toward existing businesses in manufacturing.

This government's overall objective is stated in the National Strategy for Socio-Economic Development (NSSED), one of the main documents on socio-economic development in Albania published in November 2001. Thus, the Albanian government considers:

> ... *(the) development of the private sector as the driving force behind growth and poverty reduction. The objective of the government is to stimulate the development of a dynamic private sector, increase the level of the competitiveness of the economy and create an attractive environment for private foreign investments through improvements of the legal and institutional framework that is directly related to the business sector (NSSED, 2001: 63).*

In the NSSED, one can distinguish clearly what the government wants to achieve *(dynamic private sector, competitiveness of the economy, attractive environment for private foreign investments)* and what it considers as the means to achieve these objectives *(improvement of the legal and institutional framework)*. Nevertheless, as I mentioned in the beginning of this chapter, there is an important distinction between entrepreneurship policy and business policy as well as their respective impacts on socio-economic development and pure economic development. This situation suggests some ambiguity with regard to an entrepreneurship policy in Albania, as I discuss into more detail in a later section.

In addition, the government claims that the SME Strategy was developed based on what in the literature are called the prerequisites of good governance: the interaction with the private sector and other business related organisations (Szabo, 2004). More specifically, businesses were involved through a survey questionnaire designed for the purposes of this strategy. Regional Development Agencies (RDAs), the German Agency for Technical Cooperation (GTZ) and other support intermediaries were also involved. In this respect, based on a stakeholder approach, the following objectives in terms of SME development were identified (GoA SME Strategy, 2001: 18):

1) Encourage/support the expansion of existing enterprises

2) Promote the creation of new businesses

3) Transform traders into investors in production units

4) Support production for export

5) Promote joint-ventures at an SME level

It seems clear that the government wants to encourage a dynamic economy by not only encouraging the expansion of already established businesses, but also by an increase in the number of start-ups. In quantifiable terms, data from INSTAT do not show any significant changes in the size structure or in enterprise performance indicators. Moreover, none of the recent figures implies a considerable impact of government policies on business development indicators.

Although these first two objectives seem straightforward, the third objective, driven by the government's wish to have a larger number of businesses in the manufacturing sector, in order to reverse the four to one ratio of imports and exports, is not clearly articulated. So, the government has identified that there is *"a growing economic imbalance between the country's central region (i.e. the corridor Tirana-Durres-Elbasan where most investments take place) and outlying regions and districts, where investments and actual economic growth are much less significant"* (ibid. p. 24) and puts forward in the strategy the objective of *"transforming traders into investors in production units"* which sounds to be a very macho-driven discourse, to use one of the terms of Perren and Jennings (2005), that does not take into account what the entrepreneurs themselves want to achieve.

Although my intention in this chapter is not to look as much at the linguistics of policy documents as to look at how they are being implemented and what impacts they have on the SME sector, I cannot help but comment on the language, which is not only an indication of the government's attitudes toward the business sector, but also of the kind of attitudes that this language might induce in the administrative staff that works for the implementation of the strategy. I would like to argue that since entrepreneurship is an act of free will, the kind of language being used to express this objective sounds as if it is jeopardising the whole notion of the entrepreneurial act by imposing power relationships on it. While it is reasonable enough for the government after identifying that there is a shortage of investments in the manufacturing sector to want *to encourage* businesses in this sector, the use of the words *'transform'* or *'turn'* that have a very functional connotation and make explicit the discourses of power involve does not sound correct. Going further in the strategy content, it is made clearer the intention of the Albanian government to encourage manufacturing as an entrepreneurial activity:

> *Start-ups and already existing enterprises, that intend to diversify, should be guided into more productive activities – away from trade and common services – namely into manufacturing, agro-industry, production of construction materials, tourism activities and the like. Some of them might*

also be encouraged to consider investing in high-tech ventures and to go into export activities (GoA SME strategy, 2001: 25).

In this quote, the discourse gives a role to the government as an *enabler* rather than an *imposer*. Nevertheless, the inconsistency in the usage of terms can built into the misuse or misinterpretation of the government's objectives by various actors that work with the strategy. Moreover, in another document produced by the SMEDA in 2005, on the general state of the SME sector, reference is made to the steps undertaken after the formulation of the SME strategy. In this regard, it is mentioned that: *"these actions enabled the private sector to become the driving force for economic growth"* (SMEDA, 2005: 1) which is a very declarative statement that overestimates these steps not only by the language used, but also by considering the business community as very dependent on government agendas and not as a partner in the process.

7.2.1.1 Regional and sectoral focus-the need for clarity in the SME law and SMEDA operations

In this strategy, the government emphasises manufacturing and exporting activity as well as balanced regional development. However, in the contents of the medium term plan, there is no reference to specific studies undertaken to identify any particular manufacturing activities in which the country has comparative advantage, or regional studies identifying the prospects of different regions in order to narrow the development gap between the centre and other areas of the country. The SME law articulates very clearly that the enterprises, which will benefit most from government support, are those in manufacturing, those engaged in exporting activities, or those in research and development. In this law, the government makes its commitment to implement the strategy, although it seems to be dragging its feet when it comes to implementation.

Some key issues need to be discussed further with regard to this law. *First,* the definition of SMEs, which this law has formulated, makes it easier to design specific policies that are oriented toward certain groups of enterprises. However, as my interviews with different public officials made clear, government institutions face many difficulties in adopting a consistent definition that would allow for easier information sharing and coordination, as well as for comparability of data. As I mentioned in Chapter 4, there have been discrepancies in the use of

the SME definition by the Tax Administration and the statistics office, INSTAT, to give just one example.

Second, under this law the SME Agency (SMEDA) that started its operation in 2003 was given the main responsibility for the administration of the various government and donor SME funds, and for monitoring and coordinating the different programmes of SME support. The SME strategy states that:

> ...(the agency) must be adequately funded and well equipped, as well as have a limited but highly specialized staff and functional structure to fulfil its conceptual and coordinating mission adequately (GoA SME strategy, 2001: 19).

However, my interviews revealed that the SMEDA, although created as an autonomous unit, is a government financed institution, which makes it difficult for it to take independent decisions. Sceptical views on this agency are prevalent in the business support community in Albania, not so much about the agency itself in its conceptual design, as about the limited operational capabilities in terms of financial and human resources. One interviewee from a donor programme was very pessimistic about the role of SMEDA:

> I am not an optimist. It does not have the necessary budget. The people working there are not the brightest people and at the same time there is no database of enterprises to start off with (Donor Programme).

Similar statements were made by the director of the SMEDA with regard to a number of studies that are pending due to the lack of financial resources (see below). Under the SME law it is also recognised that national and local governments can organise different support activities for businesses in their areas. However, the law specifically states that these activities have to be coordinated by the SMEDA. This hierarchical structure might not only slow down the decision-making process, but might also lead to problems of coordination and information sharing, especially considering the existing problems with the decentralisation process and the assignment of responsibilities to local governments.

Moreover, it is not clear from the SME law if the local governments will work on these activities on the basis of shared or delegated functions of local governments. In the case of the latter, the state will provide the funds and the local government will act only as an agent of the central government. This process compromises the cost-effectiveness of the programmes since it

misses out on the local knowledge and the insiders' perspectives on different issues of concern to the business community in these areas.

In addition, the strategy makes reference to strategic regional plans that are to be designed in the long term which are also priorities of the SMEDA. However, four years after the strategy was formulated, there are still no regional plans, and the ad hoc measures which are being used lack any informed knowledge of specific local areas and their needs for support. According to the interviewed SMEDA representatives, a lack of funds has been one of the reasons that no studies have been undertaken on regional or sectoral problems. This situation can compromise other steps to implement the strategy and the SMEDA action plans to provide preferential support through 'softer' lending criteria for priority activities. This lack of funding for research activities may jeopardise the SMEDA's responsibility to inform the government about the real needs of the business sector. This missing leg of the policy process, namely the proper identification of problems that need policy intervention, was also commented on by several of the interviewees. One interviewee from SEED mentions:

> ...there is a lack of research bodies that would study the market, the currency rates or other studies that should guide policymakers. There are no research institutes because there is no money available. If this was the case the policies would be more accurate and would reflect on the real needs and not just on hypothetical ones (SEED).

Moreover, many policies or laws have been changed or modified mainly because they were not in tune with the environment and the policy responses it requires. In this respect, the SME strategy itself is being subject to various criticisms. Several of my interviewees observed that the strategy needs serious revision and needs to reflect more explicitly the priorities for SME development. The interviewee from SEED mentioned that:

> The strategy lacks some focus and does not reflect a clear vision of where the country will be in 5-10 years...In this context it is necessary to make studies on the resources that are available whether natural, human or geographical that will give a competitive advantage in the future.
>
> The strategy was drafted at a period in which not too many things were evident. It is also necessary to consider some changes in the framework of the negotiations for the Association and Stabilisation Agreement. My point is that the development of the private sector should be oriented toward the EU standards, if we want to integrate. I have in mind here the SME charter adopted by the government. It is necessary to set targets and who is going to do what and when (SEED).

Furthermore, the government has not assigned any budget for the implementation of the strategy. During my interview with the director of SMEDA I was told that the *"strategy is not an operational program where the activities are expressed in financial terms"* which means that

the SMEDA, which has a very small budget and not enough staff, needs *first*, to design action plans on what its director calls *"reading between the lines of the strategy"* and *second,* make them known to the donor community.

Although these can be considered as steps forward in the implementation of the strategy, they do not exclude the imposition of political agendas and donors' agendas[19] on SME development in Albania instead of concentrating on what should be the real priorities in the Albanian business context. Different ministries have different budgets about what are considered their responsibilities in terms of SME policy. This situation gives rise to issues of coherence in SME policy that is divided among not only three main ministries (the MoECT, the Ministry of Finance and the Ministry of Labour and Social Affairs) but also to a number of other intermediate bodies, which I will discuss in the next chapter.

Furthermore, as I discussed above, the government of Albania gives much emphasis to the manufacturing sector but there is no reference either in the strategy or in the policy circles to the Ministry of Industry or to the Ministry of Agriculture that should have a voice in terms of needs of specific sectors. I was surprised to hear that in the Ministry of Industry there was no department to deal with businesses operating in the industrial sector.

Moreover, the policy process does not go through the whole cycle from the design of policies to the monitoring of specific targets to how they have been fulfilled. While one reason could be the lack of measurable or quantifiable targets, the other reason could be certain negligence on this very important step of the policy process. A public official from the Department of Business Promotion in the MoECT mentioned that no monitoring is done by different government structures. According to the interviewee, official monitoring of implementation effectiveness only takes place in the case of donor-funded programmes, since the donors typically are required to ensure the proper use of their funds. Reflecting on the underlying meaning of a statement like this, the only conclusion that I can draw is that the government is more concerned with designing policies and action plans than with their enforcement or with the real impact they will have on SMEs and are not at all concerned about feeding back the results or outcomes of policies into the policy process.

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[19] More on this in the next chapter

7.2.1.2 Government-business community relationship-a binomial one?

The lack of research bodies, research funding or other studies that should guide the policy process is an indication that the government lacks information about the real needs of SMEs, even though they are the main actors that will be affected by governmental policies in this area. In this respect, *good governance* and *businesses inclusion* in the policy making process are in practice mere political rhetoric on entrepreneurship and business development. To take just one example, the Prime Minister in February 2002 created the Business Advisory Council (BAC). The rationale for its creation was to facilitate dialogue between business and government. However, this structure is yet another in the range of *buzz* initiatives of *giving voice to businesses* or *making them heard* which is not new in the agendas of governments in many countries, including those in the EU.

But, this structure has been heavily criticised due to its members' composition, which includes mainly ministerial staff and representatives of structures that do not really represent the business community. In this respect, one interviewee reported that:

> *the government drafts the laws and the council just comments on them. I think this is a deficient process...the voice of the businesses is not really heard in the form this is operating right now. This initiative was one of the many formalities (Donor programme).*

This statement could also indicate the continuity of an inherited discretionary use of power by the government as:

> *... (the) same problems have been discussed, the same concerns have been raised by the businesses but nothing has been achieved. (Business association)*

No doubt initiatives of this kind not only give no credibility to government actions which are crucial for the implementation of reforms, but they increase the extant general distrust of the business community of formal institutions, including support structures or business associations that represent businesses in the council. The SME EU Charter 2004 outlined a number of steps that the government intends to undertake in order to improve the effectiveness of the BAC. These steps include a study conducted by SEED, whose aim was to look at the structure and operation of the BAC. In 2005, the government was expected to approve a new structure that would be more effective. In transformation economies, trial and error experimentation is expected and should be encouraged. But in some cases, such as that of BAC when it was clear

from the very beginning that its structure was undermining its original intention, the government just wastes time, human and other resources that could be devoted to better uses.

The level of awareness the business community has about the initiatives the government has undertaken and the available facilities for businesses is also of interest. It is striking that four years after this strategy was formulated and after more than a year after the government has ratified the strategy and passed the law on SMEs the majority of businesses are still not properly informed about the law and what the strategy offers to specific groups of businesses.

This lack of awareness is also made evident in the OECD EPPA reports of 2004, according to which the majority of businesses do not even know about the existence of such documents and initiatives, hence they do not know what they are entitled to by law. My interviews with public officials made it clear that the government's attitude is to be only the initiator and designer of strategies and policies and not the *awareness engineer*. This position makes the government a mere *producer* of nicely written documents with little interest in implementation and even less in the fulfilment of the stated objectives and targets. As one of my interviewees observed:

> *Businesses that are interested find ways to get to know about the strategy. If not they are not going to learn about it (Public official).*

Or with reference to the manufacturing sector as one of the priorities of the government, it was mentioned that:

> *They should know themselves that they are being protected by the law (Public Official).*

These examples show that the *voice of the businesses* or their inclusion in policy making initiatives is little more than *flinging the cap over the windmill*. I discussed the interaction of formal and informal institutions in Chapter 2 and the fact that the process of learning in transformation societies is slower the longer a country was under the previous regime (Kolodko, 2000). In this context, the actions of governments to build the credibility of reforms and an awareness of the rights and obligations of individual citizens and government officials are essential and cannot be left to spontaneous activities, as often happens in Albania.

In general, businesses will follow familiar norms of behaviour with little reference to a set of laws created by formal institutions that *first*, they do not consider as legitimate and *second*, they do not understand and do not know about. In addition, I argue that this predicament could only be overcome through effective education and dialogue between the government and businesses.

In this respect, initiatives like the BAC, although positive in terms of reaching a dialogue between the business community and the government, need to be developed further in institutions that are not only more broadly geographically spread (OECD, 2005), but also as institutions where businesses sit as partners in the process and not as just accepters and executors of biased political agendas.

The same applies to intermediate institutions that have often been excluded from these processes. As a representative from the RDA mentions:

> *In order for the public administration to play an important role it is necessary that it considers the intermediate structures as partners in its job and not just giving to them ready made policies and directives. In order to have the voice of the businesses in the policies which will affect them it is needed a real representation of the business (RDA).*

Moreover, these kinds of attitudes have their roots *first,* in a history of vertical or hierarchical relations that have characterised Albanian society for many years, which missed an important middle level, the civil society, and *second,* and most importantly, on the value that is placed on entrepreneurship and business development in the society. Unless these attitudes of cooperation between public officials and businesses and the acceptance of the indispensable role of each of them are developed, positive changes will be unlikely to happen in the near future.

