Promoting Entrepreneurship in Eastern Europe

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ABSTRACT. The past decade has seen a revival of entrepreneurship in the modern industrial economies, characterized by a wave of enterprise restructuring and of new developments in business and technology. In this paper, we argue that market transitions of the post-socialist economies of Eastern Europe cannot be successful without similar entrepreneurial restructuring. To address the massive structural distortions that still plague the post-reform economies, the governments of the region must promote entrepreneurship through policies that: (1) make use of all possible sources of entrepreneurship, including in particular the former state and social sectors; and (2) establish a macroeconomic environment and property-rights framework conducive to entrepreneurship. A successful promotion strategy will need to operate on several fronts, by: (1) redirecting entrepreneurial activities into legal, productive activities, (2) increasing the supply and effectiveness of entrepreneurs, (3) developing markets for complementary inputs, and (4) increasing the demand for entrepreneurship. An unsuccessful approach, we argue, will be one that regards the pre-reform small private sector as the only source of entrepreneurship, and as the only arena for its productive use.

Final version accepted on December 29, 1993

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I. Introduction

Much of the recent work on the restructuring of the East European economies has focused on pressing macroeconomic issues – how to control inflation, establish a convertible currency, move toward public-sector budget balance, create a viable tax structure, and promote foreign investment. This paper does not challenge the view that appropriate macroeconomic policies are vital to the transition to a healthy market economy; indeed, as we argue below, such policies are a prerequisite for positive-sum entrepreneurship. In this paper, however, we focus not primarily on the effects of macroeconomic policies, but on the emergence of East European entrepreneurship. Clearly, that development is inherently more difficult to track than balance-of-payments deficits or trends in foreign investment; why, then, do we stray into this relatively ill-defined territory? We do so because of the central importance of entrepreneurial activity in the processes of economic growth and development. Entrepreneurship, it has been argued, is the "prime mover" in development: "with it, other factors [necessary to development] can be found; without it, they will be squandered" (Jones and Sakong, 1979).

One need not adopt a "heroic view of the entrepreneur" (Leibenstein, 1987) to recognize that without competent and innovative coordination – particularly in a context of underdeveloped markets – machinery may be allowed to rust away as excess capacity, skilled labor directed into socially wasteful tasks, and capital diverted into zero-sum speculative activities. There are few better illustrations of this point than the centralized pre-reform economies of Eastern Europe, in which the suppression and misdirection of entrepreneurial talents guaranteed that impressive investment ratios would do relatively little to spur

Small Business Economics **6**: 165–184, 1994.

economic growth. In addition, the experiences to date of post-socialist economies in transition indicate that "macro stabilization will be difficult to achieve . . . in the absence of adequate micro adjustment" (Svejnar, 1991) and that neither institutional reforms nor privatization can be successful without entrepreneurship (Acs and Audretsch, 1993).

The paper is organized as follows. In Section II, we present a conceptual framework for thinking about entrepreneurship – specifically, what it is and where it comes from. After discussing the major categories of definitions of entrepreneurship, we suggest an alternative definition that, in light of the massive structural distortions plaguing the post-socialist societies, we believe to be more appropriate for contemporary Eastern Europe. The latter part of Section II examines the sources of entrepreneurship, both generally and in the East European context, and stresses the diverse origins of entrepreneurial behavior. Section III uses the framework developed in the preceding section to suggest policies for promoting East European entrepreneurship. We distinguish two types of policies, both of which play an important role: broader policies that supply the stability and predictability that undergirds much positive-sum entrepreneurial development, and policies and programs designed specifically to promote entrepreneurship. Section IV concludes briefly.

II. Entrepreneurship: A conceptual framework

As an expository device, opening a paper with a definition often adds more tedium than value. In the case of entrepreneurship, however, pausing to define terms is inevitable, both because of the diversity of definitions that have been offered and because of the differences in policy choice that each implies. If risk-taking is the essence of entrepreneurship, for example, then a government might wish to establish a public venture-capital fund to promote especially risky projects. If instead entrepreneurship consists primarily of product innovation, entrepreneurial promotion policies may need to focus on establishing public research institutes to perform basic science or to disseminate results of scientific research carried out abroad.

Students of entrepreneurship generally fail to agree on what it is they are studying, as chronicled by various surveys of the literature (see, for example, Gartner, 1988; Hebert and Link, 1989; Cunningham and Lischeron, 1991). It may be possible to clear away some of the confusion by distinguishing between *definitions* of entrepreneurship and theories about its *sources*. By doing so, we cut across strains of thought usually recognized as schools: the so-called "trait" school of entrepreneurship (Gartner, 1988), for example, falls into the second category, as it says more about where entrepreneurship comes from than what it is. From an operational standpoint, this taxonomy has the advantage of answering in sequence two questions central to the promotion of entrepreneurship: what behaviors or characteristics constitute entrepreneurship, and where should governments target their promotional efforts? This section answers each of those questions in turn, adapting the responses to the particular circumstances of the post-reform economies of Eastern Europe.

Defining entrepreneurship

Economists have long shown an interest in the roles played by the entrepreneur – both the static role of coordination of the other factors of production and the dynamic role of innovation and creation. A substantial literature exists on the subject, and the definitions of entrepreneurship that appear in the literature are legion, as chronicled extensively by Herbert and Link (1989). At the risk of oversimplifying, we may group the traditional definitions into four major categories: (i) entrepreneurship as innovation; (ii) entrepreneurship as risk-taking; (iii) entrepreneurship as stabilizing force; and (iv) entrepreneurship as founding or owning and managing a small business.

The first view, entrepreneurship as *innovation*, is associated with J. S. Schumpeter (1934), who placed the entrepreneur at the center of his theory of economic development. To Schumpeter, an entrepreneur is one who creates new combinations, thus becoming a dynamic agent of change for the economy. Such combinations can take various forms, including "(1) developing new products or sources; (2) developing new methods of production; (3) identifying new markets; (4) discovering new sources of supply; and (5) developing new organizational forms" (Brockhaus, 1987). Although risk is an inherent part of forming these new combinations, Schumpeter's entrepreneur is distinguished not by his ability to bear risk but by his insight and vision. The emphasis in this school is on "substantial" innovation, a category that excludes simple alterations of a production process to meet the demands of a new environment. As such, this definition is relatively narrow. In addition, the conditions required for Schumpeterian entrepreneurship are quite restrictive. Schumpeter's definition assumes that the entrepreneur launches his innovation from an initial state of equilibrium, and that it is the stability of that initial state that allows the entrepreneur to gather the data necessary to plan and implement his innovation (Schumpeter, 1934, pp. 235–236, cited in Loasby, 1991, p. 17).

A second definition of entrepreneurship, first proposed by Richard Cantillon, focuses on risk-taking.[1] According to this view, the economy's vitality is dependent on ventures that are inherently risky, but the willingness to take risks is distributed scarcely. Those who have such a willingness are classified as entrepreneurs. Thus, while the entrepreneur's business may often involve product innovation, it is not her foresight or technical knowledge that is the essence of her entrepreneurship, but rather a simple feature of her preference structure: her relatively low aversion to risk, which enables her to undertake an innovation that others are unwilling to attempt.

A third school views entrepreneurship as a stabilizing force that moves markets toward equilibrium. Israel Kirzner has articulated this view most clearly, building on Friedrich von Hayek's discussion of the role of private knowledge (as opposed to central planning) in achieving equilibrium (Hayek, 1937 and 1946, cited in Loasby, 1991, p. 14). Contrary to Schumpeter, Kirzner views disequilibrium as the only environment in which the entrepreneur can act. In disequilibrium, the economy is full of errors in resource allocation that can be exploited profitably by the perceptive entrepreneur. By exploiting these opportunities – essentially, by serving as arbitrageur seizing "something obtainable for nothing" (Kirzner, 1973) – the entrepreneur eliminates the disequilibrium.

