

ANALYSIS OF ENTREPRENEURIAL ENVIRONMENT IN THE SLOVAK REPUBLIC – RESULTS OF A RESEARCH CONDUCTED ON A SELECTED GROUP OF SMALL AND MEDIUM – SIZED ENTERPRISES

Elena Šúbertová

University of Economics, Bratislava, Slovak Republic

Abstract: *Slovak Republic is a member of the European Union since year 2004. Small and medium enterprises (SMEs) play decisive role in development of its economy, their number exceeding four hundred thousand in year 2008. This paper shows influence of entrepreneurial environment on SMEs after they are facing wide-open united European market space. We have researched factors and results of entrepreneurial activities for year 2008 based upon questionnaires distributed to a sample consisting of 130 SMEs. Results of the analysis were further examined by standard statistical methods.*

Keywords: *Entrepreneurial Environment in the Slovak Republic, Small and Medium Enterprises, Influence of Entrepreneurial Environment.*

1. Introduction

Entrepreneurial environment is very diverse. Literature on the topic recognizes two types of this environment: external and internal. Situation of the external entrepreneurial environment has a decisive influence on entrepreneurship both in the country as a whole as well as in its individual regions.

External entrepreneurial environment is a sum of external factors and conditions, which influence directly or indirectly the formation and development of entrepreneurship. In relation to entrepreneurs, external environment is an objective factor, independent of their requirements. To be successful, entrepreneurs must know very well all factors and conditions, so they can foresee their influences on future results of entrepreneurial actions.

External environment sums up various sub-systems (order below does not reflect importance):

- Economic situation (in country, in region)
- Political situation (in country, in region)
- System forms of support for entrepreneurships by government
- Technological environment, technology and innovation
- Social situation (in country, in region)
- Cultural environment
- Etc.

Entrepreneurial success depends substantially on numerous factors, the most important being internal entrepreneurial environment. It is a summary of internal conditions under which the entrepreneurial subject operates. Internal environment is a composition of resources, which are divided into following categories (Slavik, 2005):

- Tangible assets (material and financial)
- Intangible assets (know-how, trademark)
- Human resources (number of employees, qualification, skills and experiences).

Firms are operating in a real world – in concrete time, space and conditions.

According to subject sector, more than one third of SMEs in Slovakia operate in tertiary sector. In the year 2008 there were 27.82 % companies which operated in trade, 25.61 % in services, 19.72 % in construction, 18.39 % in industrial production and 8.46 % in other activities (agriculture, freelance).

2. Background

Detailed study of both local and international resources devoted to research on SMEs allows defining three major orientations in development of this issue:

The first orientation is formulated by those authors, who approach the issue from *a production organization and efficiency (synergic effect)* point of view (Vebster, L.,2004). As a rule, their works highlights various factors (institutional political, socio-economic), which helps SMEs development. However, there is absence of theoretical models, which would enable to verify number of these and similar factors and empirical control of hypotheses. Therefore, there is a wide spectrum of different definitions and explanations of the entrepreneurial environment. As an example, in her paper the author suggested that the most decisive factor in SMEs development in countries of Central and Western Europe is foreign trade. On the other hand, Berkowitz and Holland, proved based on statistical evidence that SMEs formation has a positive correlation with reform index. (Berkowitz, D. - Holland, J., 2001).

The second group of authors (e.g. Baumol, J.W., 1990) highlights the *SMEs development phenomenon*. They researched importance of entrepreneurship and its specific role in economic development. Baumol implied that entrepreneur is assigned a specific role of an “innovator”. If the goal is to increase entrepreneurial activities in under-developed economy, research must be concentrated to find out ways to decrease costs relative to risks. Baumol also opened an issue „how the public influences productivity by rules influencing efficiency of various entrepreneurial activities“.

The third group of research papers (Blanchflower, G. D. - Oswald, J. A.,1998) relates entrepreneurship with *theory of usefulness and human’s rational behavior on labor market*. In this case, entrepreneurship is a synonym to self-employment and is compared to the alternative of an employee. Blanchflower and Oswald are modeling inclination to entrepreneurial risk and connect it to psychological attributes of a person. They emphasize their attention to young people and to an important parameter – density of capital distribution within society.