This discussion however, does not exclude the role that the government can play in encouraging the inclusion of various actors from the business community or civil society in policy making which can build up the level of social capital needed for the credibility of reforms (Levi, 1996).

7.2.1.3 Entrepreneurship versus small business policies-is there any right balance?

I mentioned above the importance of the role that is placed on entrepreneurship. I look now at entrepreneurship policies and how present they are in the agendas of the government. A striking element in the government's objectives outlined in the SME strategy is that they make no reference to an entrepreneurship policy implying entrepreneurship and business policy are interchangeable or otherwise implying neglect from the government of Albania for policy on entrepreneurship. The discourse of the government appears to be very functional with few other remarks on entrepreneurship, rather than those related to job creation and GDP growth.

One objective of the SME strategy is an increase in the number of business start-ups. It can be considered as an implied intention to promote entrepreneurship since it is not rare that

entrepreneurship is considered as *venture creation* as I mentioned in Chapter 3. However, there is no reference made in these documents to what are the characteristics of a real entrepreneur in terms of creativity and boldness that need to be encouraged by the right system of property rights and rule of law or to entrepreneurship as a way of living that will boost the confidence of entrepreneurs.

Moreover, the means to reach these objectives by the government do not make any reference to an entrepreneurship policy that is more connected to the value placed on entrepreneurship. The lack of entrepreneurship policy in many countries has been associated with the main belief that altering the characteristics of a society takes a long time. Thus, the public policies' role in changing human orientations and preferences about business is insignificant in the short term.

However, in the Albanian context, the old prejudices about entrepreneurship as a missing productive activity[20] during communism are still present and are reflected in the attitudes of many state officials toward small businesses. This prejudice should be a reason for the government to consider a policy on entrepreneurship as soon as possible. Yet, it is known in policy making that sometimes the concern is more about the time than about the task performance, which can be associated with certain short-term political agendas.

In terms of entrepreneurship education, the provision of some training programmes for business start-ups is mentioned in the strategy. However, the contents of the policy documents and of the interviews indicate that the government is not very much concerned about education on entrepreneurship. The attention devoted to entrepreneurship education was insignificant until the recent OECD EPPA 2004 report on SME development in Albania that gave significant attention to the role of education and vocational training. A turning point in this respect can be considered the EU Charter for SMEs that the government adopted in September 2003. This is in line with the EU agenda on the need for SMEs owners to acquire entrepreneurial attitudes and skills and training to create a business (European Commission, 2002). The action plan of the European Commission to promote entrepreneurship in 1999 put forward the idea that:

> *In order to create a strong and vibrant business community we have to start by developing a spirit of enterprise, and a different approach to risk-taking as well as recognition of the value of failure as a learning experience. At present, most people do not think of, and are not prepared for an enterprising life...Entrepreneurs, in contrast, need an education, which gives them attitudes, and*

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[20] I am using the term productive activity in this sentence in order not to exclude the fact that during communism were present some kind of arbitrage or black market activities.

skills such as self-motivation, creativity, opportunity seeking and the ability to cope with uncertainty.

There is a fundamental cultural problem in Europe in that these concepts and skills are not sufficiently present in national education systems either at primary, secondary or university level (EC, 1999).

However, the government has not yet expressed an equivalent interest in entrepreneurship in the above terms in any proceeding documents or action plans. This lack of expression puts in doubt the government's real belief in entrepreneurship policies and suggests that its decisions are taken mainly to fulfil EU conditionality.

From a simple content analysis of the 2004 questionnaire for the EU Charter the emphasis on training is evident. However, the EU Charter itself lacks any more proactive approaches to promote successful businesses. These role model businesses will increase the confidence of people in trying out entrepreneurship as a viable alternative. Moreover, they can act as means to change the attitudes of people toward entrepreneurs that for the moment are considered to be arbitrageurs or tax-evaders. According to my interviewees, there is an intention to develop national training curricula and to bring entrepreneurship into high school and universities as part of their curricula. As one donor programme mentions:

> *...the role of the education system is to create awareness that running a business does not mean Coca-Cola sized businesses. Running a small business is an option everybody should consider...younger generations should understand that running a small business does not mean they have to be corrupt. They can operate in the formal sector, own property, and be able to live a very interesting and of course challenging life and, of course, make money (Donor Programme).*

However, the 2004 EU SME Charter for Albania does not mention the need for a change in attitudes toward entrepreneurship in the society. Reference to entrepreneurial culture appears only once in the entire document with regard to the National Training Program for SMEs whose aim is to improve the competitiveness of Albanian SMEs. I would like to stress the need to have a right balance between entrepreneurship and small business policies, which do not always lead to the same outcomes, as the government seems to expect.

7.2.1.4 Some preliminary remarks

In this section, I discussed the objectives of the government in connection to entrepreneurship and small business development. I referred to the ambiguity of objectives in these documents and to the lack of clarity of the objectives as such. Lack of clarity about objectives and policies

makes the process of learning in the Albanian policy making process difficult. The lack of opportunities to learn is a signal that little will be done to correct inconsistencies or revise various objectives or targets that the government has designed. This discussion becomes even more important in the next section where I will elaborate on the overall enabling environment that the government has designed to put its strategy into action.

7.2.2 Meso level

We don't suffer about laws. The laws we have adopted are based on very good models or practices elsewhere. We have laws but they are not implemented (SEED)

So far I have discussed the key objectives of the government's SME policy. I have emphasised the SME Medium Term Strategy as the core document informing the structures responsible for the fulfilment of government objectives. I also discussed the policy initiatives that the government has undertaken to fulfil its objectives on a national strategic level. The main emphasis is on improving the business environment in the country and creating a proper institutional framework for entrepreneurship.

Here, I look at the means articulated in these documents in connection with the achievement of the objectives outlined by the government in the meso level. My focus in this section is on the efforts the government has undertaken to create a financial infrastructure that is supportive and facilitates the development of the small business sector and a legal and regulatory framework that is conducive to growth. These are both recognised means of achieving a sustainable business development in any economy.

7.2.2.1 Financial infrastructure-some need for improvement?

The reform of the financial system has been slow. However, in recent years significant improvements have taken place, including an increase in the number of banks operating in Albania, the successful privatisation of the National Commercial Bank in 2000 and the privatisation of the largest bank in Albania, the Savings Bank, in December 2003. Despite this change, the EBRD financial sector reform score (2003) for Albania is only 2+, which ranks it among the countries with a poorly developed financial sector.

With regard to SMEs finance, there are two main actors that provide commercial finance to SMEs: banks and micro-credit organisations. However, the policy of banks toward small businesses has not been very favourable. The high number of bad loans and the restrictive monetary policy of the Bank of Albania to achieve macroeconomic stabilisation led to the imposition of a credit ceiling on the two tier banks that limited the amount of credit available to businesses. Over the years, the banking system has gone gradually through many changes in the ownership structure (from state dominated to a more balanced structure), location (from mainly concentrated in Tirana and some major cities to other cities), as well as the amount of services available to their clients.

Still, the lack of instruments against risk and the lack of collateral from small businesses have complicated the borrowing procedure in Albania. In 2002, the level of bank lending to the private businesses in Albania was just 4,7% of GDP. Mainly, the bank funds used to credit SMEs is just 10-30% of the money they have available and these are short term loans due to the high risk banks perceive to be associated with SME lending (GTZ, 2003). Although these figures have improved, they still compare poorly to an average of 27% of GDP lending to the private sector in the EU accession countries and 10% in the rest of SEE countries (OECD, 2003a).

The financial infrastructure in Albania includes seven micro-credit institutions. In many countries their establishment has been promoted as part of a social policy to create self-employment and to fight against poverty rather than as a pure economic policy. Their role is important considering the fact that most of Albanian businesses are micro businesses. Moreover, they operate in areas where the banking system is still not available or in rural areas. Nevertheless, what is still missing is what in the SME strategy is called *long-term development finance* which will cover the needs of many entrepreneurs that need to introduce new technologies or are committed to long-term growth of their enterprise.

The financial system is not facilitating it anyhow considering the fact that the loans should normally be repaid within a year time. In an interview I conducted with an employee of the Credit Department in the NCB of Albania, strong reference was made to the need of the bank to be cautious. In this respect, the following quote gives an explanation regarding the policy of this bank toward business crediting:

> *While there is stability of macroeconomic indicators there are many microeconomic issues that make the process difficult. The unfair competition and the fiscal evasion make the game difficult,*

especially for those enterprises that try to play by the rules of the game. In these cases a business that not only has to face these issues but also has to repay a loan is in very serious difficulties. We take these into account in our projections of a business's future from the moment it applies for a loan and further on assuming the effects of these hypothetical expenses on that business (NCB).

In addition, the idea that was put forward in the SME strategy to create a development fund that would allocate the donor funding away from the banking system, so as not to distort their lending policies, seems to have remained on paper and *out of fashion'* until now. However, from an enterprise perspective, finance has never been one of the most severe obstacles in Albania and elsewhere, since informal sources of finance like friends and relatives or emigrants' remittances have always been available, as I have shown in Chapters 1 and 5 of this thesis. Although there are still some problems with the financial system as mentioned above, it is the institutional setting that makes banks hesitant toward offering more sophisticated services to businesses and long term finance that will boost the manufacturing sector that is one of the top-priorities of the government. To further illustrate this point, my interviewee thinks that businesses will face problems for as long as:

... (the) economic reforms will deviate, will not be fully implemented or as long as rules and regulations will be used arbitrarily then SMEs will face difficulties. In this business climate when rules are not applied the same to everybody, when goods enter contraband the country, where somebody does not pay the electricity or social contributions, businesses will not feel as equal in this game. Imagine these businesses to have a loan to repay... (NCB).

7.2.2.2 The regulatory system-the Achilles' heel?

My discussion so far points to decisive role of the regulatory system. Its role becomes even more significant when seen in its broadest context of structures, processes through which they are not only created but are also enforced and adjudicated. The main aim of any government is to increase the competitiveness of the business sector in order for it to prosper and to fulfil the societal interests. However, the government should also ensure the design of a regulatory framework that will set the game right for businesses to feel confident investing on their business ideas.

The OECD (1994) has identified the following quality standards for the regulatory system as a whole as well as for individual regulations including:

- Coherence, consistency and balance between competing policies
- Stability and predictability of regulatory requirements
- Ease of management

- Transparency and openness
- Consistency and fairness in implementation
- Adaptation to changing conditions (cited in Szabo, 2004)

I use them as a reference point in discussing the wide regulatory framework in Albania in the rest of this section. The design of the *legislative framework* in Albania has not been very SME-friendly. Some measures to liberalise the entry conditions were undertaken at the beginning of transition, while the rules and regulations were introduced and implemented only at a later stage. As Hashi (2001) argued, it *"created a 'free for all' atmosphere which, although very conducive to private enterprise, did not encourage a sense of law"* (p. 223).

Moreover, the design of regulations has for many years been a *monopoly* of government structures with no or little inclusion of other actors in the process. Since this process has suffered from the lack of knowledge about SME concerns, they have not been taken into account in the regulatory and legal framework. Moreover, together with the tenuous rule of law, they have influenced the choices of many entrepreneurs to enter the informal economy, which is one of the most developed forms of unproductive activity in Albania. Although the reliability of data on Albania has always been an issue, a study was published in December 2004 by the OECD Investment Compact (OECD, 2004b) for the government on the informal economy in Albania. The study estimated that excluding the agricultural activities the size of the informal economy was 23.4% of GDP at market prices in 2002 and 22.7% of GDP at market prices in 2001.

Although there are no figures for 2003 or 2004, some rough estimates in the report state that it has been more or less the same. In general, they attribute these levels of informality to the tax regime in Albania and the threshold of 8 million lek turnover for VAT purposes which increases the incentives for businesses to underreport their turnover. In this regard, it is cited in this report that:

> *The two-tier VAT regime results in a break in the valued added chain that, in turn, facilitates turnover under-reporting, VAT and CIT evasion. Dysfunctions in the operations of the customs administration create an additional channel for turnover under-reporting, increasing the pressure from unfair competition through parallel imports (p. 13).*

Another widespread form of informal activities is the non-compliance with the social security contributions. Businesses under-pay social contributions by abusing the minimum wage

provisions or by under-reporting the labour force. According to some estimates from the Department of Social Administration, this is approximately 30%. Thus, the informal economy has a large impact on competition in the market putting those enterprises that operate in the formal economy and respect the rules of the game at a big disadvantage.

This problem has been acknowledged for many years now. The SME Medium Term Strategy also focuses on the informal economy and considers a good regulatory framework as a prerequisite for fairer competition in the market. My interviewees report the same:

> *The unfair competition has been a problem during these years. A law on competition has been approved but the right authority to implement it was not created. It exists now but the law is not any more implemented (Donor Programme).*

This chaotic situation with regard to the competition policy is also made clear by the EBRD indicators. In 2003, the EBRD gave a very low score of 2- to Albania on her competition policy which means that the legislation and the institutions to secure effective competition are not yet in place.

Moreover, the legal and regulatory framework has been continuously changed, sometimes not even being clear in its aims, making it hard for the enterprises to perform their activities. To give just a simple example, the laws *"On Income Tax"* and *"On Profit Tax"* have been changed *five times since 1993, the Law "On Small Business Tax" has been changed 4 times since 1993, the Law "On Social Insurance" has changed 20 times since 1993 and VAT exemptions 16 times since 1995"* (Preci and Hetoja, 2001; 35). This unpredictability and instability of regulations are characteristics of a low-quality regulatory framework that fails to encourage compliant behaviours and affects the credibility of the government, which is important to support institutional change.

In addition, the uneasiness of their management has created space for corruption because regulations can be interpreted subjectively and can be implemented to favour or penalise certain groups. During my interview with a business association it was stated that:

> *If businesses see that the arbitrary use of the laws is present then it is natural that they will avoid them... On the other side the agro-processing industry has to pay a 20% VAT not for the value it adds to the product but for the whole value including the price paid to the farmer...this is totally wrong...as the example of VAT shows if businesses would have to pay it the whole agro manufacturing industry would have gone bankrupt. In such cases businesses find easier to avoid paying taxes and the two parties just continue 'hating' each other (Business Association).*

In 2002, the European Training Foundation undertook a study whose aim was to discuss the regulatory framework for doing business in Albania. This study concluded that more effort is needed to implement the law rather than to improve the law itself. Micro and small size enterprises are enormously burdened by the prepayment of profit tax and the long time it takes for reimbursements. They need elimination of possibilities for subjective application of the law by the tax administration. The same applies to the customs authorities. One of the worries businesses have regards the long time and the high costs they have to endure in the process of judicial dispute resolution, including the difficulties presented by the execution of court decisions.

Nevertheless, the most significant step in this direction in terms of policy measures has been the action plan that the government formulated based on the recommendations of a study conducted by FIAS on *"Removing Administrative Barriers to Investment"*. The same issues of concern for businesses are reported in this study. Tax and Customs Administration are the main areas to be improved. The concern is about the way the administration works and the current hostility between the business community and the public administration. This study suggests that a major concern for the Customs and Tax Administration is the achievement of their revenue plans rather than an increase in the tax base of the economy.