Finally, there appears in practice a fourth major definition of entrepreneurship: *Founding or owning and operating a business*. Although not popular in the theoretical literature,[2] this view surfaces quite often as the empiricist's definition – understandably, given the practical difficulties of identifying the population of "Schumpeterian innovators" or "risk-takers" in an economy. Instead, empiricists will often define as entrepreneurs those who have started a business within the last several years, or even simply owner-operators of firms. This implicit definition gains greater currency as empiricists survey these populations and use their data to identify "characteristics of entrepreneurs".

Each of these traditional views has its weaknesses, however. The Schumpeterian view may leave little room for innovations that are not on the technological or organizational cutting edge – adaptation of older technologies to a developing-country context, for example, or entry into export markets already tapped by other firms. Schumpeter's requirement of initial equilibrium also becomes increasingly more difficult to fulfill in a world buffeted constantly by technological shocks. "Entrepreneurship as stabilizing force" also has its difficulties: it makes the entrepreneur little more than an astute reader of the market's equilibrating mechanism, and it largely neglects such questions as how the entrepreneur discovers and exploits market opportunities, or how a firm sustains its entrepreneurial character through multiple innovations. "Entrepreneurship as risk-taking" neglects other major elements of what we usually think of as entrepreneurship, such as a well-developed ability to recognize unexploited market opportunities. Finally, the empiricist's view implicitly denies the possibility of entrepreneurial behavior by established firms, thus excluding not merely intrapreneurship (entrepreneurial behavior by a manager who has no equity stake), but even entrepreneurial direction by an owner-manager who did not found her business.

Largely in response to these shortcomings of traditional definitions offered by economists – and particularly to the neglect of the possibility of entrepreneurial behavior by established firms – writers on management have in recent years turned to examining entrepreneurship within existing business organizations. Given the concerns of these researchers, it is unsurprising that within the rough taxonomy above, their writings tend to fall most naturally into Schumpeter's camp. Peter Drucker (1985), who defines the entrepreneur as one who "always searches for change, responds to it, and exploits it as an opportunity", can clearly be classified as a Schumpeterian, although his emphasis on systematic management and creativity-inducing organizational structure show that he considers innovativeness to be more created than innate. Gifford Pinchot's (1985) definition of intrapreneurship – to take another example – similarly focuses on entrepreneurship as innovation, but like Drucker extends it to managers throughout the organization.

Other definitions that have appeared recently in the literature do not fit as easily into the existing framework. One alternative definition, a broader one that takes into account the weaknesses of traditional definitions, has been offered by Jones and Sakong (1979) in their seminal study of Korean entrepreneurship.[3] To these authors, entrepreneurship consists of mobilizing other resources to meet unmet market demand – but in a way that is neither as narrowly technological as Schumpetrerian entrepreneurship, nor as dependent on innate farsightedness. In addition, the entrepreneur plays a market-supplementing role: where well-developed markets for certain inputs are lacking, the entrepreneur provides those inputs himself. This broader definition reflects views that are also prominent in the recent management literature on entrepreneurship. Jeffrey Timmons (1989), for example, clearly has in mind a heroic case of market-supplementing when he defines entrepreneurship as "the ability to create and build something from practically nothing,"[4] while Howard Stevenson (1985) incorporates both the innovative and combinatory/managerial roles of the entrepreneur in his definition of entrepreneurship as the "process of creating value by pulling together a unique package of resources to exploit an opportunity."

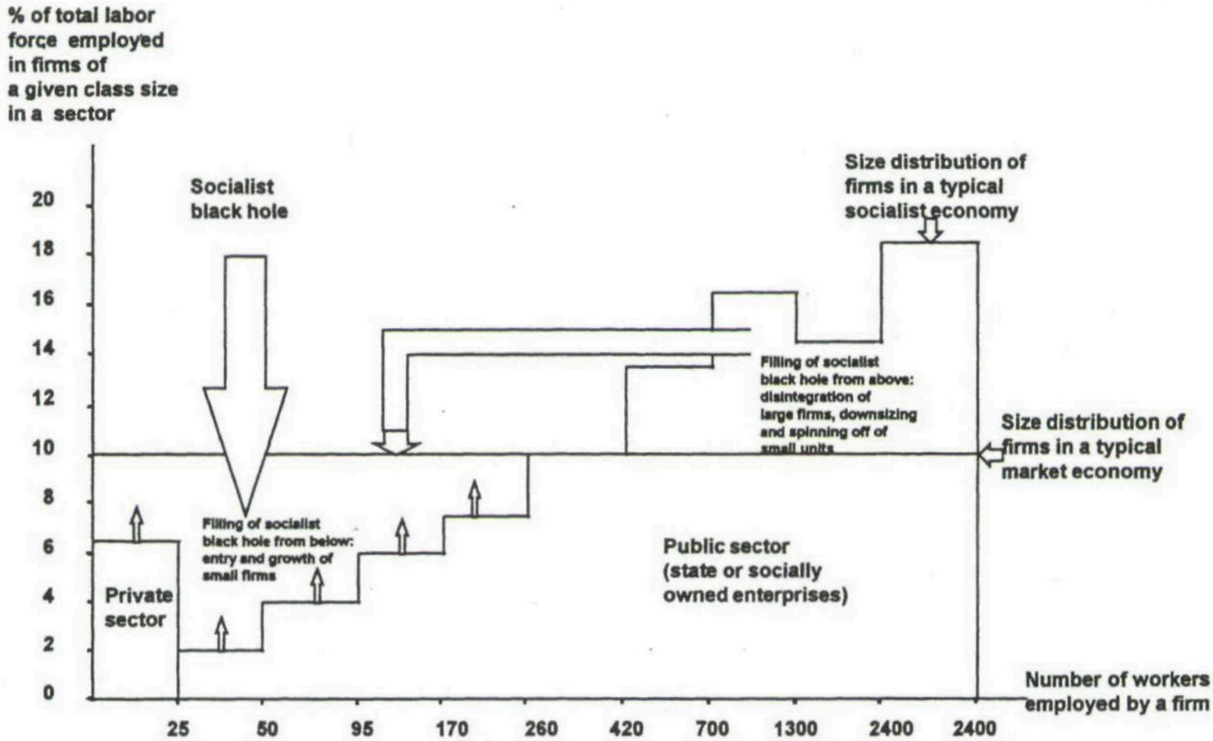
Defining entrepreneurship in the East European context

To choose the definition of entrepreneurship most appropriate for the East European context, it is important to bear in mind the entrepreneurial skills that will be needed to complete a successful transition to a market economy. In economies characterized by highly imperfect markets and substantial distortions, the conventional neoclassical assumption of self-combining factors of production is particularly unrealistic. As a result, the East European economies will have a great need for the combinatory and market-supplementing skills of entrepreneurs. By taking into account the overwhelming structural distortions that exist in the post-socialist/communist economies, we can identify three broad – perhaps even Herculean – entrepreneurial tasks.

First, entrepreneurial teams are needed to privatize and restructure state-owned enterprises. Decades of state planning have created an industrial structure that is insufficiently specialized, with enterprises manufacturing too large an assortment of products (especially intermediate goods) in production volumes that are inefficiently low, using outdated technology and wasting material inputs and factors of production.

The tasks of privatization and restructuring will thus encompass a wide variety of activities. In some cases, entrepreneurs will be needed to break up large firms, in order to free up scarce resources (particularly management time), reduce excessive diversification, and create more effective configurations of related businesses.[5] In other cases, the entrepreneurs will be needed to carry out internal reorganization of businesses – with the goals of slimming the ranks of middle management, improving managerial skills, improving incentives, introducing total quality management, and making the firms more innovative.

