Doing business in transition countries

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Abstract

This paper presents results from the 2005 Business Environment and Enterprise Performance Survey (BEEPS), drawing on the 2005 Transition Report (EBRD 2005). Jointly implemented by the World Bank and the EBRD, the BEEPS has become an important instrument for these two institutions in monitoring and understanding changes in the business environment in eastern Europe and the former Soviet Union. The survey allows both comparisons over time – the three BEEPS rounds cover the period 1999-2005 – and across countries and types of firms.

The BEEPS results presented in this paper shed light on how the business environment has changes since the survey was last implemented in 2002. They also illustrate how an instrument like the BEEPS can be used in policy analysis and some of the analytical challenges in doing so. The key messages from the BEEPS 2005 are:

- On average the business environment in transition countries has improved from 2002 to 2005. However, the transition region has not yet reached the level of mature market economies.
- Average measures mask important differences between countries, between different types of firms and between different dimensions of the investment climate.
- One area where business obstacles appear to get worse as countries develop is labour regulation. Labour regulation is more of an obstacle in mature market economies than in the transition region, and within the region it is most problematic in the advanced countries of central Europe.
- The business obstacles hit hardest those firms that are most likely to generate growth and new jobs, such as private firms, exporting companies and those that re-invest profits.
- The business environment is also more difficult for firms located outside capital cities – sharing the benefits of transition more widely remains a challenge in all transition countries.
- Micro and small enterprises also face a more difficult business environment than large firms – including, but not only, in terms of accessing finance.

These insights help organisations like the EBRD in setting operational priorities, for example by focusing on regional project outside capital cities, promoting market entry and supporting small enterprises.

1. Introduction

The EBRD's objective is to foster the development of market economies in central eastern Europe and the former Soviet Union. An important aspect of this transition to market is the development of a sound business environment that allows private enterpreneurship to florish. In monitoring and assessing progress in transition, the EBRD makes use of a wide range of sources. But one of them, the Business Environment and Enterprise Performance Survey – known as the BEEPS – has become particularly important to the EBRD's ability to monitor the performance of firms and changes in the business environment.

In 2005 the EBRD and the World Bank jointly implemented the latest round of the survey, covering over 9,500 firms in 26 transition countries and Turkey. The first round of the BEEPS was carried out in 1999 and the second in 2002. Taken together, the three BEEPS rounds provide a rich source of information on enterprises in the transition region and developments over the last six years. Surveys in a number of other countries conducted in 2004 provide comparative data from outside the transition region.

Initial results from the BEEPS are contained in the 2005 Transition Report (EBRD 2005). Drawing heavily on this Report, this paper provides a summary of the main results of the survey. Section 2 outlines the basic features of the survey. The next two sections then look at the business environment from two angles. Section 3 looks at the average business environment of a country, and section 4 analyses differences in business perceptions between different types of firms. Essentially, if BEEPS identifies an important business obstacle for, say, Russian SMEs, section 3 analyses to what extent the issue is common to firms in Russia, and section 4 analyses to what extent it is a common obstacle for SMEs in the transition region. Section 5 concludes.

2. The BEEPS

The scope of the BEEPS has grown steadily since the first round of the survey was implemented in 1999. The 1999 survey covered some 3,000 firms in 20 countries. The sample size grew to 6,100 firms from 26 countries in 2002 and reached nearly 9,500 firms from 27 countries (26 transition countries plus Turkey) in 2005. This latest survey included an additional 1,700 manufacturing enterprises from Armenia, Azerbaijan, Hungary, Kazakhstan, Moldova, Poland and Romania. The 2005 survey also included a panel component of almost 1,500 firms that participated in both the 2002 and 2005 BEEPS (see Table 1).

An additional survey was conducted in 2004 (comprising some 3,300 enterprises) in five non-transition economies: Germany (approximately 1,200 enterprises), Greece (about 550), Portugal (about 500), South Korea (about 600) and Vietnam (about 500). Two more comparator surveys in Ireland and Spain are currently under preparation. These surveys were conducted on the same basis as the BEEPS 2005.

All rounds of the BEEPS were implemented jointly by the EBRD and the World Bank and funded primarily by donors, including the Japan-Europe Cooperation Fund and the Multi-donor Fund for the Early Transition Countries.

The survey samples were constructed to give a fairly representative picture of the underlying economic structure in terms of sectors, firm size, ownership and firm location. The types of firms are described in detail in Table 2. The distribution between manufacturing and service sectors was determined according to the sector's relative contribution to the GDP in each country. Firms operating in sectors subject to government price regulation and supervision, such as banking, electric power, rail transport, and water and waste water, were excluded from the survey.

Companies with 10,000 or more employees were also excluded, as were firms that started their operations in 2002 or later. Around 90 per cent of the firms surveyed were small and medium-sized enterprises. Most were privatised or had been in private ownership from the start of their operations. Foreign-owned companies (with foreign stakes of at least 50 per cent) and state-owned firms accounted for approximately 10 and 9 per cent respectively of the total sample.

3. Differences in the business environment by country

A key part of the BEEPS are questions about managers' perception. The questionnaire asked firms to assess how the state, infrastructure and financial institutions have affected their business operations. They were asked to assess how problematic these factors were for the operation and growth of their business on a scale of 1 (minor obstacle) to 4 (major obstacle).