The emphasis toward revenue plans has been a concern for many years now and top government officials acknowledge it too, but not much has been done in terms of implementation and developing awareness, as I mentioned previously. In a recent speech to the Tax Administration, while introducing the new general director, the Albanian Minister of Finance stated that:

> *Our challenge on the Tax Administration it is not just the plan, especially if it is based on subjectivism, unprofessionalism, or abusiveness. It is first of all a challenge of reforms and strategies of increasing the performance of the fiscal administration, elimination of administrative barriers, and zero tolerance toward corruption, abusiveness, and nepotism by helping in this way the sustainable growth of qualitative and quantitative indicators (Albanian Minister of Finance, 2005).*

While the problems are well identified, the main issue is how to make the public administration willing to cooperate and to perform not on simple financial targets that are applied differently to different business scales but on the basis of transparency, accountability, capability and professional ethos that are missing in the Albanian environment. As mentioned earlier, there is an enormous problem of information sharing and in operational guidelines of different regulations and plans. The 2004 OECD EPPA report showed a lack of awareness among small

businesses about this initiative and about the measures that the government has undertaken in terms of reducing administrative barriers. However, since this exercise will be repeated it means that the government will be able to map out any positive or negative outcomes as a result of the introduction of new measures.

I referred previously to Mantzavinos (2001), who argued that the content of competition is determined by rules and regulations, formal or informal that set what is allowed in terms of market activities and the kind of knowledge that is being transmitted in the society. The above discussion showed that the regulatory framework in Albania is characterised by deficiencies of various types in its content and in its enforcement. It is clear that the behaviour such regulatory frameworks induce are non-compliant, unproductive behaviours that could be characteristic of zero or negative sum games in the Albanian economy.

Based on my theoretical discussion on the need for institutions that will reduce uncertainty and encourage risk undertaking, this analysis suggests that such institutions are absent in Albania or they are not implemented which has given raise to problems of the quality of the entrepreneurship. It is a common view in Albania that market competition is based on good connections with political actors rather than on creativity, innovativeness, boldness and alertness to productive opportunities that characterise productive entrepreneurs. In my interview with a business association it was mentioned very pessimistically that:

> *I don't think the ability to compete in the market is important because the market does not have any rules. To contraband there is no need for any specialisation apart from having good connections with politicians of high levels in order not to have difficulties with the customs. However good you are in a field you can't compete or manufacture in Albania. This is a problem that all businesses are facing (Business Association).*

Of more concern are the consequences that such behaviours have on the social fabric when society finds them acceptable, as Feige (1997) suggests. The discussion so far highlights an important pillar of good governance: the public administration.

7.2.3 Toward a better understanding of the public administration-the missing spot?

I outlined above the importance of the public administration in the formulation and implementation of the policies affecting small businesses. My discussion covered the

application and enforcement of regulations, which is a problem discussed in various countries in transition at the macro and meso level.

My theoretical and empirical discussion showed that while from a formal institutional perspective there are rules and regulations in place this current provision is not sufficient. Also, there are agencies or specific departments created that in their conceptual design do not differ from those one finds in more developed economies. However, the way they operate and the way they interpret and thereby use formal institutions is subject to the proclivities of individual officials employed within these organisations. This situation is explained not only by the particular dynamics of these organisations, typical in any environment, but also for reasons that are more specific to a transition context.

Hodgson (2004) criticised the concept of organisations as social actors used by North (1990), which although important, misses some crucial aspects of an organisation such as the conflicting objectives that individual members of these organisations might have. Moreover, while specific individuals might know what their responsibilities are under a particular organisational framework, they might not be able or willing to place themselves in the broader picture of that organisation.

These theoretical observations are also reflected in my empirical work. Many of my interviewees involved in SME development saw a need to revise aspects of the SME strategy in Albania. However, one of the interviewees, a public official in the Department of Business Promotion, responsible for formulating policies on SMEs, reported a contrary view. He argued that there was no need to revise the strategy. In the EPPA 2004, the same issue is discussed with the same Department again (maybe with other officials this time), and it mentioned the need for changes in the strategy.

This finding suggests that contradictions or lack of proper information may exist within what North (1990; 1994) calls players. This may go some way to explain poor implementation of policy by these institutions. While lack of motivation, short-term horizons, lack of capabilities are among the general reasons that have been cited to explain weak implementation of policies in the transition context, future research interest should examine the dynamics of different views and interests within these organisations. There is another issue that makes the job of the public administration more difficult. The majority of the laws that are introduced in the country are not followed by implementation regulations and operational guidelines that would outline the

responsibilities of people in the administration, would restrict the space for discretionary use of power and would compensate for lack of transparency and accountability, all crucial elements of good governance.

Conclusions

The aim of this chapter was to discuss the government's stance on SME development with a focus on its main objectives and on the impediments to effective implementation of the objectives. I showed that the objectives of the government are not much different from those of its counterparts in other transition countries and elsewhere. My analysis in this chapter was based on a multi level approach whose aim was to identify the obstacles to the implementation of the objectives. In this chapter I have been concerned with the macro and meso analysis of the SME policy framework in Albania.

I showed that there is a well-established policy framework in a national or strategic level with all the relevant laws and regulations in place. I also discussed the ambiguities in the strategy documents and in the policy initiatives about entrepreneurship and small business. Of great concern is the insufficient cooperation between the formal institutions responsible for SME development and the business community and the fact that the SME sector is discussed in a functional way and not viewed as a serious partner.

Moreover, I discussed the financial and regulatory framework and how the latter influences the operation of the former with regard to SMEs. I discussed the regulatory framework in its broadest context by comparing it to what are the characteristics of a good quality regulatory framework outlined by OECD. The Albanian regulatory framework suffers from unpredictability and instability, management uneasiness and also inconsistency and unfairness of implementation. Also, I paid attention to the administration of the policy process with a focus on the implementation stage. As my analysis showed, there is need to build administrative capacity and to increase the motivation of public officials and administrators.

In this chapter I have been concerned with the policy process in terms of initiation and formulation of policies. In the next chapter I take the argument forward with a discussion of the micro level with special reference to the actions being undertaken by various intermediate organisations such as donor programmes or support agencies. Along these lines, I will discuss the coherence of the SME policy framework in Albania and the issue of the regional focus of

strategies and structures. The coordination of actors at all three levels will complement my analysis of policy coherence.

CHAPTER 8

SME POLICY FRAMEWORK IN ALBANIA

COHERENCE AND OPERATIONALISATION

(Documentary and interview analysis 2)

Genuine learning about the problem will sometimes be prevented not only by the local policy makers' eagerness to jump to ready made solutions but also by the insistent offer of help and advice on the part of powerful outsiders...such practices will tend to cut short that 'long confrontation between man and a situation' (Camus) so fruitful for the achievement of genuine progress in problem-solving.

(Hirschman, 1973)

Introduction

In Chapter 7, I discussed the government's SME policy objectives and policy initiatives, and the formal institutions established at the macro and meso level to implement those objectives. I also discussed the functioning of the public administration and how it could facilitate or deter the enforcement of formal regulations. In this chapter, I discuss the efforts the government has made to create a support infrastructure and the coherence of the policy framework. I discuss the micro level institutions and their role in the implementation of the government's policies and programmes, and analyse the attitudes they induce in businesses.

I start this chapter by emphasising in Section 1 the two prerequisites of a coherent entrepreneurship and business development policy. These will act as a guide for discussing the coherence of Albanian SME policy. I move on the discussion in Section 2 to the operational activities of different support programmes active in the country. I explore the way these programmes work in terms of sectoral and regional coverage, the kind of support they offer, the relationships with the business community and also the attitudes these relationships have induced.

I conclude by arguing that the Albanian entrepreneurship and small business policy framework lacks effective coordination between different institutions and suffers from a lack of a regional focus and the poor quality of the programmes offered. Nevertheless, a number of positive steps are being taken, as shown by the changes in people's attitudes which reflect a learning process in the whole society. There is still much work to be done to design policies and programmes that better fit the government's priorities and the social and economic situation in the country as well as the needs and concerns of the SME sector.

8.1 Prerequisites of a coherent SME policy

It has been argued in the literature on entrepreneurship and SME policy in Western countries (Bridge et al., 2003), that there are two prerequisites of a coherent policy on small businesses: *First,* since the SME policy in the majority of the cases is dispersed in many different structures, the achievement of a good inter-ministerial, inter-agencies or programmes coordination is of great importance. *Second,* policies should not be national in coverage, but should have a regional focus. While it is reasonable to expect that policies will be formulated at the level of central government, their implementation is usually expected to be carried out through regional agencies that tailor the central government policies and strategies to local or regional needs.

In the previous chapter, I pointed out that although the SME policy is mainly designed by the MoECT, it is also a responsibility of other ministries. From a documentary point of view, the MoECT should keep close contacts with other Ministries related somehow to SME activities, such as the Ministry of Agriculture, Ministry of Transport, Ministry of Labour and Social Affairs and the Ministry of Tourism. However, my analysis at the macro and meso level demonstrated that the sectoral and regional focus is weak, owing to the low level of involvement of other ministries such as the Ministry of Agriculture or the Ministry of Industry, despite the policy emphasis on manufacturing activities and the large number of businesses in the agro-business industry.

In this chapter, I focus on the network of agencies and donor programmes that are involved in the implementation of the strategy. I study their coordination, their involvement and the extent to which their activities fit business needs in different regions. At the micro-level, the role of the state is *first,* to create a network of business support organisations and *second,* to give them the responsibility to translate policies into main areas of action that suit the regional needs. From this perspective, the main policy concern at this level should be the ability of the state to design a system that will serve better the needs of the businesses at local or national level.

In this respect, based on the high priority that was placed on the SME sector, an SME Foundation and seven Regional Business Agencies were created in 1992 (there are now ten of them, and they have been renamed Regional Development Agencies - RDAs). They were established with the assistance of EU PHARE programme (MoECT, 2001). Their aim was to assist SMEs and provide training necessary to operate in a market economy. The 1997 crisis and the ending of PHARE funds led to the closure of this foundation. Following that, during the

period up to 2000, SME policy in Albania began to be institutionalised and a number of different ad hoc measures or programmes were developed that created numerous problems of coordination of SME policy actions.

I mentioned in the previous chapter that for the first time in 2001, a Medium Term Strategy was formulated for the development of the SME sector. However, it has not yet been effectively implemented (OECD, 2003a). Within the framework of this strategy and the NSSED, a special law on SMEs was approved in 2002. An SME Development Agency was created in 2003 which, among other roles, is responsible for bridging the activities of various support providers including donor programmes. The government also signed the EU Charter for SMEs in September 2003, giving more scope for SME support. The MoECT is supported in the formulation of policies by the network of RDAs, Chambers of Commerce and the Local Economic Development Agencies, as regional policies become a more and more important part of the government's policies on SMEs. However, no studies have yet been undertaken to guide policy making in relation to the regional aspect.

Moreover, the SMEDA has signed a Memorandum of Cooperation with the RDAs in order to create a regional network of support providers funded by the government to ensure the implementation of the strategy. These efforts are concentrated on building the capacity of the established network rather than creating a new one from scratch. Nevertheless, there are some problems in the way these structures operate, as I will show in the rest of this chapter.

8.2 Toward a better understanding of SME policy operational issues-The need for a rethink?

In this section, I outline the most cited themes in my interviews, reflecting the main operational issues of business development in Albania. My discussion considers issues related to different support programmes and the kind of assistance they have been offering. I also discuss some issues related to path dependency based on these social actors' perspective and my analytical insights from these interviews.

8.2.1. Coordination and commercialisation of services

The best way to assure that a reform process has some "intrinsic motivation" or rootedness is not to start a project but to find it. (Ellerman, 2001)

A theme emphasised by the support structures in the sample including donors' programmes[21] is that the assistance of different donors has overlapped over a long period in Albania. The government has found it difficult to present its priorities to donors. On the one hand, the Albanian government has failed to identify clear priorities for the future development and potential of the SME sector. Its intention to promote a dynamic business sector and to increase the competitiveness of the Albanian economy are well acknowledged in the various documents that that government has designed such as the NSSED (Government of Albania, 2001b) and the SME strategy. However, there is still a major deficiency in the implementation of strategies. On the other hand, the approach taken by the donor community has been such that much time and effort is duplicated and effectively wasted:

> *they send a specialist for a few weeks in the country, they come up with a project and the whole duplication and wasted efforts happen again (Donor Programme)*

Thus, donor overlap and short-term approach means that important information on the local context is often neglected and instead of customised solutions *ready recipes* that are not always applicable to the Albanian context are transferred. The literature on business policies (Bridge et al., 2003) indicates that in many cases business support organisations simply follow government or donor agendas instead of responding to the perceived needs of small businesses in local market conditions and developing more appropriate and effective agendas of their own.

It is often problematic that the same services are given to the same region or group of businesses and there is often little follow-up of a group of businesses to give them more comprehensive assistance. Instead, the services follow certain donor agendas which tend to ignore what has been offered up to now. Old solution are often wiped away to make room for the new, instead of starting from where the *"doers are"* (Ellerman, 2001: 7). Situations like these have not gone unnoticed by the business support community. In this respect, another service provider comments that:

> *...it is not good that new projects start all over again on the same issues we have been dealing with...(or) in regions where different projects have been going on for years like GTZ in*

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[21] I would like to bring to the reader's attention the fact that in the Albanian context, it is mainly spoken about donor cooperation because the government itself has not had the financial means to fund SME development initiatives itself.

agribusinesses... it is needed to understand what they have been offering before a new project starts doing the same things all over again (RDA).

In addition, the literature on aid development strategies has often argued that aid has been mainly based on a *"social engineering"* approach, which has failed to see the situation through the eyes not only of policy makers in the countries involved, but also the population in general (Ellerman, 2001).

Many interviewees commented that donor support has been mainly concentrated in Tirana and some other main cities and SMEs located in more remote regions have found it difficult to access their services and support. This concern has also been expressed in the OECD EPPA reports (OECD, 2004, 2005). However, efforts to change this situation are still limited. For example, the South East Europe Development agency (SEED) is a new initiative that has been operating in the Balkan Region since 2002. It is financed by ten donors, but it has only one office in Tirana. According to the country manager for Albania:

> *...we (they) have tried to be cautious in this decision. We have served clients from different regions like Korca, Pogradeci etc. It is not that we don't want to offer our services to other regions but the lack of information about what we offer has been a main reason. We have done some promotional activities in Fier, Vlora, Korca, Elbasan, Shkodra, Durres as cities that offer more potentials ...But there is a problem. As a matter of fact our services are not free of charge while there are many donor programmes that are offering their services for free (SEED).*

The decisions of donors to locate in or to serve specific cities reflects the fact that, as their financial or other forms of assistance are charged at commercial rates, it is more profitable for them to be located in the areas with most potential. This thinking that has driven the support policies in Albania has contributed to a degree to the distorted economic structure in disadvantage not only of the poorest areas but also of industrial competitive and sustainable activities. When assistance has involved finance the donor funds have been channelled either through commercial banks or through microfinance institutions. This move has led first, to the incomplete usage of these sources over a period of time because of the over cautious policies of the banks and second, to the selection of those businesses which offer quick rate of return on investment or which already have a track record.