Second, entrepreneurial teams are needed to establish modern small enterprises to fill the so-called "socialist black hole" illustrated in Figure 1 (Vahcic and Petrin, 1989). Figure I shows the remarkable absence from the socialist industrial structure of small firms in the range of 25 to 200 employees. Although the graph of the socialist black hole was originally constructed by comparing Yugoslav and Swedish size distribution of manufacturing firms for 1986, the same "black hole" would appear if the size distribution of firms in any other socialist country – with a possible exception of China – or sector were used. This



Source: Adapted from Vahcic and Petrin, 1989.

Note: This figure illustrates the "socialist black hole," which appears when we compare the size distribution of enterprises in a mature market economy close to equilibrium with the size distribution of enterprises for a socialist economy in a sector. On the graph we find two curves, one for a typical socialist country and the other for a typical market economy. The area below each curve represents the entire industrial labor force for that economy. The size-class limits on the horizontal axis are chosen so that in the market economy the labor force is uniformly distributed over size classes, with each containing 10% of the labor force. The distribution of labor force in the socialist economy is drawn against the same scale. Originally, this graph was constructed by comparing the size distributions of Yugoslav and Swedish manufacturing firms; as a series of later empirical studies have shown, however, the socialist black hole appears in a variety of sectors and geographical comparisons.

Fig. 1. The socialist black hole: lack of small and medium size enterprises in socialist economies in comparison to market economics.

vacuum is a legacy of pre-reform state planning, which led to large firms and artificially high concentration (intended to exploit fully economies of scale) and which allowed micro enterprises little scope to expand.[6] Even in industries for which optimal unit size is small – for example, the many service industries that, in developed economies, consist primarily of small firms providing support to industrial enterprises – small firms are rare in Eastern Europe (Petrin, 1981).[7] As Acs and Audretsch (1987 and 1990, Ch. 12) show, the share of manufacturing employment accounted for by small firms lies between one-third and two-thirds in developed Western economies.[8] In Central and Eastern Europe, by contrast, the employment share of small state firms averages only about 3% (Arzeni, 1992). Even the trends moved in opposite directions through the late 1980s: while in the developed western nations, the small-firm share of manufacturing employment has increased steadily over the past two decades,[9] that share has declined in Eastern Europe (Carlsson, 1989; Petrin and Vahcic, 1991). Entrepreneurs will be needed to reverse this trend, both in traditional artisan sectors and in modern, higher-capital-intensity sectors.

Third, entrepreneurs are needed to help transform the industrial structure of Eastern Europe's economies. Over the next decade, the economic base of the region will necessarily shift away from excessive dependence on outmoded heavy industries and toward greater reliance on such industries as electronics, more sophisticated chemicals, and consumer goods, as well as banking, financial, and other business services. Market forces have already initiated these changes, as goods prices have been allowed to reflect more closely actual scarcities on world markets; but while these forces point the direction in which to move, entrepreneurs will be needed to help answer the question of how to get there.

The massive structural distortions of the region's economies thus offer myriad opportunities for constructive entrepreneurship, working from both ends of the industrial structure: from above, intra- and entrepreneurial managers in the state sector will be needed to break up firms, filling the black hole and phasing out the uncompetitive divisions of massive state enterprises; and from below, entrepreneurial founders of small firms will be needed to manage enterprise expansion and establish new sectors of comparative advantage. These challenges warn against assigning too narrow a definition to entrepreneurship in the East European context. The most appropriate definition, we would argue, is the broader one used by Jones and Sakong, for at least two reasons. First, given the very large state share in production and employment, an appropriate definition will have to encompass intrapreneurial behavior – that is, innovative behavior or risk-taking by managers of large state firms, both before and after privatization. Second, in addition to taking risks and serving as a Schumpeterian innovator, the entrepreneur in the East European context must play a market-supplementing role. Unlike Schumpeter's idealized entrepreneur, who operates in an already functioning market system and stable economic environment, the East European entrepreneur faces highly imperfect markets for most critical inputs, including land, capital, and skilled human capital. Often, the market-supplementing role of the East European entrepreneur may thus be even more important than his or her risk-taking role.[10] More generally, however, "entrepreneurship" as applied to Eastern Europe must encompass all of the major entrepreneurial functions – risk-taking, identification and exploitation of unfilled market niches, technological and organizational innovation, and market-supplementing – exercised both outside and within the state sector.

Sources of entrepreneurship

Scholars of entrepreneurship also differ on the sources of entrepreneurship (Cunningham and Lischeron, 1991). Empirical research on the sources of entrepreneurship is extensive,[11] particularly within the disciplines of psychology and sociology. Typically, these studies have tried to answer one of three questions: (i) are some cultures more conducive to entrepreneurial behavior than others?; (ii) to what extent are entrepreneurial traits inborn?; and (iii) to what extent can entrepreneurial skills be acquired through training?

From these three questions have resulted three different sets of answers to the question of where entrepreneurship originates. The research on culture as the dominant source of entrepreneurship – research of ten conducted by anthropologists and sociologists – suggests that some cultures are simply more entrepreneurial than others, due to their varying assessments of the value of risk-taking, individualism, and profit orientation (McClelland, 1961, cited in Leibenstein, 1987). The people of South China and India, for example, are often seen as more entrepreneurial than the Javanese or the people of many African countries. Another version of the cultural argument stresses minority status as an incubator of entrepreneurial talent, noting that much entrepreneurship originates in minority groups that have found traditional means of advancement blocked by the dominant group in a society (Hagen, 1962, cited in Greenfield, 1979; Curran and Burrows, 1987). By contrast, the second school of thought – the "trait approach" often favored by psychologists – focuses on individual differences in the distribution of entrepreneurial talent and inclination within a society, identifying a battery of personality characteristics that tend to be correlated with starting or owning a business (Carland, Hoy and Carland, 1988). The third line of research focuses on training as a possible source of entrepreneurship – a possibility that underlines the establishment of entrepreneurial development centers in a number of countries, including even some pre-reform and reforming socialist economies. According to this view, entrepreneurial abilities consist largely of good management practices, and are thus learned rather than culture-bred or innate. Alternatively, the second and third views can be combined, as in Leibenstein (1987), which proposes that potential entrepreneurs be selected on the basis of certain traits but then trained to develop their entrepreneurial capacities.

Few researchers in any of these schools, however, have focused explicitly on the role of government policy in determining the level or direction of entrepreneurship in a society.[12] Yet it is clear that, at a minimum, productive, positive-sum entrepreneurship requires a stable system of property rights and some freedom of action in the economic sphere – whatever the ownership structure of the economy. To deny even this role would be to argue that entrepreneurial skills are completely innate, and their supply invariant over time. It seems far more likely that either:

(1) *Entrepreneurial skills are innate, but require a certain environment to be released productively.* A government that bans all private enterprise, for example, is unlikely to exploit fully society's latent supply of entrepreneurship, as even a black market ill use such skills relatively inefficiently, and the state sector will often be constrained in ways that discourage entrepreneurship; or

(2) *Certain qualities that contribute to entrepreneurial success are innate or culturally determined – propensity for risk-taking, for example – but policy has a role for three reasons:* (a) other aspects of entrepreneurship, such as managerial skills, can be learned or improved; (b) the effectiveness of entrepreneurial talent depends in part on the availability of other inputs in an economy; and (c) finally, even entrepreneurial skills that are inelastically supplied can be directed away from zero-sum activities (bribing public officials) and toward positive-sum enterprises (producing a new export good).