3. Main Focus of the Chapter

Questions, discussion, problems

From the time perspective, number of entrepreneurial entities has shown a very dynamic development between years 2003 and 2007. While in the year 2003 number of entrepreneurs exceeded 300 thousand, it was over 400 thousand in the year 2007, which shows a strong growth dynamics in a country with population of 5.4 million. Most of the firms were SMEs – micro-companies with less than 10 employees.

Considering geographical distribution, the highest rate of active entrepreneurs per 1000 population is in Bratislava and its region in southwestern part of the country, the lowest number is in Kosice region in eastern part of Slovakia. It looks as if entrepreneurial activity decreases with increasing distance from capital city to east.

Changes in the entrepreneurial environment and at the same time changes in legislation might influence entrepreneurial conditions. We selected 130 companies for our research, while concentrating to four major groups of problems (questions):

1. How long are these SMEs actively operating, what are their major activities, number of employees
2. Their exports and imports from/to Slovakia
3. Possibilities for SMEs financing in Slovakia – own versus outside resources
4. External and internal barriers in entrepreneurial activities

Re 1. How long are these SMEs actively operating, what are their major activities, what is their number of employees?

During the first two years after Velvet Revolution (years 1990 – 1991) there were 200 thousand starting entrepreneurs. Margin of 300 thousand was not exceeded until year 2003. Selected sample of businesses has a structure similar to the whole Slovakia – 60.9 % of the researched companies have started between years 1990 and 2000; other 27.3 % between 01.01.2001 and 04.30.2004 (that is before Slovakia joined European Union) and 12.1 % of the companies have started their activities after Slovakia became EU member.

It is interesting to see relation between number of employees in a company and perception of the company's economic situation: we have found out that there is indirect dependence between these two parameters within the sample. The fewer employees are in the company, the higher was owners' perception of its „economic strength“. It is interesting to observe, that questioned about economic situation after Slovakia entered the EU, only 10.6 % of entrepreneurs claimed that their situation is worse. Half of the entrepreneurs responded that their situation is the same as before and the rest, 39.4 %, claimed that their situation improved.

Re 2. Exports and imports by SMEs from/to Slovakia

After Slovakia joined the EU, internationalization activities in industrial production are stronger than in trade. Only 35.8 % of companies were either exporters or/and importers, mostly to European Union countries – almost two thirds of companies consider this market as the most attractive. It is logical, that mainly large companies execute export/import, for example large shopping stores chains or mechanical construction companies like automotive industry. However, these types of companies were not included in our research, because they together do not represent major part of employment force or a major part of GDP.

There are 64.2 % of companies not involved into export or import, which is a result of various facts: most of the companies started in 1990s and entrepreneurs – their founders – had a very good knowledge about regional markets, but did not know that much about conditions on foreign markets and are not familiar with relevant legislation. Another reasons - indicated in questionnaires as the main ones for not entering foreign markets – are lack of financial resources for marketing, competition of foreign markets, problems in obtaining foreign licenses and certificates. Basically zero export/import is in restaurant services, which buy supplies from local wholesalers. It might be interesting that part of the companies pointed out scarce of qualified human resources, but on the other hand micro-companies did not plan any further hiring. The more employees the company has, the higher was its willingness to hire even more. In their hiring process Slovak SMEs value highest experience and skills, the second rank is education and the third are personal qualities.

Re 3. Possibilities for SMEs financing in Slovakia – own versus outside resources

Based upon research results, we can state that share of outside capital in Slovak companies is increasing. Two thirds of entrepreneurs have experience with outside capital resources during the starting phase of their activities. In our sample, 56.9% of those who responded to the questionnaire started their entrepreneurial activities in Slovakia in year 2008 based upon bank loan, which is a positive sign. It is related to decrease of bank loan rates, because before entering the EU, the decisive financial resources for entrepreneurship were either own savings or loans from family and friends. Own savings as a source for financing SME activity – in our sample – decreased to only 20.7 %, loans from relatives and friends accounted for 5.2 %. Financing obtained thru inheriting or lotteries were quite low, as expected – 3.4 %. Other financial resources accounted for 1.7 %. There is a substantial problem for Slovak entrepreneurs to find and obtain financing from banks, mostly for new entrepreneurs because the problem with securing the loan. In Slovakia, the interest rate is still higher than in West European countries (for example, the neighboring Austria has better credit conditions). On top of that, there is quite a complicated procedure related to all documentation.