SEED, for instance, offers assistance to those businesses that need loans over $100,000 and that already have a track record. As Bateman (2003) argues, the *"adverse selection"* of trading and importing activities as those that could repay the high interest loans over a short period of time has not only created import dependency but has not given any chances to production activities to strengthen their capacities to be viable and competitive businesses.

Adding to this picture of the institutional deficiencies in Albania, it is even more difficult to plan to invest in manufacturing. As one member of a business association says:

> *(in services) the investment is quick and the rate of return is high. This is the best option considering that the competition is fairer in this sector, one does not have to deal with the customs or the tax administration as much as in any other type of activity...(and) you do not have to compete with the imported goods...not many people dare to invest in manufacturing as many products such as oil, tobacco, food, alcoholic beverages etc enter as contraband in Albania...the manufacturers despite the customs duty, have to pay for the raw materials and all other fiscal obligations which mean that one that brings goods as contraband has a 40% advantage as a result of evading all these obligations...consider if these businesses also have to repay a loan... (Business Association)*

These arguments reinforce the institutional thesis that *"the organisations that come into existence will reflect the opportunities provided by the institutional matrix"* (North, 1994: 361). In this respect, the institutional setting in Albania is offering more scope for service activities and also for unproductive activities.

Despite the worrying evidence about the informal economy in Albania, another theme that was brought to attention was the distortion of markets by donor intervention. The case of Albania suggests that the non-coordination of donor interventions has created another form of unfair competition[22] between businesses in Albania as is best stated in this quote from another donor programme:

> *...under a number of World Bank programmes, grants are being provided to businesses that are competing with our clients that are borrowing at commercial rates of interest...(Donor programme)*

This statement draws attention to another main issue in Albania that is well acknowledged in the NSSED as well as in the SME strategy, namely the imbalanced regional development and poverty alleviation. I mentioned previously that the disparity between different population groups and the high level of poverty are prominent problems of Albanian transition, with one quarter of Albanian population living in poverty (Government NSSED, 2001b). Poverty has a marked spatial and regional dimension in Albania. The rural areas and the mountain regions are the poorest on all dimensions of poverty (De Soto et al., 2002).

Moreover, in these regions there is an almost total lack of SME support infrastructure, including banking institutions and local SME support providers. Taking this into consideration, it would

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[22] Unfair competition is a major concern of businesses in Albania and comes from businesses operating in the informal economy or the arbitrary use of laws and regulations by public authorities.

be more sensible for donors to offer grants to those areas in which financial and support services are absent and which are in greater need of subsidised support.

Similar issues with support providers can also be traced in the literature on Western countries. It is widely argued that in the majority of cases, support providers operate in their micro worlds that are part of a wider system about which they have only limited knowledge (Perren et al., (2001) cited in Bridge et al., 2003). The creation of the SMEDA and its objective of bridging these micro worlds, in order to avoid duplication of efforts and initiatives, seem to be a positive development.

However, it remains to be seen whether it will succeed in fulfilling its role not only because of its problems as an isolated structure but also with regard to its role within the broader Albanian formal and social institutional context.

8.2.2 "One size fits all" programmes

Perhaps the best-perhaps even the only-effective slogan for aid is: Find out what people are trying to do and help them to do it better (Schumacher, 1964: 374)

Under the heading of means being used to reach the objectives of SME strategy, the government gives special attention to *"the improvement of SMEs operational capacities"* (GoA SME Strategy, 2001). This effort is concerned with various training programmes offered to both start-ups and established businesses. In my interviews with different support providers, I asked about the kind of training they offered to businesses and whether they had any criteria about the choice of businesses to receive training through their programmes.

One of the issues that emerged from the interviews is the identification of training needs. The identification of training needs has been neglected in Albania and for many years support structures were aimed at easily accessible businesses, irrespective of whether they would benefit from training. This has brought with it two main problems. *First,* the businesses and the localities that would benefit most are mainly excluded from the training activity and *second,* it has built up a degree of scepticism about training and its aims of transferring skills and knowledge to the entrepreneurs. Also, because the training has been offered free of charge for many years and the evaluation of a training activity has been made only on the basis of the number of people who have attended it, a certain legacy of *no value* has become attached to training. As an interviewee from a donor programme mentioned:

> *...the clients are a bit sceptical about the value of training. They've had it for years and it's been provided for free. Unfortunately in Albania as anywhere else, free is not perceived as having value and people do not see any benefit of free services. On the other hand they are reluctant to pay because they have received training free for years. So, they undervalue training because of this experience (Donor programme).*

Moreover, personal contacts are a very important aspect of doing business in Albania as the survey evidence showed and as I discuss in a later section. Training activities, on various occasions, have been organised on the basis of personal contacts with the organisers and a kind of informal obligation to help each other out, rather than on businesses' needs. As one entrepreneur in Elbasan says:

> *I have attended some of the trainings from the RDA because my friend from the PSHM (the Albanian Partner for Micro-credit) asked me to do it because otherwise the activity could fail...other people in the course thought they were going to be paid for participating in that training activity.... (Entrepreneur in Elbasan)*

I mentioned before that there is a lack of *clear targeting* of businesses which should be supported: start-ups or growth businesses. There is some agreement that what counts is the quality of the businesses rather than their quantity (Storey, 1994; Hart, 2000). However, in my opinion these choices have to depend on the specific conditions of a country and the specific needs of its small business sector. So, those schemes that are more specific in their aims trying to fill market gaps work better than other schemes.

In the SME strategy document, as well as in the SME law, as I argued in Chapter 7, the inclination of the government toward manufacturing activities in the country is made clear. The most recent Stabilisation and Association process (SAp) report for Albania recognised the need for Albania *"to rapidly develop and implement a strategy in order to create a basis for fresh industrial investment and to enable it to restructure those existing industries in which viable operations can be foreseen"* (CEC, 2004: 26). Nevertheless, the number of initiatives in the country that work with manufacturing activities not only in terms of financial assistance, but also in terms of alertness to previously unknown knowledge is still low, as suggested by my survey evidence (Chapter 5, Section 3).

One of the few such initiatives is the USAID SBCA project. This initiative is trying to fill the gap in lending to manufacturing activities, which may be one of the reasons for the weakness of the industrial sector in Albania. It may also set a positive example that *"there is no higher risk in lending to these (manufacturing) enterprises than to trade and other forms of economic*

activity" (SBCA). SBCA has two credit lines: one which ranges from USD 3,000 to USD 25,000 which operates through the Albanian Partner for Micro Credit and another which ranges from USD 15,000 to USD 25,000 through the NCB of Albania. Apart from the financial assistance to businesses, it offers technical assistance, that according to managers of the programme is really necessary because:

> *what is missing are good projects and that is when technical assistance comes in, being able to help businesses to put together good business projects, realistic plans finding markets and therefore reducing the risk of financial institutions in lending money to these clients (SBCA)*

This initiative seems to be aligned with the SME strategy objectives in offering assistance: first, to manufacturing businesses in the country and, second, by concentrating its efforts in regions that have not been offered any assistance so far. So far, 3,151 businesses have been involved in this project of which, according to SBCA representatives:

> *75% ... are outside the Tirana, Durres, Kavaja conurbation. So we are getting out into regions where we know we have had little impact up to now. This is the North-East region. Until recently from all the NGOs operating there, none of them have any business orientation (SBCA).*

However, the fact that not only information is missing in many remote regions, but also the basic infrastructure still remains problematic. As one member of a business association argues:

> *It is an adventure to go to certain areas in Albania, imagine doing business there. Investments in infrastructure have been really low these recent years especially if we speak about rural roads (Business Association)*

Going back to the case of SBCA, it is noteworthy that it does not distinguish between businesses operating in the formal or informal sectors. Although it sounds eccentric to support the informal sector, in the current stage of the Albanian economy this initiative could provide these businesses with the opportunities to increase their capabilities and their chances of survival once they join the formal sector. The other programmes or initiatives with which I conducted interviews did not do any sectoral targeting, but they were working with businesses of different sizes and from different sectoral activities.

I also asked my interviewees about the kind of assistance that they offer to SMEs. It was made clear by the interviewees that mass general training has been the prerogative of the support structures. The most common service has been the writing of a business plan or just general management training. Although this initiative could have been a good choice at an earlier time to make businesses familiar with the concepts of the market economy and business management the commitments to FTAs or WTO imply that off-the shelf programmes should leave their

space to targeted assistance and to customer led approaches that will fulfil the specific needs of particular businesses. For example, Albania has been granted autonomous trade preferences by EU, but Albanian manufacturers have so far been unable to meet standards of product quality, certification and so on. From my interview with a GTZ expert in Albania only seven manufacturers fulfil the ISO 9000 criteria, although efforts are being made to increase the number of businesses that want to be certified under CARDS programme as outlined in the EU SME Charter for Albania.

Moreover, SME support structures have rarely offered any training or assistance with specific issues that are of greater concern to a business. This observation reinforces the previous discussion on the need for support providers to strengthen their capacities and skills. It also points towards the need for support structures to create a common language with their clients in order to understand their concerns better. Thus, support providers should redefine their role and be closer to the business community and their specific needs.

As many SME manufacturers said to me training on quality management has rarely been offered. Although they have to compete with imported products, there are no modules on pricing, packaging or distribution - all factors that would help businesses to better meet this competition. Not only the kind of knowledge, but also the way this knowledge is transmitted to businesses are of immense importance. In the development assistance literature (Ellerman, 2001), it is mentioned often that:

> *the main problem in knowledge based development assistance is the standard, default or naïve theory in use that the agency has development knowledge in the form of answers that need to be taught, transmitted and transferred to the target population of trainees. The methodology is taken as so obvious that the focus is simply on how to deliver knowledge, how to scale up the knowledge transmission in the country and how to measure and to evaluate the impact of these efforts (p. 17).*

Thus, it is sensible to argue that initiatives should be more creative or innovative and offer not only passive training where businesses only sit and listen as *"passive containers into which knowledge is poured"* (ibid. 17), but also offer possibilities to apply it to real life situations and to make businesses feel the *ownership* of this process. One entrepreneur in Tirana goes further dismissing any kind of assistance that might be provided in the country pointing out that:

> *My Turkish partners help with the technological expertise and quality problems... in my opinion, if an Albanian business is successful it has a foreign partner (Entrepreneur in Tirana)*

Reading carefully into this sentence, the underlying meaning of this quote is that successful approaches are those based on the active participation of the business because the assistance is

given on site and more importantly the assistance involves a better knowledge of the problems facing the business.

As I mentioned in the previous chapter, the director of the SMEDA recognises the need for a revision of the training curricula as well, which will be more in tune with the needs of the SME sector and of economic development in Albania and efforts to prepare it have already started. However, only a small number of businesses have been assisted over the years by support initiatives.

8.2.3 Path dependency-Communist legacies or context-imposed behaviours?

Now Albania is catching up fast but it is still Balkans and has many of the problems that come with Balkan mentality (Donor programme)

In Chapters 1 and 2, I discussed the concept of path dependency and its relevance in a post communist business context. I argued that while old behaviours are prevalent and culture and mentality are among the factors explaining the pace of transition by overestimating them one risks to leaving aside other factors that can be as much of explanatory value, as culture or inherited behaviours. Moreover, I argued that these approaches do not offer much space for reform and the role that good policies have in adapting people's behaviour to new structures of rights and obligations in the society and thereafter achieving social change.

The Albanian mentality, in terms of old inherited behaviours, was among the most common themes in my interviews. Mentality was discussed with regard to the kind of enterprises created in Albania, the kind of relationships with and expectations about the state and, the forms of trust and social cooperation. In the rest of this section, I show how these behaviours or induced attitudes affect the government objectives of business development and the operational issues related to them.

8.2.3.1 Demonstration effects-how successful businesses are being promoted?

I argued in the previous chapters that entrepreneurship's role in a society can be appreciated not only through the value placed on it by the education system, but also through more proactive policies that will promote successful entrepreneurs and entrepreneurial practices as role models. Entrepreneurship and business policies in many countries, among other reasons, are favoured

for the imitation or demonstration effects that successful SMEs have on other entrepreneurs and aspirant entrepreneurs. This also follows my definition of entrepreneurship as not mainly an innovative act, but also as incremental changes and imitations in the market that open the way to a process of knowledge accumulation, which I considered to be an important factor in encouraging market dynamics.

In Albania however, for the reasons I outlined previously, the most successful business stories are found in the trade and services sector. Although the total isolation of Albania during communism had its own influence on the range of business opportunities to which people have been exposed, little has been done until recently to change this and to expose people to the whole range of business opportunities that are available. This lack of exposure to a wide array of business opportunities was considered by one interviewee to be the main reason why people in Albania would have as their first choice of business a restaurant or café and not a manufacturing activity. Although demonstration effects are strong since potential entrepreneurs would go for *"what they see around them, i.e. 'me too' businesses"*, the interviewee considered Albania to have a café culture, and thus since:

> *people like to sit and drink coffee, opening a café or restaurant is the first opportunity they see (Donor programme).*

In this regard, the inclination to attach explanatory value to a history of isolation and non-exposure and to fashionable headings such as path dependency is obvious. But transition is not only path dependent on the legacies of the past, but also path shaped through well-designed policies that ensure the reshaping of the available resources in an innovative and productive way (Hausner et al., 1995). I argued above that institutions play an important role in channelling entrepreneurial behaviour and discussed barriers to entry as important institutional factors in determining the choice of businesses to be set up. Thus, starting up a business in the trade and services sector means fewer barriers to entry for the potential entrepreneur rather than just a mentality issue.

Nevertheless, going back to the role model businesses, even if I assume that these barriers would not be an issue for the entrepreneurs in the Albanian context, it still remains the fact that little has been done in terms of working with role model businesses that can produce demonstrative effects. In the content of all my interviews and also in the content of policy documents, role model businesses and the positive effects they might have in exposing people to different opportunities and encouraging positive attitudes towards entrepreneurship were

mentioned only twice: *First,* in an interview with an international manager of a donor programme and, *second,* in one section of the SME EU Charter for Albania. This omission further reinforces my argument in the previous chapter about unclear means for fulfilling the objectives of the government in terms of business development.

This also sheds light on the kind of approach that is chosen to business development that excludes what Hirschman (1958) called horizontal learning. Success stories when transmitted to those facing similar situations or problems will start to tear away old beliefs as a result of new ones proving to be more beneficial and thus will encourage a process of knowledge transmission and accumulation in the society as one thing will lead to another.

However, in the Albanian context, the support structures suffer from other problems that affect not only good ideas, but also good implementation. I mentioned at the beginning of this chapter that although SME policies are formulated at a national level, it is usually the network of support providers created which tries to implement or to give a regional or sectoral focus to the strategy. However, on the basis of the contents of my interviews, support providers have been more worried over the years about their own survival and sustainability than about using their funds in the best ways possible. The RDAs are the only structures that have managed to survive over these 13 years. They have worked mainly on the basis of donor projects funded by GTZ, SOROS or USAID. Also they have survived *"due to personal contacts with the MoECT rather than institutional support"* as they admit themselves. Sustainability is still an issue for them. The presence of the donor community is a source of assurance in terms of sustainability and as one representative from this agency told me:

> *the situation in Albania is such that for the next ten years the donor community will be present. Thus, we will continue to work on a donor funding basis (RDA)*

However, the need to increase their capacities and to diversify their business services is also inevitable. As time goes by, businesses become more aware that they need specific expertise, which has rarely been provided so far. Although there are ten different agencies in ten districts, not all agencies in districts other then Tirana are fully operational (RDA). One reason is the lack of capacities, whether human or physical and also the lack of information and clear responsibilities. Another is the kind of dependency they have created with the centre, which might reflect the inherited paternalistic culture of communism. One representative from the RDA agency in Tirana says that:

the agencies in some regions like Shkodra or Vlora are more "sluggish" in supporting businesses and in collaborating with the donors. Some agencies are very dependent on the centre and need clear directives in many things going on (RDA).