In our view, the second of these hypotheses describes the world most accurately. Historical experience shows that nations that have fostered entrepreneurial innovation through supportive policies have seen it become a driving force of international economic expansion (Suarez-Villa, 1987), while countries whose institutions, policies, and cultures have hindered entrepreneurship have stagnated. The centrally planned economies are an illustration of the latter; for examples of the former, we can turn to the world's fastest-growing region in recent decades, East Asia.

Each of the three leading success stories of East Asia – Japan, Korea, and Taiwan – provides a case in which government policy and historical circumstance combined to overcome cultural barriers to entrepreneurship. Japan in the second half of the nineteenth century exemplifies this transformation: whereas merchants had languished at the bottom of the social hierarchy before the Meiji period, by the late 19th century business had become a respectable profession, and much of the samurai class had been redirected into entrepreneurship or into the promotion of economic growth. This social conversion prepared the way for Japan's remarkable development over subsequent decades (Hirschmeier and Yui, 1981). Traditional Korean society accorded even less prestige to mercantile success than did the Japanese, and the entrepreneurship that emerged in the fifteen years after independence in 1945 was primarily zero-sum. These cultural and historical factors notwithstanding, the government's shift toward outward-oriented growth in the early 1960s succeeded in releasing or creating a flood of entrepreneurial talent. Taiwan, despite its proximity to relatively mercantile and entrepreneurial South China, was an agrarian backwater at the time of its annexation by the Japanese in 1895, and while Japanese capital and infrastructure contributed to industrial development during the colonial period, few Taiwanese were able to rise to positions of economic prominence. Taiwan's reversion to Chinese rule after the Japanese surrender initially exacerbated the shortage of entrepreneurial talent. When the Nationalist government killed thousands of Taiwanese in its harsh suppression of the 1948 anti-government demonstrations, those who died were disproportionately the well-educated and those with leadership ability – in other words, those who should have formed the core of the island's entrepreneurial class (Gold, 1986). Despite this historical legacy, the economic reforms launched by Chiang Kai-shek's government in the late 1950s and early 1960s unleashed an entrepreneurial dynamism virtually unmatched elsewhere. Together, these East Asian experiences warn against excessive determinism: while culture and individual differences clearly play some role, policymakers need not despair of their ability to foster productive entrepreneurship.

Sources of entrepreneurship in Eastern Europe

In the East European context, it is particularly important to consider carefully the question of where to look for entrepreneurial skills, because of the misleading implications of widespread beliefs about their distribution. There is a widely held view that the second economy is the main (if not the only) source of entrepreneurship in socialist and post-socialist economies. Entrepreneurship is often equated with both private ownership and small business, and because of the hostile environment in which they functioned in the pre-reform period, private businessmen tend to be viewed as "heroic" individuals. This glamorous image in turn encourages the perception that entrepreneurial abilities are largely innate, and that private enterprise is both necessary and sufficient for unleashing these abilities – essentially echoing the first explanation above.

Small privately owned firms are undoubtedly essential to the development of competitive market economies in Eastern Europe (Petrin, 1987; Acs and Audretsch, 1993). Such firms already make a substantial contribution to the supply of consumer good and services in these societies, and they have great symbolic significance as well, because "they preserve and foster the images of competitiveness, mobility, risk-taking, and other values essential to market systems" (Bechhofer *et al.*, 1974, in Davis, 1987). But there are several reasons to doubt that the small-firm private sector will produce all of the entrepreneurial talent needed to carry out the economic restructuring, and to believe that government should not attempt to channel all such talent into the small private sector.

First, recent research on the expanding role of the private sector in Poland, Hungary, the Czech and Slovak Republics, Bulgaria, Romania, Slovenia, and Croatia (Johnson, 1992; Laky, 1990 and Laky *et al.*, 1991; Vitez and Petrin, 1992; McDermott and Mejstrik, 1992; Johnson and Loveman, 1993; Puchev, 1990) raises doubt that the small private sector can grow fast enough to compensate for structural problems in the state sector in the near future. Sheer size is one major problem: even dramatic growth of that sector, combined with stagnation of state enterprises, will leave it a relatively small portion of the economy. As a result, the small-scale private sector alone will not be able to carry Eastern Europe's economies out of their recessions in the foreseeable future, nor to provide employment opportunities sufficient for all those now working in uncompetitive state firms. Governments will thus need to encourage a flowering of entrepreneurial talent in the much larger state sector.

Second, even in countries where the private sector is relatively strong, it "remains unclear whether they [the pre-reform small private firms] provide the basis for a modern, industrial economy" (Johnson, 1992). Both a shortage of management skills and lack of entrepreneurial inclination may keep many small private enterprises from achieving sustained expansion and efficiency improvements. Most small firms in eastern Europe are similar in many respects to small businesses that can be found in any Western market economy: they produce for local markets; they are sub-contractors to large firms, which in Eastern Europe are state-owned firms; they rely mostly on their own labor; and they are reluctant to expand because of strong psychological preferences for autonomy and independence.[13] As a consequence, the organizational structures of small firms differ significantly from those of large capitalist firms (Scase and Goffee, 1980, 1982; Goffee and Scase, 1985, cited by Curran and Burrows, 1987), in particular in the degree of diffusion of decision-making authority within the firm. With their heavy dependence on a single owner or small group of owners who delegate little decision-making authority, small businesses do not usually accumulate the knowledge necessary to manage complex modern organizations. While solo entrepreneurs running small businesses usually make a living – and occasionally make a killing – sustained expansion of a firm usually requires an entrepreneurial team, consisting of both a lead entrepreneur and a skilled, experienced management team guided by a coherent strategy.

One particularly extensive empirical study of small-firm entrepreneurship was carried out by

Laky *et al.* (1991), who in 1988 surveyed four thousand Hungarians working in small ventures, either as their sole or secondary occupation. Although these individuals can be considered as potential entrepreneurs, their survey responses were often notably unentrepreneurial. Many of them stated that they did not want to become independent and that they had taken a second job in the private sector simply to supplement primary incomes earned in the public sector. These individuals gave a variety of reasons for this preference – lack of capital, lack of customers, struggles with bureaucracy, and unfavorable taxation and social security rules. Revealingly, artisans in secondary occupations typically assumed that the future growth of their businesses depended more on government policies than on their own efforts. Laky *et al.*'s results thus suggest that while some of these small-scale businesspersons could be encouraged to expand through elimination of red tape and discriminatory tax policies, others may require extensive training in business management skills, and still others may be very hard to induce to act entrepreneurially.

Finally, in the East European context, the stirring morality tale of the highly efficient pre-reform private entrepreneur is often little more than a myth. Many small businesses, especially those that developed under the central planning system, enjoy monopoly positions and have as their primary goal protecting their monopoly rents. Furthermore, small private firms that may have been profitable and efficient relative to the very inefficient state sector often fail to appear similarly competitive when compared to potential foreign competitors from market economies (Laky *et al.*, 1991).[14]

Thus although entrepreneur-led expansion of the pre-reform small private sector will be a necessary component of growth and structural change in Eastern Europe in coming years, it will not come costlessly, nor will it prove a panacea for Eastern Europe's economic problems. Successful transition to market-based economies also requires managers and prospective owners with entrepreneurial skills to devote themselves to the task of restructuring state enterprises. Entrepreneurs are desperately needed to identify and mobilize talented managers and engineers in the state sector to turn around state-owned companies. These turnarounds will often require foreign expertise and the introduction of new production and organization principles based on such foreign business principles as just-in-time production and total quality control; again, these innovations will depend on entrepreneurial leadership and vision.