Re 4. External and internal barriers to entrepreneurial activities

It is clear that any entrepreneurial activity has its positives and negatives, as well as it has some limits.

The most favorable entrepreneurial situation, indicated by respondents, is based upon following facts:

- a) **The market is still not satisfied** (note: during the research, Slovakia was preparing for switch from Slovak Koruna to Euro, so there were products in demand exceeding offers – e.g. new electronic cash registers, new software, special accounting software, etc.)
- b) **Social and environmental influences** (obligatory contributions to social fund, means related to environment protection)
- c) **Technological environment** (innovations of processes and products, thanks to fast information transfer).

On the other hand, entrepreneurs had their say also tom problems. During the research they have a choice from 28 possibilities to choose from to indicate what they consider as major barriers. From their point of view, following are the **major obstacles entrepreneurs are facing**:

A. Financial problems, mainly in following:

- a) **Insolvency of customers** – in reality, the crisis begun with not enough liquid capital to cover short term debt of customers, which triggered a chain reaction.
- b) **High Social security insurance** - every entrepreneur in Slovakia pays for his/her employees more than one third of levies to Social security insurance, which increases the cost on an employee.
- c) **Various amendments in calculation of taxes, levies and other charges** – there is continual change and amending of all legislation related to taxes, with particular problems with indirect taxes. The Act on VAT influences not only entrepreneurs, but also consumers. Based upon their type, direct taxes are paid to various authorities. Levies are paid to at least two different institutions – to a health insurance company by persons' choice, and to Social Insurance institution. If an entrepreneur has employees, it is his/her duty to subtract employee's health insurance and social insurance from

paycheck and send the employee's portion of insurance contribution directly to insurance institution. However, there are number of various levies, quite often illogical – e.g. membership fees in associations even if the membership is mandatory for specific entrepreneurial activities or occupations (e.g. publishers to Literary foundation).

B. Administrative problems, which can be divided into three categories:

- a) **Complicated registration** – for example there is no “Single Point of Contact” where an entrepreneur can register to all required institutions, but he/she has also visit in person Social Insurance institution and institutions of other authorities (e.g. local/municipal office to register for local taxes, for garbage removal services and other fees).
- b) **Extensive documentation** – small entrepreneur has to have the same accounting and other documentation as a large one, which creates problems for micro-entrepreneurs and SMEs. Most of them have to hire specialist for this agenda, which can be non-efficient in case of small business and small revenues and can lead to loss of profitability.
- c) **Frequent changes of legislation** – changes and amendments of relevant legislation in Slovakia are way too frequent. For example Act 455/1991 on Business Code has been amended ca 20 times since year 1991, which is similar to the case of Act 513/1991 Commercial Code as well as for other legislation. Therefore SMEs are more probable to face large problems than companies with their own legal departments.

C. Other problems, which can be divided into three categories

- a) **Crime** – is related to inadequate protection of ownership rights and with interests of entrepreneurs. Delays in legal processes cause insecurity among citizens, including entrepreneurs. It seems that problem with extortion can not be solved.
- b) **Controls** – there are too many controlling institutions, which distract entrepreneurs from their real entrepreneurial activities.
- c) **Penalties and fines** – some of the penalties and fines are illogical: they have to be paid first and only afterwards appealed. It is mostly a case for payments to large companies – e.g. utility services – which have major market share and quite often their contracts are unfavorable to SMEs.

4. Solutions and Recommendations

Re 1) Cooperation

For such a small country as Slovakia, the number of operating SMEs is sufficient; the problem is more in their efficiency. Therefore it is appropriate to look for various forms of cooperation, so those small isolated entrepreneurship could pool their capital and become efficient.

Cooperation can be:

- a) Case by case
- b) Short-term
- c) Medium-term
- d) Long-term.

Cooperation can be working either on horizontal level, or in vertical direction or both. In such a way the risk is diversified, scope of activities can be increased and Slovak companies can be competitive. In general, on a large global market there is potential to succeed only with quality products priced appropriately.

Re 2) Internationalization of SMEs

Slovak market is not a large one, but still interesting for all suppliers. It would be appropriate to turn attention more to export of products and in preparation of contracts to utilize assistance available to entrepreneurs – well-built infrastructure of various entrepreneurial associations and their advisory and consulting capacities. Only 16% of respondents are currently using these services – and it is not enough. One of the reasons of low trust in these institutions has its roots in lack of information – 23.1% of entrepreneurs either did not know about these organizations or they considered them as obsolete.