It is often heard in policy circles that the RDAs should be strengthened in terms of their capacities, but up to now their efforts have not yielded any very satisfactory results since for the transition of these agencies to top support-providers in the country to happen is needed more time. Moreover, this situation has not benefited the local business community in these areas and has also contributed to an increase in cynicism towards them by many businesses. One entrepreneur in Vlora says:

I don't even open the door anymore to organisations like those...I did this for years but I haven't seen any beneficial results for my business... (Entrepreneur in Vlora)

However, there are cases of entrepreneurs that have different mentalities and who are more open to new and innovative initiatives, characteristics of productive entrepreneurs who are in business not just to survive but also to fulfil certain aspirations. The unfortunate fact is that these businesses are not being promoted by the various support initiatives to produce the expected demonstration effects. One entrepreneur in Tirana mentions:

I keep contacts with all these organisations because I believe that partnerships are important in doing business. There are many people that say to me "Why do you go? What do you get from them?"...Unfortunately this is the prevailing mentality in Albania (Entrepreneur in Tirana)

My discussion up to now has highlighted the need for more emphasis in policy circles and by support programmes on the role that 'real' entrepreneurs have in bringing about change.

8.2.3.2 State is seen as the answer to everything

Attitudes towards the state emerged as another theme of my interviews. The contradictory need for a paternalistic state on the one hand, and the mistrust of any initiative or reform undertaken by it on the other, are characteristics of the Albanian environment. In the beginning of transition, many people lost their jobs, lost the security they had previously had in their lives and, moreover, lost the pre-ordained way of life removed from the anxiety of having to decide for themselves. The moral and economic crossroads, to which they were exposed, influence the need for the paternalistic state. Most interviewees were surprised that entrepreneurs also manifest these kinds of attitudes. According to them, entrepreneurs should be the example of people with independent and creative mindsets and away from structures that bound them or put restraints to them. As one interviewee said:

> *Enterprises were used to the state taking care of everything and to some extent this is still the prevailing mentality... They think that state can resolve everything. But state is a partner. The state and its civilians are one. It is like the two hands that wash the face. But this is inherited from the past (SEED).*

Although it can be argued that such attitudes may restrain the expression of the entrepreneurial talent latent in every society and may block the way to activities that add value and contribute to economic growth, it is worth returning briefly to the discussion of the entrepreneur I presented above where I suggested that for entrepreneurial acts to take place, entrepreneurs should be alert to opportunities. But, in order to act upon these opportunities some framework conditions are also needed. Based on the objectivist/subjectivist view on opportunities, it is the state that develops the conditions for opportunities to be *'out there'*.

If the Albanian entrepreneurs lack the ability and skills *to see* opportunities once they are *out there* I would argue that path dependency is taking place. However, in the chaotic institutional situation in the Albanian context it is difficult to give definite answers as to what leads to what. Moreover, although everybody expects the state to act, it is evident that the state is not given any credibility regarding reforms. After the upheaval of transition, people supported the reforms. But the high levels of poverty and the rising inequalities in a country where previously there was greater equality contributed to the view that the state *was to blame* and that the reforms no longer deserved any support. As was argued quite often in my interviews:

> *Businesses see the state as an enemy or as a superior while the state has some rules and laws to obey (Donor programme).*
>
> *This existing chaos is due to the political willingness to have a lack of the rules of the game in order to abuse easier the power. This is reflected in a legislation that suffers great deficiencies, which in many cases are made in purpose to gain personal benefits or to please particular interest groups. The respect for the law is an exception rather than the rule (Business Association).*

From this perspective, because the state and its rules and regulations do not apply the same to all individual businesses, they may be caught into a game of non-compliance as long as others are doing the same. Both business associations and some SME support providers sympathise with businesses on this issue. For example, one of the interviewees from a donor programme says:

> *...they are disappointed when for example they see that the Government has spent nothing on infrastructure that might benefit their business...To make businesses more responsible they need to see results and they are not seeing any so far...The Albanian mentality (like that in many other countries) is not to worry about compliance unless they will get caught and punished-a rare event in Albania (Donor programme).*

Another interviewee said that *"the business is a victim sometimes" (Business association),* while another said that some change can come from businesses themselves by understanding that *"their record is built through honest, transparent work and not paying bribes although to escape certain situations" (RDA).*

This discussion demonstrates the contradictory attitudes that exist in the Albanian business context toward the state. However, none of these quotes exclude the responsibility of the state to establish a business environment conducive to productive businesses enterprise. The business community needs to feel that the state is creating these framework conditions. In an interview with a business support provider, it was mentioned that:

> *Fair competition, fair customs are among the steps for such thing (institutional trust) to happen and for the business to understand that they should work through institutions and not through contacts (RDA).*

This section highlighted issues of mistrust and use of personal contacts that are other phenomena that might be of help in completing the picture.

8.2.3.3 Trust and cooperation in the society-the balance between personal and institutional trust

Mistrust of the state and of formal institutions is an aspect of the Albanian transition discussed throughout this thesis. Such mistrust of formal institutions can motivate entrepreneurs to engage in informal activities, which although they might not be economically productive resolve some of the issues facing an entrepreneur. Although such behaviour may partly be explained by the legacy of the past, it may also be explained as an outcome of the transition process and of the lack of a 'level playing field' in the current Albanian context. My survey showed that businesses use primarily personal contacts and informal means in their business activities. The interviews with other social actors have confirmed a similar picture. Because of these attitudes, support structures find it difficult to deal with businesses. They have observed how unwilling businesses are to cooperate with support structures and among themselves. As the manager of one donor programme says:

> *...the Albanians are natural entrepreneurs but they tend not to share information among themselves, and they tend not to admit when they need help... (Donor programme)*

Business networking, social cooperation and relationships based on trust are values or concepts associated with business success and with economic development in many countries. I discussed above how trust and social cooperation are linked to democratic cultures (Putnam, 1993) and this is one of the reasons that low levels of trust in post-communist economies have been always connected to the legacy of the communist regimes (Raiser, 1997; Pejovich, 1999). However, if distrust with state institutions existed during communism, the same would not apply to the rest of the society. And as a matter of fact, in transition economies including Albania, informal connections are strong especially considering the inefficiency of formal institutions as my survey suggested.

Still, in my opinion the hesitation of people to engage in cooperation and in business networking that could create economic externalities is associated with the kind of capitalism that has emerged in Albania and other transition economies. This may well be one reason why the majority of the businesses are micro businesses and remain so.

I discussed in Chapter 3, Section 2, how SME development in transition economies has been advocated on political grounds. The promotion of SMEs was seen as a way to introduce a capitalist culture and its values of individualism, self-responsibility and performance based results. On material and ideological grounds, the SME sector is playing the same role as in other mature capitalist economies (Scase, 2000). However, the individualistic philosophy of transition has encouraged the *individual survival* and short-termism and, to some extent has spoiled the social cohesion in many post communist countries. One entrepreneur in Tirana says:

> *...you need partners to succeed and for them (businesses) the cooperation is just something scary or as an opportunity they give to the other to cheat on them...in the manufacturing sector the partnership is inevitable because businesses have so many complex needs in this sector. So, those people that have these kinds of mentalities have it impossible to grow or to be successful....*
> *(Entrepreneur in Tirana)*

I mentioned short-termism in the previous chapter with a reference to the public administration. Each time one party comes to power it fires all the previous employees and hires its own supporters. Of course, this uncertainty and crisis of governance has created short time horizons of people in the Albanian society and has impeded the progress of reforms.

The business support providers and the business community have not been immune to this problem, as I discussed with regard to the problem of coordination of donor activities. Cooperation between different support providers is also an issue. Reading between the lines of various comments made by interviewees, the tendency not to cooperate is also evident in their

work. Although each of them separately says that they are open to cooperation, it seems that, apart from occasional meetings where some exchange of information happens, it is nothing more than this.

As I discussed previously, there is an over sensitivity to issues of sustainability for various support providers that jeopardises cooperation because they see sharing of information as putting themselves at the risk of non-survival. Even the latest initiative for the SME donor forum, whose purpose according to the SMEDA director is to:

> *contribute to the harmonisation and coordination of the donor assistance in SME development through an exchange of experiences, practices, information as well as sharing when possible, resources in potential projects and programmes utilising cooperation opportunities among them (SMEDA)*

is seen with scepticism, as the following quote makes clear:

> *The donor meeting is a good initiative but still there is no exchange of information and this creates problems (Donor programme).*

Short-termism is also evident in the business community, although it might be attributed to other factors related to the institutional environment and those conditions that will give entrepreneurs the opportunities to take risks and to commit themselves to long-term projects with the certainty that their property will not be stolen, damaged or extorted and with the certainty that they will be the ones to reap the returns on their investments. One of my interviewees says:

> *People do not want any more to work for others but just for themselves. ...From my conversations with different people I have understood that they see things just in the short run and they don't even consider what is going to happen in the medium or long run (Donor programme).*

In addition, some of the support providers are frustrated that businesses have not created any active business associations and other alliances in order to protect their rights and to lobby the government. As an interviewee from a donor programme says:

> *...the business community should understand its role. It has to organise itself in associations or organisations. But I think that businesses are still in an infant stage and still think that is the government that will take care of them (Donor programme)*

Others think that although businesses adopt certain strategies to escape certain situations, those strategies might not be the most effective ones from a rational point of view.

Many deals are made in cafés which make their (businesses) payments higher...But at the end of the day these bribes might be higher than if the business would do it in a legal way. The law is applied arbitrarily by many public officials so businesses find bribes as the solution (RDA).

In this section, I brought some evidence about what different actors involved in SME development in Albania think about trust and social cooperation in Albanian society. Their discourse indicates the same as the survey evidence that captured entrepreneurs' perspectives. These attitudes, however, are not only present in the business community, which leads to discussions about the socialisation of actors other than through the mechanism of path dependency. For example, knowledge and learning are also very important means of socialisation and as I show in the next section are already taking place in the Albanian context.

8.2.3.4 The role of knowledge and learning in the Albanian society-some space for reform?

Support providers and business associations have closer contacts with businesses and as a consequence they have noticed the changes in the way businesses operate. These changes indicate that learning is taking place with regard to relationships with banks, customers, support providers-all new relationships that have been established only after 1990s. This suggests that individuals have sociability and also power of reflection as well as values and beliefs that are always in a process of formation and change.

The more positive comments were made with regard to relationships with banks because the majority of the programmes are concerned with financial assistance to businesses. A credit department employee in the NCB of Albania made a very interesting comment regarding a change in the attitudes toward banks. According to him:

In Albania the tradition of client bank relationship was lacking. As long as the banks were state owned this gave a certain level of comfort and security to the clients. Also the bank was seen as a place you could go and get loans if you needed without having to give any logical explanation as to why you needed the loan and which has given negative results in the Albanian transition. However, it has started to be cultivated the relationship between banks and clients. Banks are institutions of transparency, trust and cooperation and where you should work on a complete documentary basis. But the Albanian businesses are sometimes annoyed with all the documents they have to present, with explaining the logic of their investments. They think one goes to a bank and asks "I need this much money and you have to give it to me because you know me". This has started to change. Those businesses that have been in the market for a long time now have understood that the bank is an institution that requires a certain communication style different from the simple commercial transactions (NCB).

Along the same lines comes a comment from the representative of a donor programme offering financial and technical assistance to businesses. He mentioned that:

> *I was involved in an earlier loan scheme in 1992-93, back in the early days of transition when getting businesses to train and assist was very difficult as few businesses existed. Now there is a whole change in mentality...99% of our clients have repaid the loans. Fewer than half of clients repaid their loans in the early 1990s. This is a huge change in mentality... (and) businessmen feel more responsible about repaying their loan, as they may want to borrow money again in the future (Donor programme).*

Thus far, it is worth mentioning that people are open to change and when policies or the programmes are reflexive, the learning process that takes place is much easier. Another example is an interviewee from SEED, which offers training programmes that involve follow-up of the businesses after the first assistance, who thinks that:

> *Our aim is to strengthen their capacities...From our experience I can say that is easier to work with those enterprises you have already worked before and this means something, that we are making a difference (SEED).*

This statement suggests that piecemeal support would not affect much change. It is important that businesses are followed through certain stages in their life-cycle so as to understand what the impacts of intervention are. The kind of evaluation indicators adopted is crucial. The interviewee from one RDA said that: *"It is part of our job to keep contacts with these businesses but sometimes we lack funds to do this as most of our agencies have 3-5 employees which makes it difficult"*. This statement brings into attention the issue of strengthening support structures capacities.

Although developing evaluation indicators is difficult, it does not mean that the evaluation of programmes should not be attempted. Otherwise, this assistance will just add to the rhetoric of business support by the government and donor programmes and be used for their agendas instead of bringing about change. The SME European Charter report on Albania shows that many businesses have received training through a variety of training programmes. Although it may be that little qualitative change in business behaviours has been achieved through such training, it seems clear from my qualitative research interviews that new knowledge is being accumulated by Albanian entrepreneurs. We may conjecture that this new knowledge may in turn lead to further social change and serve to speed up the development of the SME sector in Albania.

Conclusions

My aim in this Chapter was to discuss the coherence of the government SME policy and operational issues on the micro institutional level. The evidence I analysed showed that support policies in Albania have suffered from 'methodological holism'. I make this argument on two main grounds: *first,* all the enterprises in Albania seem to be considered as sharing the characteristics of the group they are included in, the broadly defined SME sector, and *second,* no differentiation is made between different areas or localities which have different potential for SME development. Moreover, no differentiation is made between different sectoral activities considering that SME needs vary with the type of industry or sectoral activity they are operating.

The policy toward SMEs has been concentrated on supply side measures. The overall enabling environment is a very important factor in SME development and the institutional deficiencies have often compromised other efforts in SME development. However, problems that SMEs might have in developing specific skills, in finding markets or suppliers, productive capacities, technology or information systems have not been properly addressed. Whilst there are anecdotal cases of more innovative ways to tackle problems in Albania such as the SBCA case, the general conclusion is that mass general assistance has been provided to SMEs with little concern for specific issues that prevent SMEs to be more competitive and to grow.

Legacies of the past influence the transformation process and the relationship between the business community with the state and other institutions. Old behaviours still manifest themselves but it is hard to draw the line between the reproduction of these behaviours for familiarity or legitimacy purposes or the reproduction of these behaviours as an imposition of the wider context and short-term responses to the existing rules of the game. Further learning is needed in Albanian society and one way is to encourage the promotion of role model businesses, which has not been done so far.

I also showed that a process of new institutional learning is taking place in the Albanian society and thus to conclude, I believe that policies should be more innovative and proactive and, with a clear vision as to what are the best prospects for the SME long-term development so as to encourage a faster learning process.