One source of this entrepreneurial talent will necessarily be the management of state enterprises. Recent studies on the social stratification of entrepreneurs in Hungary (Laky *et al.*, 1991) and Slovenia (Kremser and Vahcic, 1991) reveal that the state and cooperative sectors are important "incubators" of entrepreneurs and new ventures with real growth potential. Armed with the skills they have acquired through education and experience, many managers and professionals previously employed by state-owned firms prove better at assessing and seizing promising business opportunities than do those coming from artisan families or having experience in artisan shops. Laky *et al.*'s (1991) study, for example, found that 57.5% of the new entrepreneurs in Hungary after 1982[15] came from families with relatively high-status occupations – that is, families of skilled workers, managers, or intellectuals. These new entrepreneurs are well educated: two-thirds of the 4000 entrepreneurs surveyed had professional qualifications. Almost three-fourths of them had held five or more jobs before, thus gathering experience in a variety of markets and situations. The study also revealed that those who had previous managerial positions in state-owned firms had the most experience, were the most mobile, and in general were the most qualified entrepreneurs. Those with previous managerial experience had skills that allowed them to judge the pros and cons of business opportunities, to assess the consequences of decisions, to do more accurate cost accounting, and to adapt more efficiently to supply and demand. In this respect, of course, both Hungary and Slovenia[16] have an advantage over the other East European economies, because in the pre-reform period, the managers of their state-owned enterprises operated in quasi-market economies with substantial scope for enterprise discretion over production and pricing decisions.

III. Promoting entrepreneurship in Eastern Europe

What specifically, can policymakers do to promote entrepreneurship, in Eastern Europe? One lesson that we can derive from the foregoing discussion is which policies to avoid. First, if the appropriate model of the entrepreneur is Jones and Sakong's innovative, market-supplementing businessperson, then policymakers should not focus narrowly on encouraging any single aspect of entrepreneurial success, whether risk-taking behavior or technological advance. Second, if entrepreneurs can be found and are needed throughout the economy – including within the management of currently state-owned enterprises – policymakers should avoid the temptation to single out the small private sector for government support and encouragement.

But there are also positive lessons to be drawn. The discussion above, combined with a review of the historical experiences of developing economies, allows us to suggest a number of policies that can contribute to the efficient use of entrepreneurial talent, both realized and latent. These policies fall naturally into two categories: first, the broader foundational policies of macroeconomic stability and well-defined property rights, both of which seem necessary but not sufficient for economy-wide productive entrepreneurship; and second, policies and programs targeted more specifically at the development and channeling of entrepreneurial talent.

Foundational policies: Macroeconomic stability and property rights

The first foundation stone of entrepreneurship development is an enabling macroeconomic environment. Amid the economic instability of the post-reform period, Western advice to the countries of Eastern Europe has largely been built around a widely accepted list of policies to improve the macroeconomic environment for investment and growth. These policies include: (i) *stablilization* of the macroeconomy, which entails, at a minimum, establishing control over inflation, rationalizing government budgets, and allowing interest rates to reflect market scarcities; (ii) *removal of price controls*; and (iii) *currency convertability* (Tyson, 1991; Petrin, 1987a; Petrin and Vahcic, 1987).

Each of these macroeconomic reforms is aimed at removing an important barrier to entrepreneurship. Inflation and price controls not only reduce the profitability of much positive-sum entrepreneurship, but also increase uncertainty about future earnings: rather than projecting the growth in demand and anticipating the emergence of competing products, the entrepreneur must spend her time in political prognostication, estimating the probability that the government will allow the price ceiling on her product to keep pace with inflation. A lack of currency convertability may introduce similar uncertainty into the entrepreneur's calculations, by requiring her to obtain foreign exchange through the state's administrative rationing procedures. In short, prudent macroeconomic policies will not only promote the efficient use of scarce resources; they will also encourage entrepreneurial ventures by removing layers of policy uncertainty. This assumes, of course, that the policies are applied in a reasonably consistent fashion. However well-conceived, macroeconomic measures will fail to bolster entrepreneurship if they shift often with the whims of bureaucrats, or of the populace. Erratic policymaking at any level – but especially at the macroeconomic level, because of its pervasive effect – can be as damaging to entrepreneurial development as administrative controls.

Most of the economies of Eastern Europe have already taken substantial strides toward macroeconomic stability by adopting orthodox stabilization programs. The costs of these programs, in terms of lost output and unemployment, have been very high,[17] but the resulting reducing in inflation has also been dramatic in several cases. In Slovenia, for example, inflation dropped from 1240% in 1989 to 25% in 1992; in Poland, from nearly 586% in 1990 to 43% in 1992. The results in Hungary and Czechoslovakia have been somewhat less dramatic, but both countries won substantial reductions in inflation between 1991 and 1992 – from 40% and 58%, respectively, to 19% and 11%. Recent studies have strengthened the presumption that inflation reduction and stablization of other macro variables are indeed a prerequisite for entrepreneurial development. The recent World Bank study in Poland as well as the

"Revitalization of Enterprises" project in Slovenia (carried out by the government in 1992–93) present evidence that the proper mix of monetary and fiscal policies is a necessary (although not sufficient) condition for initiating needed improvements in enterprise organization, performance, and marketability, as well as the cost reduction and efficiency improvements required to create world-class manufacturing in these countries (Pinto, Belka and Krajewski, 1993; Petrin, 1993).

The other foundation stone on which entrepreneurial promotion must rest is a stable system of well-defined property rights. Economists have long ascribed a variety of salutary effects to a strict delineation of who owns what, in what ways the owner may use his property, and under what circumstances that property may be taken away. For example, Ronald Coase, the Nobel Prize recipient in economics in 1991, is known largely for emphasizing the contribution of property rights to static economic efficiency (Coase, 1960). Others, among them 1993 Nobel laureate Douglass North, have stressed the role of well-defined and -enforced property rights in spurring property owners to make investments that they otherwise would not dare to make, for fear of expropriation or robbery. North (1981) has taken the argument even further, arguing that such dynamics are at the heart of humankind's great economic revolutions.

This investment argument has obvious applications to Eastern Europe. Factory managers who labor under uncertainty about whether their factories will be returned to pre-1945 owners are likely to have too little incentive to invest in future production; indeed, for the less scrupulous, the incentives suggest selling off assets and pocketing the proceeds. More generally, if potential entrepreneurs are uncertain about the state's commitment to respecting property rights, they may invest only in projects involving short time horizons and requiring little fixed capital. These characteristics in turn imply an economy based on exchange rather than production, which – except in the case of entrepot economies on major trading routes, or of those centered around financial services – is rarely a recipe for sustained economic growth.

Note, however, that stressing the need for well-defined property rights is not equivalent to advocating wholesale privatization of the economy. A decision to retain public ownership of heavy industry might be inadvisable for efficiency and other reasons, but it would not necessarily undermine the property-rights foundation for entrepreneurship, assuming that the delineation between private and public ownership were drawn clearly. What East European governments must guard against is any perception of state capriciousness or acquisitiveness in its dealings with private property. In practical terms, this is likely to mean (Tyson, 1993): (i) carrying out privatization in a way that protects the interests of new entrepreneurs, and allows them to invest without fear of later claims by former property owners, (ii) creating a legal framework for resolving disputes among property-holders, and between them and state; (iii) carefully circumscribing the state's right of eminent domain; and (iv) generally working to reduce the uncertainty surrounding entrepreneurial investment decision.