Re 3) Means of SMEs financing

Slovak SMEs do not use funds from the European Union in an extent they are available. The problem SMEs indicated is complexity of the project they do not have time to prepare or money to put in. Therefore, in financial difficulties they rather turn to banks or their relatives or friends. There is currently a lot of information on Internet regarding possibilities to finance SMEs from various resources and so an opposite situation can happen – that in their effort to get “fast money” from non-banking institutions they might loose even more.

Re 4) Barriers to entrepreneurial activities in Slovakia

A. **Financial problems**, which can be split into three categories:

- a) *Insolvency of their customers* – it is crucial to be very careful in preparation of any business relations and contracts.
- b) *High level of Social Security Medicare and Health insurances* – the only legal way to decrease high levies in Slovakia is to employ disabled persons, or – instead of full-time employment – either to use contracts or part-time employment. Slovak entrepreneurs mostly use cooperation with subcontractors, who invoice for their work and pay the levies.
- c) *Changes in calculation of taxes, levies and other fees* – to limit frequent legislative changes can be probably accomplished only by electing highly qualified legislators – members of the Parliament. It is worth to think about “one point of payment” instead of separate payments to be made various authorities (e.g. property taxes, health insurance, social insurance, etc.)

B. **Administrative problems** are divided in three categories:

- a) *Complicated registration* – can be solved by automated information system. However, during current economic crisis such a solution might be unrealistic due to one-time initial investments to information technologies. The other problem might be created by probable decrease in employment of those people whose work will be replaced by AIS.
- b) *Extensive documentation* – small entrepreneur should be required to keep only basic business documentation.
- c) *Frequent changes of legislation* – changes and amendments of relevant legislation were logical due to legislation approximation with other European Union and Eurozone countries (EU member states using Euro as their currency). It could be foreseen that new generation of experts will ensure more efficient and more stable legislative framework.

C. Other problems divided in three categories:

- a) *Crime* – to fight crime means increased interest from both the society as a whole and entrepreneurs in particular. It is inevitable to speed-up trials and court decisions and to fight low law enforcement.
- b) *Controls* – should have primarily preventive and educative functions.
- c) *Penalties and fines* – speed-up all processes related to appeals

5. Future Research Directions

This research was conducted on a sample of 130 SMEs in Slovakia. Most of the entrepreneurial entities were established before Slovakia joined European Union.

While entrepreneurial base in Slovakia is regionally strong, it is important to build-up its competitiveness outside of the country – and not only towards European Union countries. Cooperation of companies is inevitable – division and specialization in production calls for cooperation.

Economic crisis clearly demonstrated that companies throughout the whole world are interlinked either directly or indirectly via market and banking sector.

It is needed to research in detail cooperation ties among SMEs not only on regional, but also on international level. Communication and cooperation is often missing within various regional and multinational consulting institutions. I advise to re-evaluate cooperation of a large number of institutions that are associating SMEs under different goals, and to re-evaluate efficiency of their activities regarding entrepreneurship development.

6. Conclusion

We have found out some very interesting facts in this research: first of all that most of entrepreneurs are afraid of cooperation. Therefore the cooperation – be it horizontal, vertical or matrix – is moving forward slowly. Micro-companies are domineering in Slovakia. Working with a large team or with cooperative partner is more risky, especially if joint financial resources are in question. Decisive form of entrepreneurship in Slovakia is business (self-employment) in case of physical persons. In spite of all problems indicated, entrepreneurs in Slovakia see the economic situation after joining European Union mostly as positive.

During the recent years Slovakia has the highest GDP growth among all EU countries, amounting to 6 % in the past year. The reason was a good timing for start of reforms. Slovak entrepreneurs are facing problems in obtaining financial capital – specifically from banks. The solution is rational and mutually beneficial cooperation of SMEs, which might bring in capital even during a crisis and so help in increasing competitiveness. Introduction of Euro as a currency and joining the Eurozone helped to stabilize Slovak market. Slovak entrepreneurs proved that they are able to be functional even in hard times. As the economic development and situation in Slovakia shows, barriers are not impassable. Situation on labor market has improved to some extent by lay-offs of qualified workers. If they are flexible, they can help to reinforce other – active - entrepreneurial entities.