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CHAPTER 9

MAIN FINDINGS, REFLECTIONS ON THEORIES, *CONCLUSIONS AND* POLICY RECOMMENDATIONS

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There should be greater intellectual effort towards a better understanding of the role of the policies and institutions and-especially the later-in economic development, by throwing out historical myths and overly abstract theories that are blinding many theoreticians and policymakers

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(Chang, 2002b)

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Introduction

In this thesis I have emphasised the role of institutional change on SME development in post-communist transition. I also posed the research question: *To what extent do institutions influence the prospects for business growth and how the local setting and the intentions and abilities of entrepreneurs moderate this effect.* My main focus has been on the emergence of entrepreneurship in post-communist transition in the form of small and medium sized enterprises (recognising that entrepreneurship may also present itself in other sectors of the economy and society). I proposed that entrepreneurship is a widespread proclivity in all societies but that different forms of entrepreneurship emerge depending on the incentives embodied in the prevailing formal and social institutional framework. I argued these issues with respect to the manufacturing sector employing more than five employees, sector which has been under-researched in post communist contexts and to the case of Albania, one among the least researched and accessible countries in Europe.

I discussed these issues from a multi actor perspective that brought evidence about a fascinating mix of formal and social institutions that have their influence on SME growth and give scope for various forms of entrepreneurship and their policy implications, as I presented in Chapters 5-8. In the rest of this chapter, I look at my main findings, how do they reflect the theories of new institutionalism and of entrepreneurship and business growth and what are their implications for post-communist transition. I discuss my findings under some main headings based on the conceptual framework I have adopted for my thesis.

9.1 Enterprise behaviour and entrepreneurship levels

I embarked in my fieldwork with the expectation that Albanian entrepreneurs are mainly in business to passively achieve a target income to feed their families and that few aspire to pursue opportunities for business growth. The literature on post-communist transition has often argued that entrepreneurship could have no significant role in transition (Storey, 1994; Scase, 1997, 2000; Bateman, 2000; 2003; Acs et al., 2005) since most entrepreneurs set up their business out of necessity (Scase refers to such individuals as *'proprietors'* rather than entrepreneurs, Storey and Acs et al. in a different advanced economy context refer to push factors which impel unemployed people to set up businesses as a defensive strategy to avoid hunger). While this debate on the balance between *'necessity'* and *'opportunity'* is still prevalent even in the developed world the significant finding from my research is that most entrepreneurs in Albania are in business to pursue an *'opportunity'* rather than out of *'necessity'*.

This finding might be linked to the fact that the majority of businesses in my sample were manufacturing businesses, employing more than five employees. In other words, the finding may be specific to the manufacturing sector and not easily generalisable across sectors. Further research on other sectors of the Albanian economy would be needed to investigate this possibility. However, this means that the policy implications from my research are well targeted to this sector and could be helpful in addressing the particular needs of this sector.

I also found that most entrepreneurs in the sample reinvest their profits within their firms rather than use them for consumption or other non-business purposes. This finding supports the argument that entrepreneurs in post-communist transition pursue business opportunity rather than being satisfied with a fixed target income, which contradicts ideas about the prevalence of proprietorship and *'booty capitalism'* (Scase, 1997; 2000) in these countries. Furthermore, Albanian SMEs are open to new skills and knowledge, to information on new technologies and to information on products and markets. This suggests that Albanian entrepreneurs are quite alert to new opportunities and engaged in active rather than passive entrepreneurship. Also, their attitudes toward external finance are another indicator that these enterprises have strong growth aspirations.

9.2 Enterprise behaviour and formal institutions

In my discussion of formal institutions, I emphasised the role of the polity in their design and enforcement. My empirical research suggested that enterprises perceive the government as a *'grabbing hand'*, along the lines of the model proposed by Shleifer and Vishney (1998). Their negative perceptions of the state were revealed *firstly* by perceptions about courts which the majority of the businesses considered as dishonest, unfair and unaffordable; *secondly* by perceptions of business legislation and SME policies that have been introduced with minimal consultation; and *thirdly* by the hesitation of many enterprises to undertake investments which I link to the weakness of the investment climate and the regulatory framework provided by the state.

My interviews with social actors involved in SME development and my textual analysis also pointed at an uncertain investment climate that restricts the opportunities of entrepreneurs to take out risks and to invest in their ideas. Moreover, the institutional theories suggest that, while it is easy to design formal institutions, the main challenge is in their enforcement (North, 1990). Based on my data, the enforcement of institutions can be debated in two ways:

First, an important element in ensuring the credibility of formal institutions and institutional reforms that governments undertake is the commitment of the government to behave responsibly. The entrepreneurs' responses in my research clearly suggest the lack of credibility and legitimacy of many of these formal institutions in Albania. My textual analysis and interview material showed that the SME discourse is very functional. The initiatives and policies designed do not involve all the actors in the process and moreover they suffer from poor implementation as I discuss later on in this Chapter.

Second, government consists of many state actors whose individual interests often diverge from the general social interest. I discussed this situation in relation to *public choice theory*, and the *new institutional theories*. Moreover, the perspectives of survey and interview respondents suggested the existence of a *hostile* relationship between public officials and the business community. On one hand, entrepreneurship does not have the status it deserves in Albanian society, as shown in government policy documents and initiatives and in the attitudes of public officials toward enterprises. In this respect, I discussed the need for an entrepreneurship policy that will wear out old prejudices about entrepreneurship and will encourage entrepreneurship as way of living that will boost the confidence of entrepreneurs

On the other hand, my interview material showed that the instability and uncertainty of transition has contributed to the short-term horizons of individuals which are more evident in the public administration. In addition, my textual analysis and my interviews showed that laws and regulations have been introduced continuously and have not been accompanied by clear responsibilities or guidelines that prevent the pursuit of individual agendas by public officials, give no scope for discretionary use of power and increase accountability and transparency in the process.

9.3 Enterprise behaviour and informal institutions

The new institutional theory (North, 1990) warns against reducing the analysis of institutions to formal institutions and the state alone. It is equally important to understand the role of informal institutions such as culture and social norms and the different forms their interaction with formal ones (Nee, 1998; Pejovich, 1999; Mantzavinos, 2001) take. Formerly communist countries had a more collectivist culture that de-emphasised values such as responsibility, individualism, result orientation and entrepreneurship. My results in Chapter 5 suggested that the majority of the entrepreneurs have embraced entrepreneurial values such as hard work and responsibility, skills and knowledge as well as alertness toward opportunities that are presented in the market which suggest complementarity with formal institutions.

However, my data also suggested that a number of businesses are willing to carry out '*immoral actions*' or to be involved in what Baumol (1990) calls unproductive forms of entrepreneurship that contribute more to the wealth of the individuals involved in it than to the GDP of these countries. Their (im)morality or involvement in *unproductive entrepreneurship* is defined through cheating, avoiding regulations and by bribing officials. Many avoid or ignore formal institutions altogether and rely on oral agreements, friends and connections for assistance instead of relying on business support institutions established by the state or by international donors and NGOs.

While such behaviour may seem perfectly rational in the short term (see Axelrod, 1988) in the long term many opportunities may be missed especially those that derive from extending the circle of partners that might bring new skills and knowledge to the business. Nevertheless, taking this situation into consideration little has been done in terms of using personalised and collectivised trust as an asset in cases when business linkages or new knowledge and skills need to be encouraged.

9.4   Enterprise behaviour and organisations

Institutional theory (North, 1990) argues that formal and informal institutions enable the creation of certain organisations that are a reflection of the institutional mixture. I discussed in this thesis government policy and initiatives on SME development, as well as their operationalisation. I also argued the role that these organisations could have in facilitating the transmission and accumulation of new knowledge in a post-communist transformation setting.

My textual analysis in Chapter 7 showed that the policy framework in Albania is well established at national and strategic levels. However, this is not sufficient since the regulatory framework is weak. It suffers from unpredictability and instability, management uneasiness, as well as inconsistency and unfair implementation, as confirmed by my survey too.

I have argued in Chapter 8 that the government's SME policy is not coherent because *first*, clear responsibilities are not dispersed to the organisations involved in SME development policy and *second*, the SME strategy lacks a regional focus. Furthermore, my analysis showed that SME support policies have merely reflected the strengths of the SME sector and have paid little attention to the needs of poorer areas and economic sectors ignoring the fact that different areas and localities have different potential for SME development and that SME needs vary with the type of industry or sectoral activity they are operating.

My analysis in Chapter 8 showed that the government structures do not cooperate with or appreciate the business community. This deficiency is further exacerbated by a lack of cooperation among other actors involved in SME development, which I argued has roots in the individualistic strategies of early transition that damaged social cohesion. In this respect, more work should be directed toward enhancing the collaborative capacities of all these social actors.

In addition, in terms of the implementation of the SME policy I have suggested in Chapter 8 that the assistance offered to SME sector has been too standardised and has been concerned too much with quantitative impacts and very little with real structural, technological and attitudinal changes in small and medium sized businesses.

A major deficiency I identified in the policy framework, as well as in the programmes of business support institutions has been the lack of attention toward role models in the Albanian society that could promote business values, success stories and new ways of doing business, all proactive strategies of development. This finding suggests the need for various donor organisations and other support organisations to work more closely with the local actors and to

base their interventions on a better understanding of business needs rather than the simple number of enterprises trained that are neither realistic nor accurate indicators of the effectiveness of an intervention.

9.5   Enterprise behaviour and path dependency

From a path dependency perspective, the first years of transition mark the critical juncture, where any of the choices made would have had an impact on future choices. Many of the business policies undertaken proved to be unsuccessful because they had not been preceded by the introduction of an effective institutional infrastructure. Nowadays, the importance of institutions is recognised, new institutions have been implemented and if the polices are not successful the *'blame'* is placed on the inherited informal institutions that are not receptive of these new institutions.

Nevertheless, my analysis of path dependencies in a business context does not fully support the arguments of this approach. The increasing returns argument, one of the strongest legs of the approach, is difficult to hold. I mentioned on more than one occasion the common reliance on bribing or other forms of corruption. One could argue that such behaviour increases entrepreneurs' chances of being *'successful'* (making profits) through their evasion of many formal institutions. From a short-term perspective, I agree it could be the case (as the survey evidence also showed) but if an entrepreneur wants to grow or expand her business, she cannot continue to work through corruption or narrow in social groups. Thus, while corruption or other networking activities can be past inherited behaviours that are learned and legitimised and thereby increase the entrepreneurs' returns, they can be easily overcome by better and more specific policies as my interview evidence showed. Businesses almost always adopt those skills that are more beneficial for their enterprise.

In addition, many of the behaviours encountered in the Albanian environment could be classified as inherited behaviours that manifest themselves in the attitudes of people towards the state, the reliance in social networks as well as in the relations with different social actors involved in SME development as my interview evidence showed. However, since the development of the SME sector was left to spontaneity, these were the only behaviours familiar to people and they started to legitimise them in order to fill the existing gap in the institutional knowledge available.

Nevertheless, I showed that learning that is the basis of any institutional change is taking place in the Albanian society. This process was shown by the answers of entrepreneurs and by their attitudes towards bank and other support organisations discussed in my interviews. These processes of learning and social formation also allow individuals to revise their perceptions and beliefs about the institutional framework. The main problem is that entrepreneurs often totally mistrust the government. In order to counter this mistrust the government should strengthen the administrative capacity of the business support institutions and reinforce its commitment to reforms.

This change can only be achieved through transparent formal rules that subordinate the government to the rule of law and through a strengthening of civil society. My analysis in Chapters 5-8 showed that entrepreneurs are open to positive changes and when polices and programmes are designed to reflect their business needs, the learning process is much easier and the interaction between formal and informal institutions is harmonious. This process ensures the endogenous path change contrary from path dependency arguments that see change happening only during critical junctures. In this respect, I stress that the *inherited culture of communism* is receptive of change thus, the type of policies designed are of crucial importance in transition, especially when they are informed by the local context and reflexive of the local knowledge. Nevertheless, none of my arguments so far have identified any causal patterns, which is the basis of the path dependency approach and at the same time the most difficult to establish theoretically and empirically.

9.6 Enterprise behaviour and enterprise growth-toward a business growth theory?

My research has several new implications for business growth theories. My conceptual framework was designed to capture the simultaneous effect of various characteristics and behaviours on business growth. In this regard, I extended the institutional model to a broader model that takes into consideration the intentions and the abilities of the entrepreneurs, which are used to interpret the opportunities (Davidsson, 2003) offered by the institutional setting. Also, I discussed in Chapters 7-8 the perspectives of other actors in order to increase the validity of my research and to add to my explanation of business development in Albania.

My research supported the work of various authors that argue that business growth is a function of various determinants to growth (Davidsson, 1991; Storey, 1994; Morrison et al., 2003). My research also showed that institutional factors have a significant impact on growth. Specifically, negative perceptions about the state seem to have a negative impact on business growth in all the regression models I presented. Regulatory and information barriers are detrimental to growth while corruption related barriers have had a positive effect on growth. This is a very fascinating mix of institutional impacts on growth. It shows how corruption or other informal ways of doing business compensate for the inefficiencies of the formal institutions. In addition, is interesting to observe that intentions of entrepreneurs in terms of being in business for *opportunity* pursuance and abilities in terms of receiving business qualifications during the period they have been in operation affect growth positively. Moreover, good networking and *outward looking* perspectives in terms of embracing new business values that did not exist during communism and which are variables not tested before have also positive impact on growth.

I analysed several aspects of interaction between the variables, which determine SME growth including the size of the business and the age of the business. These also produced some interesting results. My analysis of interaction effects showed that larger businesses suffer less from the regulatory environment but that their growth is hindered more by information barriers. Information barriers proved to have a more significant impact on businesses that have been longer in operation that might consider information as a mean of being able to stay in business and to improve their business performance. In addition, my analysis showed that the investment climate in Albania is still weak since capital accumulation does not increase the probability of perceiving a satisfactory business performance, possibly due to the risks associated with business investments.

My analysis showed that Albanian businesses are growing mainly because of the knowledge they have accumulated on how to play the system in their favour. This finding shows how the inefficient formal regulations are being ignored and how informal institutions are complementing for their inefficiency. Whilst a situation that has positive effects in the short term, it has important policy implications in terms of strengthening the formal rule and also in providing the necessary framework conditions in doing business. This will prevent the negative effects of these unproductive forms of entrepreneurship in the longer term first, in the GDP of the country and second, in the cultural attitudes and value placed on entrepreneurship.

My institutional research on manufacturing SMEs in Albania confirms that SME development is highly dependant on the formal and social institutional framework and the scope they offer for different forms of entrepreneurship. SME development is a *collective effort* that rather than just the skills and propensities of individuals to take upon risks, needs the commitment of the government and other social actors involved in SME development in designing and enforcing institutions that impose stability and structure, as well as in designing policies that reflect business needs and emphasise entrepreneurship as a viable alternative of life. The results of my research are limited to the manufacturing sector which suggests that my framework can be utilised to include other sectors as part of future research. Moreover, it would be of future interest to develop the issues my research suggested in other contexts that have different characteristics and different institutional arrangements from Albania.