Because of its centrality in determining the nature of property rights in the post-reform economies, the privatization of state-owned enterprises deserves further discussion here. Privatization can be a powerful instrument for promoting entrepreneurship, provided two conditions are satisfied – privatization gives entrepreneurs the right to entrepreneurial profit, and awards them access to the resources needed to carry out their entrepreneurial functions (Wright and Petrin, 1991). Privatization of small enterprises, as it has been carried out in most East European economies, satisfies both of those criteria. As a result, the small-enterprise privatization in Hungary and Poland, now nearly completed, has contributed significantly to the entrepreneurial vitality of these countries. In Hungary by 1992, the 66,000 small private firms and 180,000 one-man firms already accounted for roughly 40% of GDP; in Poland, private firms of all sizes (micro, small and large) also accounted for 40% of GDP (The Economist, 1993, p. 9). By contrast, in the Czech Republic and Slovakia, where small-scale privatization has not been completed yet, the private sector contribution to GDP is much smaller – some 20% in the Czech Republic and 17% on Slovakia. In both sets of countries, governments must turn their attention to privatizing and restructuring the firms accounting for the largest share of production and employment: large state-owned enterprises. Since the majority of these firms are grossly inefficient, the real policy challenge is to privatize them in ways that at the same time promote entrepreneurship.

When measured by this yardstick, the mass privatization approach, which works through the wide distribution of shares or vouchers at relatively low prices, is revealed to have at least one serious drawback. Even when it assigns an important role to financial intermediaries (such as holding companies, investment funds, and pension funds), mass privatization may simply replace one kind of passive ownership with another. Dissipation of ownership over a broad and ill-defined group of shareholders is likely to grant top managers and their boards of directors "power without property" (Jensen, 1989), resulting in serious agency problems. This managerial autonomy can in turn discourage managers from behaving entrepreneurially (Jensen, 1989; Ellerman, Vahcic and Petrin, 1991). Mass privatization could thus fail to cure one of the most significant weaknesses of state ownership: ownership "by everyone and thus by no one". This ambiguity of ownership could persist for quite some time before blocs of shares become concentrated among groups of active owners (Ellerman, Vahcic and Petrin, 1991; Tyson, 1991).

As an alternative, decentralized privatization through management-worker buyouts or private share offerings seems the best approach for foster entrepreneurship. this approach opens the door to interested active owners – that is, owners who are willing to invest and create something new through either portfolio or organizational restructuring. In Hungary, which has experimented the most with these forms of decentralized privatization, the managerial elite of the previously state-owned companies has emerged as a powerful source of entrepreneurship, with encouraging results. In choosing strategies for privatization, of course, these potential entrepreneurship-promoting advantages of management-worker buyouts must be weighed against the potential substitution of managerial and employee self-interest for the goals of efficiency and profitability,[18] as well as against equity concerns. The wholesale transfer of large-scale enterprises to current managers at low prices would unfairly benefit them relative to the rest of the society.

Policies and programs specifically targeting enterpreneurship development

It is already possible to observe throughout Eastern Europe the positive effects on new venture creation of foundational policies already implemented – that is, policies to "get the macro environment right" and to enshrine property rights in law. The entry of new small firms, many of them in retail and wholesale trade, construction, light industry, and consulting, has been particularly dramatic. In the Czech and Slovak Republics, for example, the number of private firms increased from 488,000 in 1990 to 1.13 million in September 1991. In Poland, the increase was even more rapid, from 66,900 at the beginning of 1990 to 516,200 by the end of the same year (Johnson, 1992, p. 8 and 25). These impressive developments indicate that the attitudinal impediments to entrepreneurship can break down quickly, suggesting that supportive policies targeted specifically at promoting entrepreneurial activities could have even more dramatic effects.

But although "entrepreneurship" is among the words most commonly used in Eastern Europe today, the governments of the region have formulated few specific policies to foster its development. A need for such policies clearly exists. For decades, entrepreneurship was constrained in socialist countries not only by the hostile macroeconomic environment and property-rights structure, but also by an ideology that rejected entrepreneurship as incompatible with social goals. Under socialism, planners reduced economic development to a set of technological relationships, viewed industrialization as a set of technological imperatives, and established engineers and technicians as the principal agents of change. Among the functions of the entrepreneur, only invention was considered desirable. As a result, psychological rewards and social status accrued to inventors and engineers, but not to the innovator/entrepreneur who combined inventions with other factors in establishing a new enterprise (Petrin, 1989). Moreover, because competition for social investment capital was restricted by limited rights to entrepreneurial activity and by widespread bureaucratic patronage, it was the well-connected – rather than those who had the best investment prospects and offered the highest return – who were able to obtain investment capital. The result, of course, was that many people with entrepreneurial skills or potential never obtained substantial entrepreneurial experience, while those who did have access to capital tended not to act entrepreneurially.

Thus although the improvements in the macro environment have created opportunities for entrepreneurship, potential entrepreneurs continue to face myriad difficulties: some lack important entrepreneurial knowledge that comes with experience; others lack the social approbation that is necessary to push them into entrepreneurship; still others are dissuaded by the great uncertainties inherent in the prolonged economic dislocations that have accompanied stabilization. Beyond getting the macro environment and property laws right, what can governments and others do to improve the climate for entrepreneurship and eliminate the national waste embodied in largely unexploited entrepreneurial talent? Fortunately, the histories of developed and newly industrializing countries that have successfully fostered entrepreneurship contain numerous examples of promotion policies that appear to work. These policies can be grouped into several broader categories, each aimed at a different facet of entrepreneurship promotion.[19]

1. *Redirecting entrepreneurship into legal, productive sectors of the economy.* At least one prominent economist (Baumol, 1990) has suggested that the redirection of entrepreneurial effort is at the core of the promotion of entrepreneurship. According to this view, entrepreneurs supply their skills inelastically, so that government policy and the institutional environment influence only the direction of their efforts – for example, channeling them into the black market, toward rent-seeking, or into productive innovation. While this argument seems too strong, Eastern Europe provides fertile soil for its application. Clearly, much of the entrepreneurial skill available in the pre-reform economies of the region was not exercised in formal markets. A major challenge for post-reform policymakers is to create structures that channel into productive uses the entrepreneurial talent that is already available to their economies. Almost certainly, this approach will entail lower costs than working to develop new entrepreneurs.

One approach that may prove fruitful for East European governments is the carrots-and-stick strategy: lower the costs of operating in the formal market by streamlining administrative procedures and emphasizing policy stability as a goal (the carrot); give entrepreneurship greater legitimacy through supportive governmental pronouncements and awards for successful producers or exporters (an additional, non-pecuniary carrot); and exhibit low tolerance for entrepreneurship exercised outside of productive channels, thus reducing the rewards to rent-seeking and black-marketeering (the stick). In some cases, policies to facilitate the decentralized privatization of state-owned enterprises through management-worker buyouts (such as those implemented in Hungary and Slovenia) may offer them an appealing alternative.

2. *Increasing the supply of entrepreneurs.* Policies to increase the supply of entrepreneurs – that is, to convince a larger proportion of the labor force to choose entrepreneurial careers, rather than entering civil-service, academic, or non-entrepreneurial private-sector positions – overlap heavily with those aimed at redirecting the existing supply of entrepreneurship. As a prerequisite, policy makers must explicitly recognize entrepreneurship, in both its entre- and intrapreneurial forms, as a vital ingredient in economic development.

Legitimation of entrepreneurship will be particularly crucial to economic success in Eastern Europe in coming years. If the free market continues to be viewed as the domain of black marketeers and former Communists, only those who lack other opportunities will be willing to bear the stigma associated with entrepreneurship. Too often, the negative examples of the new entrepreneurs are high publicized, while insufficient attention is given to the entrepreneurial success stories. These trends are beginning to change, however, especially in Hungary and the Republic of Slovenia, where an entrepreneurial revival occurred even before the beginning of the reform period. In Slovenia, for example, a combination of private, academic, and government initiative has led to the founding of a very successful private school for non-degree entrepreneurship, the inclusion of curricula on entrepreneurship at all educational levels, public presentation of business plans through Enterprise Forums (modelled after the MIT program), and the creation of an entrepreneurship support network that now counts 400 individuals and institutions that provide consulting and training services to firms. Television and radio now commonly air shows focusing on entrepreneurship; Slovenian entrepreneurs go on organized study visits to the US, Germany, and the East Asia; the university offers a specialized M.A. in entrepreneurial studies; magazines devote sections to news and tips about entrepreneurship; and one periodical devoted to entrepreneurship has established a national "Entrepreneurship of the Year" award.