Acknowledgement

This paper was prepared under project of Scientific and Education committee VEGA at the Slovak Ministry of Education, project number 1/0330/08, registered at the University of Economics, Bratislava under number 241.

Key Terms & Definitions

Small and Medium Sized Enterprises (SMEs) – about European Commission Recommendation No. 2003/361/EC since 1st January 2005 :

Micro, small and medium-sized enterprises are defined according to their staff headcount and turnover or annual balance-sheet total.

A medium-sized enterprise is defined as an enterprise which employs fewer than 250 persons and whose annual turnover does not exceed EUR 50 million or whose annual balance-sheet total does not exceed EUR 43 million.

A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million.

A microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

References:

- [1] SIVAK, R. & MIKOCZIOVA, J. (2009) *Teória a politika kapitálovej štruktúry podnikateľských subjektov*. 2. edition. Bratislava : Sprint dva, 2009. ISBN 978-80-89393-06-0
- [2] SLAVIK S.(2005) *Strategický manažment*. Sprint. Bratislava 2005. p. 120. ISBN 80-89085-49-0
- [3] BAUMOL, W.J. (Oct. 1990) Entrepreneurship: Productive, Unproductive, and Destructive. *The Journal of Political Economy*, Vol. 98, No. 5, Part 1, pp. 893-921
- [4] MYŠKOVÁ, R. (2007) *Využití externích informací pro úspěšné řízení podniku*. Scientific Papers of University Pardubice No 12, pp. 101-107, ISSN 1211-555X
- [5] VEBSTER, L. (2004) *Restructuring for Recovery*. A World Bank Country Study. The World Bank, Washington, D.C., ISSN 0253-2123
- [6] KOVAĽOV, A. (2008): *Zhodnotenie vplyvu podnikateľského prostredia na fungovanie malých a stredných podnikov*. Unpublished dissertation Ekonomická univerzita.Bratislava, Slovak Republic., pp. 127-128
- [7] HEIGL-MURAUER, M.a (2009). *German small and medium-sized enterprises in Slovakia: the effect of selected financial management problems and taxation aspects on investment decisions* : Unpublished dissertation Ekonomická univerzita.Bratislava, Slovak Republic, 2009, pp. 4-5
- [8] BERKOWITZ, D. & HOLLAND, J.: *Does privatization enhance or deter small enterprise formation?* University of Pittsburg, 2001. working paper.
- [9] BLANCHFLOWER, G. D. & OSWALD, J. A : *A study of labour markets and youth unemployment in Eastern Europe*, a report to the ILO, 1998a.
- [10] http://faculty.washington.edu/latsch/SISAF444_Baumol_Entrepreneurship.pdf.
- [11] http://europa.eu/legislation_summaries/enterprise/business_environment/n26026_en.htm

- [12] ŠÚBERTOVÁ, E. (2006) Development of entrepreneurship and financial sources of small and medium size enterprises. In *Management, economics and business development in the new european conditions : IV. international scientific conference*. - Brno : Vysoké učení technické v Brně. ISBN 80-7204-454-0, s. 1-7
- [13] ŠUBERTOVA, E. (2008) *Podnikateľské prostredie pre malé a stredné podniky v SR a vo svete*. In *Nové trendy v manažmente : zborník príspevkov z medzinárodnej vedeckej konferencie* [elektronický zdroj]. - Trenčín : Fakulta sociálno-ekonomických vzťahov Trenčianskej univerzity Alexandra Dubčeka v Trenčíne. ISBN 978-80-8075-370-2 from http://www.fsev.tnuni.sk/uploads/media/Nove_trendy_v_manazmente.pdf
- [14] ŠÚBERTOVÁ, E. (2008) *Podnikateľské prostredie v SR - podmienky a výsledky*. In: *Nová teorie ekonomiky a managementu organizací : from "Svět v pohybu" [CD]*. - Praha: Vysoká škola ekonomická v Praze - Nakladatelství Oeconomica, 2008. ISBN 978-80-245-1408-6

Contact address:

Assoc. Prof. Ing. Elena Šúbertová, PhD.
Ekonomická univerzita
Fakulta podnikového manažmentu
Dolnozemska 1/b
852 35 Bratislava, Slovenská republika
Email:elena.subertova@euba.sk, subertov@euba.sk