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Appendix 1: SME GROWTH: Variables included in the survey

1. Intentions
- ➤ Firm's Age
- ➤ Manager's Age
- ➤ Size of Firm
- ➤ Legal Status
- ➤ Reasons for starting up (unemployment or not)

2. Abilities
- ➤ Education (General)
- ➤ Education (Business)
- ➤ Entrepreneurial experience (in terms of knowledge of the specific business is running)
- ➤ Business founder or not (privatised or new enterprise)

3. Opportunities
- ➤ *Formal Institutions*
- Unpredictability of laws
- Licensing
- Employment, environmental, foreign trade regulations
- Taxes

➤ **Informal institutions**
- Trust (personalised or institutional)
- Business values
- Moral attitudes

➤ **Enforcement characteristics**
- Corruption
- Arbitrary use of power
- Fairness, affordability, impartiality of courts

➤ **Organisations**
- Information
- Finance
- Technical Assistance
- Partnerships

Appendix 2

SURVEY QUESTIONNAIRE

Section A: General information on the enterprise

1. Name of the enterprise_____

2. Location_____

3. Your company is:

    a) privatised _____ if yes please specify year of privatisation_____
                           and the initial year of start-up_____
    b) de novo_____ if yes please specify year _____

4. Legal status of your firm?

    a) individual ownership   (1)
    b) partnership   (2)
    c) limited liability   (3)
    d) joint-venture   (4)
    e) other   (5)

5. What was the structure of employees (in number of employees) in the following years?

		Year of start-up (5.1)	Current year (5.2)
Full time employees	(1)		
Part time employees	(2)		
Manual workers	(3)		
Administrative staff	(4)		
Managerial staff	(5)		
Total number of employees	(6)		

Section B: Product and market characteristics

6. What category of manufacturing industrial activity does your business belong to?

    a) foodstuffs industry   (1)
    b) textile industry   (2)
    c) chemical industry   (3)
    d) other_____ (please specify)   (4)

7. What are your main products in the market in order of the rates on sales revenue?

    a) _____ (%)   (1)
    b) _____ (%)   (2)
    c) _____ (%)   (3)

8. Your inputs' market is: (please give the relevant proportions)
    a) domestic_____(%)   (1)
    b) foreign _____(%)   (2)

9. Where do you sell your products? (please give the relevant proportions)

a) domestic market _____ (%)   (1)
b) export   _____ (%)   (2)

10. How would you rate the position of your company in comparison to your competitors?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a) domination of a market niche	(1)	1	2	3	4	5
b) competing on quality	(2)	1	2	3	4	5
c) sophisticated technology	(3)	1	2	3	4	5
d) product innovation	(4)	1	2	3	4	5
e) other_____(please specify (6)	1	2	3	4	5

11. How would you describe the competition in the market?

	No competition (1)	Just a little (2)	Medium (3)	Fierce (4)	Very fierce (5)
a)domestic (11.1)					
b)export market (11.2)					

Section C. Motivation and Business Performance

12. What was your motivation to start the business?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a) Unemployment	(1)	1	2	3	4	5
b) Pursuance of a satisfactory market opportunity	(2)	1	2	3	4	5
c) Dissatisfaction with your job	(3)	1	2	3	4	5
d) Autonomy	(4)	1	2	3	4	5
e) Comfort-zone business	(5)	1	2	3	4	5
f) Lifestyle choice	(6)	1	2	3	4	5
g) Other _____(please specify) (7)	1	2	3	4	5

13. How would you consider the performance of your business?

a) Very satisfactory   (1)
b) Satisfactory   (2)
c) Less than satisfactory   (3)

14. How has the performance of your business been in the following indicators during the period of business operation?

	Increased (1)	Remained the same (2)	Decreased (3)
Turnover (14.1)			
Assets (14.2)			
Employment (14.3)			
Profits (14.4)			

Section D. Entrepreneur Characteristics

15. Are you:

    a)   the owner but not the manager   (1)
    b)   the manager but not the owner   (2)
    c)   the owner and the manager   (3)
    d)   other_____ (please specify)   (4)

16. What age group do you belong to?

    a)   18-35   (1)
    b)   36-50   (2)
    c)   over 50   (3)

17. What is the highest qualification achieved by you?

    a)   elementary   (1)
    b)   high school   (2)
    c)   university   (3)

18. Have you taken any business related qualification during business operation?

    a)   Yes _____ (please specify)   (1)
    b)   No   (2)

19. What was your previous job before starting the business?

_____

20. If you would make a profit on your business how would you spend it?
Please give the respective percentages

    a)   repaying the money borrowed   _____(%)   (1)
    b)   training   _____(%)   (2)
    c)   consumption   _____(%)   (3)
    d)   investment in assets for the firm   _____(%)   (4)
    e)   other_____ please specify   _____(%)   (5)

Section E. Finance

21. Could you please specify the financial sources of your business?

Financial structure (in %)		Year of start-up (21.1)	Current year (21.2)
1. own funds	(1)		
2. friends	(2)		
3. bank	(3)		
4. credit lines	(4)		
5. local government	(5)		
6. other	(6)		

22. Do you need a loan?

    a) Yes   (1)
    b) No   (2)

if your answer was "yes"

23. Why do you need the loan?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

			1	2	3	4	5
a)	investment in premises	(1)	1	2	3	4	5
b)	investment in equipment	(2)	1	2	3	4	5
c)	investment in know-how	(3)	1	2	3	4	5
d)	work in progress	(4)	1	2	3	4	5
e)	other_____ (please specify)	(5)	1	2	3	4	5

if your answer was "No"

24. You don't need a loan because:
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

			1	2	3	4	5
a)	feel you are losing control of the business	(1)	1	2	3	4	5
b)	there is a lack of possibilities in your region	(2)	1	2	3	4	5
c)	profits are enough to carry on with your business	(3)	1	2	3	4	5
d)	don't have the collateral	(4)	1	2	3	4	5
e)	other_____(please specify)	(5)	1	2	3	4	5

25. "It is not difficult to get a bank loan providing that I present a good business plan"
Do you think this statement is true?

                                Now (25.1)   Year of start-up (25.2)
    a) always   (1)
    b) mostly   (2)
    c) frequently   (3)
    d) sometimes   (4)
    e) seldom   (5)
    f) never   (6)

26. What do you think are the most important barriers to get a loan?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

			1	2	3	4	5
a)	availability	(1)	1	2	3	4	5
b)	high interest rate	(2)	1	2	3	4	5
c)	high collateral	(3)	1	2	3	4	5
d)	banks bureaucratic procedures	(4)	1	2	3	4	5
e)	other_____ (please specify)	(5)	1	2	3	4	5

Section F. Business Services

27. Which of the following business services do you consider necessary for improving your business performance?
Please rank the importance on a scale from 1-5
1. very important, 2. quite important, 3. medium, 4. just a little, 5. not important

a)	technical advice	(1)	1	2	3	4	5
b)	training/qualification	(2)	1	2	3	4	5
c)	information	(3)	1	2	3	4	5
d)	sales and marketing advice	(4)	1	2	3	4	5
e)	finance and accounting advice	(5)	1	2	3	4	5
f)	export advice	(6)	1	2	3	4	5
g)	other_____(please specify)	(7)	1	2	3	4	5
h)	none of the above	(8)					

28. Do you use the services of business agencies or business associations?

    a)   Yes _____ (please specify)   (1)
    b)   No   (If no go to 31)   (2)

29. How often do you use their business services?

    a)   often   (1)
    b)   sometimes   (2)
    c)   rarely   (3)

30. How are the business services offered by them?

    a)   helpful   (1)
    b)   quite helpful   (2)
    c)   not helpful at all   (3)

31. Why do not you use the services of business agencies or business associations?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a)	lack of trust	(1)	1	2	3	4	5
b)	lack of information	(2)	1	2	3	4	5
c)	miss local presence	(3)	1	2	3	4	5
d)	other _____(please specify)	(4)	1	2	3	4	5

Section G. Formal Institutions

32. During the time you have been operating did you have to cope with unexpected changes in rules, laws or policies which have affected your business?

Changes in laws and policies are
    a)   completely predictable   (1)
    b)   highly predictable   (2)
    c)   fairly predictable   (3)

d)	fairly unpredictable	(4)
e)	highly unpredictable	(5)
f)	completely unpredictable	(6)

33. "Governments have ensured to inform the businesses affected by new rules or policies".

This is true
a)	always	(1)
b)	mostly	(2)
c)	frequently	(3)
d)	sometimes	(4)
e)	seldom	(5)
f)	never	(6)

34. "Businesses are not only informed about changes in laws or policies that affect the business operation but their concerns voiced directly by them or business associations are taken into account."

This is true
a)	always	(1)
b)	mostly	(2)
c)	frequently	(3)
d)	sometimes	(4)
e)	seldom	(5)
f)	never	(6)

35. From the time I have started the business operation the predictability of laws and policies has:

a)	increased	(1)
b)	remained about the same	(2)
c)	decreased	(3)
d)	don't know	(4)

36. "I don't think that the state protect my person and my property from criminal actions"

To what degree do you agree with this statement?

Now (36.1) Year of start up (36.2)
a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

37. "Unpredictability of the judiciary presents a major problem for my business operations."

To what degree do you agree with this statement?

Now (37.1) Year of start up (37.2)
a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

38. "It is common for firms in my line of business to have to pay "additional payments" to get things done."

This is true
    a) always   (1)
    b) mostly   (2)
    c) frequently   (3)
    d) sometimes   (4)
    e) seldom   (5)
    f) never   (6)

39. The "additional payment" ensures the delivery of service as agreed."

This is true
    a) always   (1)
    b) mostly   (2)
    c) frequently   (3)
    d) sometimes   (4)
    e) seldom   (5)
    f) never   (6)

40. "If a government agent acts against the rules I can usually go to another official or to his superior and get the correct treatment."

This is true
    a) always   (1)
    b) mostly   (2)
    c) frequently   (3)
    d) sometimes   (4)
    e) seldom   (5)
    f) never   (6)

41. During my business operation the difficulties in dealing with government officials have:

    a) increased   (1)
    b) remained about the same   (2)
    c) decreased   (3)
    d) don't know   (4)

42. Have any of the following constrained the growth of your business?
Please rank the importance of each of these on a scale from 1-5
1. very important, 2. quite important, 3. medium, 4. just a little, 5. not important

42.1 Governments-Business Interface

a)	Complicated business licensing procedures	(42.1.1)	1	2	3	4	5
b)	Unfair competition	(42.1.2)	1	2	3	4	5
c)	Foreign trade (exports, imports) procedures	(42.1.3)	1	2	3	4	5
d)	Financing	(42.1.4)	1	2	3	4	5
e)	Burdensome employment regulations	(42.1.5)	1	2	3	4	5
f)	Tax regulations and/or high taxes	(42.1.6)	1	2	3	4	5
g)	Inadequate supply of infrastructure	(42.1.7)	1	2	3	4	5
h)	Environmental regulations	(42.1.8)	1	2	3	4	5

i)	Inflation	(42.1.9)	1	2	3	4	5
j)	Crime and theft	(42.1.10)	1	2	3	4	5
k)	Corruption	(42.1.11)	1	2	3	4	5
l)	Other_____ (please specify)	(42.1.12)	1	2	3	4	5

42.2 Business support infrastructure i.e. business agencies and associations (including chambers of commerce)

a)	do not understand our concerns	(42.2.1)	1	2	3	4	5
b)	miss local presence	(42.2.2)	1	2	3	4	5
c)	high fees for their services	(42.2.3)	1	2	3	4	5
d)	other_____(please specify)	(42.2.4)	1	2	3	4	5

42.3. Lack of information on

a)	markets	(42.3.1)	1	2	3	4	5
b)	finance	(42.3.2)	1	2	3	4	5
c)	product technology	(42.3.3)	1	2	3	4	5
d)	other_____(please specify)	(42.3.4)	1	2	3	4	5

43. Have you ever decided not to make a major investment because of government regulations?

a) yes   (1)
b) no   (2)

If your answer was "yes"

44 Which of the following alternatives better describes the rationale for your decision?

a) Costs of compliance are *too high*, but clearly known   (1)
b) Costs of compliance are *too uncertain* for investment planning   (2)
c) Other _____ (please specify)   (3)

45. To your knowledge would businesses exploit any possible chance to cheat on:
Please rate the frequency of each on a scale from 1-6
1. always, 2. mostly, 3. frequently, 4. sometimes, 5. seldom, 6. never

a)	income taxes	(1)	1	2	3	4	5	6
b)	social security taxes	(2)	1	2	3	4	5	6
c)	environmental regulations	(3)	1	2	3	4	5	6
d)	accounting standards	(4)	1	2	3	4	5	6
e)	public procurement regulations	(5)	1	2	3	4	5	6

46. "Every business is allowed to evade the above listed regulations in order to maximize business profits"

To what degree do you agree with this statement?

a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

47. "The moral attitude of Albanian businesses toward formal institutions is low"

To what degree do you agree with this statement?

Now (47.1)   Five years ago (47.2)

a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

48. "If businesses comply with formal institutions they would benefit from better public services"

To what degree do you agree with this statement?

Now (48.1)   Five years ago (48.2)

a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

49. "If businesses decide to evade formal institutions this is because they don't trust the government"

This is true

Now (49.1)   Five years ago (49.2)

a)	always	(1)
b)	mostly	(2)
c)	frequently	(3)
d)	sometimes	(4)
e)	seldom	(5)
f)	never	(6)

50 In general how would you consider state and bureaucracy in doing business?

	Helping hand	Neutral agent	Grabbing hand
Now	1	2	3
Year of start up	1	2	3

Section H. Informal networks

51 In your line of business is it important to have long-term partners?

a)	yes	(1)
b)	no different short-term partners are needed	(2)
c)	both long and short term partners	(3)

52 How do you connect to your partners?

a)	through written agreements	(1)
b)	through oral agreements	(2)
c)	one or the other depending on the partner	(3)

53 Would you go to court if you had a dispute to resolve?

a)	Always	(1)
b)	Mostly	(2)
c)	Frequently	(3)
d)	Sometimes	(4)
e)	Seldom	(5)
f)	Never	(6)

54 "Courts are fair and honest and this facilitates my business operation"
To what degree do you agree with this statement?

Now (54.1) Year of star-up (54.2)

a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

55. Courts are quick and affordable for resolving my disputes.
To what degree do you agree with this statement?

Now (55.1)   Year of star-up (55.2)

a)	fully agree	(1)
b)	agree in most cases	(2)
c)	tend to agree	(3)
d)	tend to disagree	(4)
e)	disagree in most cases	(5)
f)	strongly disagree	(6)

56. In what basis would you choose a business partner?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a)	Family ties	(1)	1	2	3	4	5
b)	Friends	(2)	1	2	3	4	5
c)	Recommendation	(3)	1	2	3	4	5
d)	Business agencies/associations	(4)	1	2	3	4	5
e)	Chambers of commerce	(5)	1	2	3	4	5
f)	Other_____(please specify)	(6)	1	2	3	4	5

57. Do you trust your business partners?

a)	Always	(1)
b)	Mostly	(2)
c)	Frequently	(3)
d)	Sometimes	(4)
e)	Seldom	(5)
f)	Never	(6)

58. If you would need any kind of assistance whom would you ask for it?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a)	Family	(1)	1	2	3	4	5
b)	Friends	(2)	1	2	3	4	5
c)	Business agencies/associations	(3)	1	2	3	4	5
d)	Chambers of commerce	(4)	1	2	3	4	5
e)	Other_____(please specify)	(5)	1	2	3	4	5

59. What do you think are the most important factors in doing business successfully?
Please rank the importance of each of these on a scale from 1 to 5:
1. very important 2. quite important, 3. medium, 4. just a little, 5. not important

a)	hard work	(1)	1	2	3	4	5
b)	skills and knowledge	(2)	1	2	3	4	5
c)	family and friends	(3)	1	2	3	4	5
d)	business support infrastructure	(4)	1	2	3	4	5
e)	good business partners	(5)	1	2	3	4	5
f)	good contacts in the public sector	(6)	1	2	3	4	5
g)	alertness to opportunities	(7)	1	2	3	4	5
h)	contacts in the financial sector	(8)	1	2	3	4	5
i)	other_____ please specify	(9)	1	2	3	4	5

Section I. Financial figures

Could you please provide us with some more information about your business?