The histories of other countries provide numerous indications that legitimation is achievable. For example, Etzioni (1987) [citing Casson (1982)] notes the sea change in French attitudes toward entrepreneurship in the late 1970s, when entrepreneurship became "quite fashionable" after earlier being viewed as the province of "pigs". An even more dramatic shift in attitudes is needed in Eastern Europe, with government serving as catalyst and accelerator. Public exhortation by political leaders alone will not suffice. Governments must also use taxation and fines to prevent ill-gotten wealth from being parlayed into dominant positions in newly privatized sectors, without necessarily depriving the economy of the talents of pre-reform entrepreneurs.

3. *Developing the markets for other inputs into successful entrepreneurship.* The ability of an entrepreneur to do her job – to combine and to innovate – depends on far more than her own talents. Jones and Sakong's assertion that "with [entrepreneurship], other factors will be found" correctly emphasizes the importance of the combining factor, but with some hyperbole: as later sections of their book suggest, requiring the entrepreneur to provide too many of the inputs herself may discourage all but the most highly skilled and motivated potential entrepreneurs. Entrepreneurship may involve creating a whole that is greater than the sum of the parts, but the task is easier if the parts are well developed.

Other than final-goods markets, of course, all markets in the economy produce some input into an entrepreneurial process; thus the challenge of "developing the markets for other inputs" is nothing less than a challenge to develop the economy as a whole. Rather than trying to address the problem of economic development, we will content ourselves with suggesting several inputs that may be of particular importance: *capital*, which may pose special problems in the medium term because of the scarcity of acceptable collateral; *management*, an input closely related to entrepreneurship itself, but one that can more clearly be taught and thus developed directly through training programs; *technology*, an area in which some government assistance will be warranted to help Eastern Europe's economies bridge the tremendous technological gap with the West; *information*, particularly about market opportunities, both domestically and abroad; *land and buildings*, which are in short supply but are needed desperately as both space and collateral; *communications and transportation infrastructure*, the shortcomings of which are most visible in the region's antiquated telephone systems; *distribution channels*, which will remain inefficient as long as state firms retain their monopoly positions; and *skilled labor*, which is likely to be essential if the countries of Eastern Europe are to compete in export markets with the upper-middle-income economies of East Asia and Latin America.

To meet these complementary input requirements of entrepreneurial activities, the governments of the region should focus on programs to:

- provide seed financing and venture capital targeted at higher-risk start-ups;
- provide equity financing for new start-ups of all kinds, including retail establishments;
- revise tax rules to bolster incentives for start-up investments;
- improve the protection of intellectual property;
- foster entrepreneurship through appropriate educational institutions (at all levels of formal educational system as well as specialized centers for entrepreneurial training);
- develop entrepreneurship instruction at all levels within all types of businesses and provide incentives that facilitate spin-offs from and business start-ups in the vicinity of these institutions;
- create agencies explicitly charged with encouraging entrepreneurship or the start-up of new firms;
- gather data and undertake analyses to help

policymakers recognize the distinction between encouraging start-ups and promoting ongoing firms; and
- acknowledge and reward exemplary entrepreneurial performance at the local, regional, and national levels (Vesper, 1983, in Petrin, 1991).

International development assistance can be of great help in formulating such domestic entrepreneurship development programs. This assistance may take many forms, including workshops, seminars, and conferences, direct financial assistance, and provision of foreign consultants and experts to advise state-owned enterprises on organizational restructuring that will promote intrapreneurship. Some programs along these lines, financed by UNDP/UNIDO, the World Bank, USAID, and the European Community through the PHARE and TEMPUS programs, are already part of the foreign technical assistance provided to the region.[20]

4. *Increasing the effectiveness of entrepreneurs.* A study of Slovenian small-scale industry and new entry into this sector (Licen, 1992) showed that of 37,896 full-time entrepreneurs registered in 1991, only 12,958 were active (that is, were reporting income statements and balance sheets to the Social Accounting Service). Likewise, in Czechoslovakia, out of 1.13 million small firms that existed on paper by the end of September 1991, fewer than 5000 firms had been incorporated by June 30 of that year (Johnson, 1992, p. 8). This discrepancy suggests a substantial gap between the small business sector's potential and actual contributions to GDP and job creation. One reason for this gap, it is clear, is the insufficient management or business expertise of many of the potential entrepreneurs.

The evidence from a large number of studies reveals that 70% of the entrepreneurs who fail do so not because their product or service is deficient or because they lack money, but because they lack the relevant management or business expertise. These findings suggest that business incubators and other conduits for timely technical assistance, counseling, and practical advice can drastically reduce the mortality rates of new entrepreneurial businesses. In addition, the experiences of several developed countries indicate that a production-oriented, strategic industrial policy, based on partnerships between local universities, governments, and the private sector, can foster the development of new and revitalized industries, thereby increasing the effectiveness of entrepreneurs in those industries (Meeder and Vahcic, 1991).[21] Such an approach has been used with considerable success in less developed regions in Italy, Jutland, Baden-Wuertenburg, and several US states. In all of these cases, policies have been designed to create new institutions – including business incubators and consortiums among firms to allow networking and dissemination of knowledge, skills, and technology as well as private venture capital companies for start-up financing – that will promote entrepreneurship and the entry of successful new firms. Often the annual death rate of such firms has been as low as 10% to 30%, compared with an average death rate of nearly 70% to 90% for new start-up ventures (all types of new firms) in developed countries (Smilor, 1987, and Timmons, 1990, p. 11).

The Italian program to set up a new Agency for Youth Entrepreneurship in southern Italy offers a promising model for Eastern Europe. This program provides training and financial assistance for young would-be entrepreneurs in designated regions for projects that involve the production of agricultural, craft, or industrial goods or the supply of services to agriculture, industry, and tourism. Project proposals are screened by agency experts for their market potential before they are granted public support (Arzeni, 1992).

In the East European context, industrial-policy approaches to regional development and entrepreneurship promotion must recognize that agriculture and services – including tourism, travel, construction, and trade – are likely to be the most promising avenues for entrepreneurial development. Entrepreneurship in these sectors is likely to develop more effectively than in much of the manufacturing sector, where the legacies of the past weigh heavily and where capital and skill shortages constrain expansion.

5. *Increasing demand for entrepreneurship.* Paradoxical as it may seem, given our assertions about the scarcity of entrepreneurship, government may also have a role in increasing the demand for entrepreneurial skills. It can do so primarily

through easing access to potential markets – both export markets, through a shift to export-led growth policies and improved port and transport infrastructure, and domestic markets, again through infrastructural investments. Government procurement may also be an effective tool for promoting local entrepreneurs, although one that can be wielded as easily to coddle the well-connected as to support the near-competitive.

In carrying out each of these five types of policies, decisionmakers in formerly socialist countries must learn to distinguish between entrepreneurship and small business, and between entrepreneurship and private ownership. A policy orientation toward small business is likely produce policies that mainly help existing small firms to stay in business, while orientation toward private ownership may lead policymakers to overlook the substantial potential of entrepreneurial creativity within the state sector and to equate ownership itself, rather than innovation and risk-bearing, with entrepreneurship.