60. What is the total investment you have made on this firm?

Investment (in million lek)		Year of start-up (60.1)	Current year (60.2)
<50	(1)		
50-200	(2)		
200-1000	(3)		
>1.000	(4)		

61. How would you characterise the performance of your business in terms of turnover?

Turnover (million lek)		Year of start-up (61.1)	Current year (61.2)
<50	(1)		
50-200	(2)		
200-1.000	(3)		
>1.000	(4)		

Section I. Comments (to be filled by the interviewer)

    a. Name of the interviewer_____

    b. Duration of the interview_____

    c. Reliability of the data_____

_____

_____

Appendix 3

CONSENT LETTER

Dear Sir/Madam,

This is to inform you about the research you are kindly requested to participate to:

As part of her PhD research study, Mirela Xheneti, current PhD candidate at the School for Policy Studies, University of Bristol, UK, is conducting some interviews with organisations dealing with SME issues. The research is supervised by Professor Will Bartlett. The overall purpose of this research is to study the development of the SME sector in Albania by exploring the impact of institutions (formal and social) and of the organisations dealing with SME issues, created under this set of institutions, on the growth of the small business sector in Albania. The study aims to examine the direct effect that institutions and organisations have on business growth and whether the local setting and the intentions and the abilities of the entrepreneurs moderate this effect. The information collected by these interviews will complement the data collected by an enterprise survey conducted with SMEs in Albania.

You will either be contacted by telephone or personally and discuss with the researcher a convenient time and place for the interview to take place. The interview is estimated to last about an hour. With your consent the interview will be tape-recorded to help the researcher keep detailed records. Although the interview will be unstructured it consists of some main issues for discussion. You will be asked about your organization and your role in this organization and in particular how does your organization deal with SME concerns. You will also be asked to talk about your beliefs about the role of small businesses in Albania, the impact of formal and social institutions on business growth and possible policies you consider important in addressing the small business issues better.

There are no direct benefits related to your participation in this study. However, the outcome of this research might be a better understanding of opportunity structures for entrepreneurship and in this way a better understanding of the prevailing formal and informal institutions in Albania, the business behaviours induced by these structures and also the outcomes of any possible policy change. This understanding can be useful in addressing in the best way possible the issues problematic to this sector.

All of the information collected during the interviews will be treated as confidential. The data collected from this study will be analysed and presented in the PhD thesis of the researcher. Also, your name will be kept completely confidential and not used in any publications following this research that will report the results of this study. The only individual who will have access to these materials is the primary researcher (Mirela Xheneti). You are free to choose not to talk about any particular topics or answer particular questions and you will not be pressurised to do so. You are also free to withdraw from this research at any time.

For any further information about this research do not hesitate to contact the researcher.
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Email: Mirela.Xheneti@bristol.ac.uk

SIGNATURES

By signing this consent form, you agree that you have read this informed consent form, you understand what is involved, and you agree to participate in this study. You will receive a copy of this consent form.

_____

Participant (Print name)

_____

Signature

_____

Date

RESEARCHER'S STATEMENT

I certify that the research study has been explained to the above individual by me, including the purpose, the procedures and the outcomes of this research study. Any questions raised have been answered to the individual's satisfaction.

_____

Researcher (Print name)

_____

Signature

_____

Date

Appendix 4: Interview topic guide

1. Role of small business

In what grounds is small business considered important?
What kind of businesses would better be beneficial to the economy?
The commitment of the government toward SME issues. To what extent is the SME strategy being implemented?

2. Distinction between productive and unproductive entrepreneurship

What businesses would you consider as being productive?
Path dependency (socialist values) and informal behaviour
Macroeconomic planning in reducing rent seeking behaviour and opportunistic behaviour

3. Formal rules and regulations (SME infrastructure)

Openness
Transparency
Dialogue
Acceptance and enforcement

4. Informal rules (culture mainly trust)

Trust (personal versus institutional)
How to build on social networks
Awareness of informal means of doing business

5. Quality of bureaucracy

Efficiency
Capability
Professional ethos
Autonomy from political pressure

6. Skills and knowledge (training activities)

Support given to SMEs
Choice of businesses
Training programmes
Geographical coverage
Coordination with other activities dealing with the same issues

Appendix 5: Main sample characteristics

In this Appendix, I would like to familiarise the reader with the main characteristics of my enterprise sample which behaviours and perceptions I discuss in this chapter and Chapter 6. In order to make it as informative as possible, I describe my sample characteristics under three main headings: general characteristics of enterprises, business performance indicators and entrepreneurs' characteristics.

5.1. Main business characteristics

Characteristics		N	Mean	SD
Location		**110**	**2.25**	**1.83**
	Tirana	60		
	Durres	18		
	Elbasan	8		
	Shkodra	5		
	Korca	9		
	Vlora	5		
	Gjirokastra	3		
Business Type				
	Privatised	23		
	De novo	87		
	Individual ownership	9		
	Partnership	13		
	Limited-liability	81		
	Joint-venture	1		
	Other	5		
Number of employees		**106**	**1.52**	**0.61**
	Micro-businesses (<=5)	4		
	Small businesses (6-20)	57		
	Medium businesses (21-80)	43		
	Large businesses (>80)	6		
Business Sector				
	Foodstuffs Industry	30		
	Textile Industry	18		
	Chemical Industry	3		
	Construction materials	13		
	Mechanical Industry	6		
	Other	38		
Years in operation		**107**	**0.79**	**3.02**
	0-7	44		
	>=7	64		

As the table shows, the majority of the businesses in my sample are located in the district of Tirana, which reflects my stratified random sampling method as I mentioned in Chapter 4. The data confirm the belief that the liberalisation of entry conditions led to the creation of

large numbers of businesses during the transition period. 76% of the businesses in my sample are newly created and 74% of businesses have limited liability legal status. Businesses are distributed in various manufacturing sector activities but with a slightly higher number in the food processing industry. Moreover, in terms of businesses' age it varies from businesses as young as one year to businesses that have been in operation for 14 years.

Nevertheless, the number of businesses that have been created at the years following the collapse of communism is slightly higher which reflects the data for the whole business sector. There is also a slightly equal representation of small and medium size businesses in my sample. Table shows that there is a very small number of businesses that do not fit the Albanian definition of small and medium size enterprises. However, those have not been excluded from the analysis due to their low impact on the data.

5.2 Entrepreneurs' characteristics

I show below some of the characteristics of the entrepreneurs. The majority of them are middle aged, with university education and also with a majority without any business qualification received during the years they have been in operation.

Entrepreneur's age		110	2.08	0.53
	(18-34)	11		
	(35-50)	79		
	(>50)	20		
Education		110	2.73	0.45
	(high school)	30		
	(university)	80		
Business qualification				
during business operation		104	0.23	0.42
	(yes)	24		
	(no)	80		

5.3 Business performance indicators

The figures below show the distribution of businesses in my sample according to business performance indicators such as turnover and investment. In terms of turnover the majority of businesses in my sample are included in the group of small businesses according to the specification of the Albanian law on SMEs that considers as small businesses those that have a turnover of less than 80 million Lek. In terms of investment, it can be noticed that with a few expectations businesses have not made large investments.

Turnover (in million Lek)		102	1.67	0.98	
	<50	62			
	50-200	21			
	200-1000	10			
	>1000	9			
Total Investment on the firms		103	1.79	0.89	
(in million Lek)					
	<50	48			
	50-200	35			
	200-1000	14			
	>1000	6			

I also present below some qualitative business performance indicators, which I base on the answers to Questions 14 and 15 about rating business performance in general terms and also on specific performance indicators.

Business Performance	*Very satisfactorily*		*Satisfactory*		*Less than satisfactory*		*Total*	
	12		74		23		109	
	Increased		*Remained the same*		*Decreased*			
Turnover	77	69.7%	10	9.2%	23	21.1%	110	100%
Assets	77	69.7%	21	19.3%	11	10.1%	109	99.1%
Employment	71	64.2%	9	8.3%	30	27.5%	110	100%
Profits	69	62.4%	12	11%	28	25.7%	109	99.1%

Note: The total does not add to 110 in some cases due to missing answers

The table shows that the majority of businesses in the sample, 70% report an increase in both the turnover and the assets. This is the first indication that businesses in the sample are investing in the assets of their firms and have capital accumulation intentions that are among the features of real entrepreneurs as I discussed in Chapter 3. The same situation appears for the other business performance indicators such as employment and profits with the latest being reported as increased fewer times.

Appendix 6: Correlation Matrix

	1	2	3	4	5	6	7	8	9	10	11	12	13
Government business interface barriers													
1. Licensing procedures													
2. Unfair competition	0.20*												
3. Foreign trade procedures	0.26**	0.21*											
4. Employment regulations	0.28**	0.06	0.39**										
5. Inadequate supply of infrastructure	0.16	0.02	0.20*	0.27**									
6. Environmental regulations	0.40**	0.19	0.35**	0.48**	0.31**								
7. Inflation	0.36**	0.26**	0.52**	0.56**	0.34**	0.58**							
8. Corruption	0.43**	0.56**	0.27**	0.24**	0.27**	0.34**	0.37**						
Business support infrastructure barriers													
9. Do not understand our concerns	0.12	0.24*	0.23*	0.20*	-0.01	0.06	0.24*	0.11					
10. Miss local presence	0.15	0.16	0.26**	0.25**	0.16	0.21*	0.32**	0.08	0.71**				
11. High fees for their services	0.40**	0.19	0.35**	0.46**	0.24*	0.33**	0.49**	0.25*	0.51**	0.49**			
Lack of information													
12. Markets	0.34**	0.24*	0.24*	0.19	0.30**	0.33**	0.46**	0.28**	0.34**	0.34**	0.23*		
13. Finance	0.26**	0.19	0.18	0.29**	0.03	0.17	0.39**	0.14	0.47**	0.37**	0.32**	0.62**	
14. Product technology	0.30**	0.27**	0.29**	0.25**	0.16	0.31**	0.36**	0.23*	0.41**	0.35**	0.27**	0.51**	0.45**

Note: * Correlation is significant at the 0.05 level (2-tailed)
    ** Correlation is significant at the 0.01 level (2-tailed)

Appendix 7: Explanatory variables used in the survey analysis

Name	Definition	N	Mean	SD
Intentions				
Pursuance of a satisfactory market opportunity	1="very important"; 2= "important" 3= "medium"; 4= "less important" 5= "not important"	109	1.93	1.28
Years in operation	Number of years the business has been in operation	107	7.92	3.02
Start up year	One if business is created after 1996, zero otherwise.	107	0.40	0.49
Old entrepreneurs	One if the entrepreneurs is over 50 zero otherwise	110	0.18	0.39
Small business	One if the business has 6-20 employees zero otherwise	110	0.52	0.50
Location	One if the business is located in Tirana, zero otherwise.	110	0.55	0.50
No need for loan-enough profits	One if this is a "very important" and "important" reason not to ask for loan, zero, otherwise.	110	0.39	0.49
Difficulty to get a loan on the basis of good business plan	One if entrepreneurs can get a loan "always" and "mostly" and zero, otherwise	110	0.34	0.47
Abilities				
University education	One if the entrepreneur has university education, zero otherwise.	110	0.73	0.45
Business qualification	One if the entrepreneur has received business qualification during business operation, zero otherwise	104	0.23	0.42
Need for marketing and sales advice	One if answers "very important" and "important", zero otherwise.	110	0.75	0.44
Lack of information on product technology	One if answers "very important" and "important" as a barrier, zero otherwise	110	0.63	0.49
Competing on the basis of sophisticated technology	One if answers "very important" and "important" as a competitive advantage, zero otherwise.	110	0.70	0.46

Appendices

Opportunities

<u>Regulation related barriers-</u>   Factor created through principle
component analysis which includes:

Burdensome employment regulations	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	109	3.49	1.31
Inflation	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	109	2.61	1.52
Environmental regulations	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	109	3.56	1.27
Inadequate supply of infrastructure	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	110	1.90	1.23
Foreign trade procedures	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	110	3.25	1.49

<u>Information related barriers</u>   Factor created through principle
component analysis which includes:

Lack of information on product technology	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	106	2.35	1.41
Lack of information on markets	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	106	2.89	1.46
Lack of information on finance	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	106	3.04	1.37

<u>Support related barriers</u>   Factor created through principle
component analysis which includes:

Do not understand our concerns	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	108	2.58	1.43
Miss local presence finance	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	108	2.52	1.46
High fees for their services	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	108	3.00	1.38

<u>Corruption related barriers</u>   Factor created through principle
component analysis which includes:

Unfair competition	1= "very important", 2="important", 3= "medium", 4= "less important"	110	1.78	1.20

250

	5= "not important"			
Corruption	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	108	1.86	1.28
Complicated licensing procedures	1= "very important", 2="important", 3= "medium", 4= "less important" 5= "not important"	110	3.05	1.49
Bribing activity	One, if the entrepreneur has answered that is "always", "mostly" and "frequently" common to make additional payments, zero otherwise.	110	0.60	0.49
Business success hard work	1= "very important"; 2= "important" 3= "medium"; 4= "less important" 5= "not important" as factor for business success	108	1.18	0.58
Business success skills and knowledge	1= "very important"; 2= "important" 3= "medium"; 4= "less important" 5= "not important" as factor for business success	108	1.13	0.39
Trust in business partners	One if trusts them "always" or "mostly" zero, otherwise.	110	0.81	0.39
State perceptions	One if the state is considered as a grabbing hand, zero if state is considered as a neutral and helping agent	108	0.59	0.49
Difficulties with government officials	One if they have increased, zero otherwise	110	0.51	0.50
Perceptions about moral attitudes	One if "fully agree", "agree" and "tend to agree" and zero, otherwise.	110	0.54	0.50
Better public services	One if "fully agree", "agree" and "tend to agree" and zero, otherwise.	110	0.61	0.49

Performance indicators

Business performance	1= "more than satisfactory" 2= "satisfactory"; 3= "less than satisfactory"	109	2.10	0 56
Investment	Ordinal variable indicating cumulative investment in the enterprise. Four categories: 1= <50mln lek; 2= 50-200 mln lek 3= 200-1000 mln lek; 4= >1000mln lek	63	65.45	108.30
Turnover	Ordinal variable indicating turnover of the enterprise. Four categories: 1= <50mln lek; 2= 50-200 mln lek 3= 200-1000 mln lek; 4= >1000mln lek	67	142.05	620.14