One illustration of the conflicting implications of these views of entrepreneurship is provided by the East European debate over restitution or reprivatization. On the grounds of social equity (rather than to promote efficiency or entrepreneurship), most of the societies in the region have pushed for restitution of property to former owners. In some cases, this policy may produce an entrepreneur. But the Czech, German, and even Slovenian experiences reveal that sometimes the claims of previous owners represent a barrier to entrepreneurial development – that is, the reprivatization will not bring an increase in entrepreneurial behavior, if the former owner is unprepared to use the property efficiently. In Germany, this tension has now been reflected in legislation that allows any private individual who has an entrepreneurial plan for the property to bid against the former own (Bannasch, 1993).

IV. Conclusion

Straining already under the great demands of an unparalleled economic and political transformation, East European policymakers are likely to find daunting a list such as this one, with its twin foundations of macroeconomic stability and property rights and its five areas of entrepreneurial promotion. given the crucial role that domestic entrepreneurs must play in that transformation, however, governments cannot afford to immerse themselves in the problems of the macroeconomy to the exclusion of micro-level policies. One particularly stark statement of this view – applied to the economy of the former Soviet Union, in which the near-term prospects for entrepreneurship are probably bleaker than in much of Eastern Europe – is that "price liberalization alone will not convert a parasitic private sector into one which manages resources to favor productive activities" (Zhokov and Vorobyov, 1991). Nor should policymakers who wish to promote entrepreneurship succumb to the temptation to focus exclusively on small private-sector firms, by doing so, they will allow substantial reserves of entrepreneurial skill in the former state sector to go untapped.

Throughout the process of entrepreneurship promotion, governments and firms in the post-socialist countries must take into account the increased complexity of the division of labour, which implies a need for new management approaches. With the emergence of new product-led competition (Best, 1990), vertical management – the management of hierarchical relationships through scientific management – is becoming a major source of declining competitiveness. The new strategy of continuous changes in process, product, and design calls for managers who are opportunity-driven – in short, for entrepreneurs. Without entrepreneurial restructuring in line with global competitive trends, the new countries of Eastern Europe will become progressively less able to compete successfully in world markets. Fortunately, most governments in the region have already shown some recognition of the need for entrepreneurial vitality, and have taken at least halting steps toward promoting it. This paper, we hope, has suggested further steps in that direction, as well as some pitfalls to avoid along the way.

Notes

[1] Under this category we may include definitions such as that of John Stuart Mill. Although risk is not central to his definition, the entrepreneur for Mill is nearly indistinguishable from the capitalist, who in any new venture is clearly placing his capital at some risk.

[2] For an exception, see Gartner (1988). Also see for example, Blanchflower and Meyer (1994), Evans and Leighton (1990) and Evans and Jovanovic (1989).

[3] For a similar definition, see Leibenstein (1987). The turn-of-the-century economist Friedrich von Wieser also proposed a rather comprehensive definition of entrepreneurship, but broadened it even further by including ownership as a prerequisite for entrepreneurship.

[4] As we argue later in the paper, requiring the entrepreneur to build from "practically nothing" may deter all but the most enterprising potential entrepreneurs from trying; as a result, government policy may need to lighten the burden by reducing the extent of market-supplementing that is necessary.

[5] In the developed market economies, increased complexity of the industrial structure has been accompanied by a shift from industries in which vertical integration predominates toward industries in which firms are typically linked horizontally (Winiecki, 1986). In the former socialist countries, where this shift was not allowed to take place, high levels of concentration and vertical integration have created intractable management problems, which can be addressed only through disaggregation and reduction in the size of socialist enterprises.

[6] Because of the lack of small firms in the region, final (consumer) demand for goods produced by such firms substantially exceeds domestic supply of those goods, as an examination of the structure of East European imports will show.

[7] The lack of small firms in the service sector in Eastern Europe is a consequence of import-substitution-based development strategies and their orientation towards capital-intensive projects, which led to a neglect of the service sector. With the greater complexity and importance of the industrial sector, however, has come an even greater need for services supporting manufacturing; their growth is thus a prerequisite for continued industrial growth.

[8] The share of manufacturing employment accounted for by small firms is 39.9% in the United Kingdom, 57.9% in (West) Germany, 35.2% in the United States, 39.9% in the Netherlands, 55.2% percent in Northern Italy, and 68.4% in Southern Italy. By contrast, as of the late 1980s, the small-firm manufacturing share of employment was only 1.4% in Czechoslovakia, 1.1% in East Germany, and 10.0% in Poland.

[9] The increased role of small firms in western economies is especially notable in industries characterized by flexible production technology. See, for example, Drucker, 1985; Duche and Savey, 1987; Storey and Johnson, 1987. Considerable entrepreneurial opportunities in the underdeveloped small sector have been opened by the emergence of computer-based technology, which has improved the quality and productivity of small and medium-scale production relative to the standardized mass production technologies that have predominated since the nineteenth century.

[10] Indeed, if the entrepreneur is able to find foreign investors to provide the capital for his venture, he may not need to assume substantial risk himself.

[11] Often such research is tied to the analysis of small business, even though, as noted above, many small-business owners do not qualify as entrepreneurs under our or most other definitions. In these cases, the owners inherit or purchase an established concerns or replicate a proven form of business, and never carry out substantial innovation of any kind (Curran and Burrows, 1987).

[12] The research on training is an exception, to the extent that it recommends government involvement in establishing entrepreneur development centers.

[13] For empirical evidence, see Klandt, chapter 3; Mayer, chapter 4; and Boissevain and Grotenberg, chapter 7, in Goffee and Scase, 1987, cited in Curran and Burrows, 1987. As noted by Curran and Burrows, "this often declared desire by the owners of small capital for autonomy and independence provides something of a paradox. Because although they might be 'free' from the formal management structures which exercise domination over wage labor, they are often controlled in an even more restricted, albeit indirect, sense by banks, large buyers and suppliers and the state".

[14] For an illustration of this point, see the case by Dr. Thomasz Mroczkowski on the Akita International Co.

[15] It was in 1982 that Hungary launched its first round of economic reforms, which led to robust growth and substantial transformation of the small business sector.

[16] Poland also belongs to this group, although decentralization on the enterprise level occurred later than in Slovenia and Hungary.

[17] In Poland, Hungary, and Czechoslovakia, for example, the already dismal employment growth rates of 1989 – -3.7%, -2.5%, and 0%, respectively – had worsened further by 1992, falling to -5.6%, -19.9%, and -12.0%. Growth of GDP also declined substantially in Slovenia, Hungary, and Czechoslovakia over the same period, plummeting from -3.6% to -6.8%, 0.4% to -5.0%, and 1.4% to -8.5%, respectively. Only in Poland did it increase somewhat, from 0.2% in 1989 to 0.5–2.0% (Banka Slovenije, 1993, and WIIW, 1993).

[18] As one of the authors has noted elsewhere, "the Yugoslav experience with self-management suggests that managers and workers often maximize short-run returns and wages at the expense of reinvesting profits. Some studies in the US show that management-controlled companies tend to be less profitable than corporations with a concentrated outside ownership group. On the other hand, studies have found that a management ownership interest between five and twenty-five percent is often enough to encourage profit maximization. Also, numerous studies indicate that partial employee ownership and profit-sharing plans, when accompanies by channels for real employee participation in work place decisions, tend to increase productivity" (Tyson, 1991).

[19] The taxonomy used here is inspired in part by Jones and Sakong's (1979) treatment of the Korean case.

[20] One of the authors of this paper, Tea Petrin, is the local coordinator of the Tempus project "M.Sc. Course in Entrepreneurial Studies" for Slovenia (a project that also includes Great Britain, the Netherlands, and Spain) and was also the co-director of the Yugo-Italo lead center of the UNDP/UNIDO project "Entrepreneurial Small and Medium-sized Firms".

[21] For example, Acs, Audretsch and Feldman (1993) find that R&D spillovers play an important role in the innovative activity of entrepreneurial small firms.

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