Chart 1 shows the result of these perception questions by country, comparing the 2005 results with the 2002 survey. Survey answers were aggregated into the following seven categories

- *Regulation*: weighted average of title and leasing of land, customs and trade regulations, business licensing and permits, and uncertainty about regulatory policies
- *Labour*: weighted average of labour regulations, and skills and education of available workers
- *Taxation:* weighted average of tax rates and tax administration
- *Institutions and property rights*: weighted average of functioning of the judiciary, corruption, street crime, theft and disorder, and organised crime
- *Infrastructure:* weighted average of telecommunications, electricity, transportation, and access to land
- *Finance*: weighted average of access to financing (for example, collateral requirements or unavailability of bank finance) and cost of financing (interest rates and charges).
- *Macroeconomic environment*: a separate component covering inflation and exchange rates.

The ranking of business obstacles in this way is a useful initial indication of how firms perceive the quality of the business environment. However, perceptions of what constitutes an obstacle are likely to differ from country to country (based on country-specific characteristics such as cultural norms, levels of political freedom and economic well-being). Perceptions within countries are also likely to be affected over time due to economic cycles and other events that make firms feel more or less optimistic or pessimistic about business conditions and prospects. Moreover, average firm perceptions on the quality of the business environment does not provide specific, detailed information on the costs imposed by these obstacles in each area of the business environment. Therefore, the BEEPS asks firms to quantify the costs to their business from lapses in economic governance.

A comparison between the quantitative and qualitative survey questions shows that the two sets of responses are broadly consistent. This suggests that the information contained in Chart 1 can shed some light on differences in the business environment across countries and over time.

Chart 1 shows that companies in central Europe and the Baltic States have generally seen an improvement in the overall business environment between 2002 and 2005. Perceptions improved most sharply in the Slovak Republic. However, in some other central European countries, companies believe that the state’s governance of the economy has worsened since 2002. In the Czech Republic, for example, firms on average reported more problems across every aspect of the business environment in 2005 compared with 2002. Perceptions of the business environment among firms in Hungary have also weakened on average, particularly in areas related to tax and the regulatory environment. Economic governance in Lithuania strengthened in most areas but the survey reveals that firms are having a more difficult time with corruption.

The business environment in in south-eastern Europe has also improved, according to the survey. In particular, firms in Bulgaria on average believe there has been a significant strengthening in all areas. Firms in the region as a whole reported improvements in key aspects of governance although not all countries experienced this positive trend in equal measure. Moreover, in a few countries governance structures appear to have weakened since 2002. For example, in FYR Macedonia and Serbia and Montenegro, firms on average reported more problems with the judiciary and corruption t[1]han three years ago. Similarly, bribes are paid more frequently to “get things done” compared with 2002. In both countries contract enforcement was weaker in terms of the number of weeks it takes to resolve overdue payments.

In the Commonwealth of Independent States the view of the business environment and economic governance improved most dramatically in Belarus, and, to a lesser extent, Tajikistan since 2002. In the past, these largely unreformed countries, together with Uzbekistan, have tended to receive favourable ratings for economic governance from firms (although by some measures corruption in Uzbekistan looks worse in 2005), despite clear indications of more heavy handed state intervention in the economy. This may be partly because firms operating in such generally oppressive political environments may be unwilling to speak openly with interviewers. (This problem has prevented implementation of the BEEPS in Turkmenistan since 1999.) Also, in countries that have yet to reform the state’s role in the economy, firms are less likely to detect any reduction in services and so report increased obstacles to doing business. Furthermore, in countries with less dynamic private sectors and less competition – where there are fewer opportunities for entry and state subsidies prevent exit by poorly performing firms –, respondents may perceive a business environment where the state intervenes on their behalf as having certain advantages. As for the ratings on corruption, in countries with more centralised, autocratic power structures corruption may be more predictable and institutionalised, making firms less likely to perceive it as an obstacle.

In two other CIS countries – Armenia and Azerbaijan – economic governance is noticeably worse in 2005 in areas such as the judiciary, crime and corruption, according to the survey. In both countries, firms on average reported a higher share of annual revenues paid in bribes (the “bribe tax”) and more senior managers’ time spent with public officials to deal with regulatory issues (the “time tax”). See EBRD (2005) for further details.

4. Differences in the business environment by types of firms

How firms evaluate constraints on their development depends in part on the overall business environment in their country. For example, a survey of firms in a country with an inadequate and inefficient telecommunications system is likely to report frequent service interruptions, poor-quality connections and delays in getting new lines. However, firms' perceptions of specific obstacles will also vary according to their characteristics. For instance, expanding firms may identify delays in obtaining a new line as an especially costly constraint on their ability to reach new markets and extend sales, while poorly performing firms may not be aware of this particular problem. This section analyses differences in the business environment from this second angle, the characteristics of affected firms.

The observable characteristics of a firm that are used to explain the magnitude of constraints include ownership, export activity, size, location, competitive environment and industrial sector.[1] Ownership is well established as a key factor in determining a firm's performance. In particular, new private firms have been shown to be more productive than privatised or state-owned firms (EBRD 2005). On the other hand, state-owned firms may have privileged access to resources or markets, and closer links to government. The analysis therefore distinguishes between new private firms and privatised firms, with state ownership as the benchmark for both.

Foreign ownership is also associated with stronger performance of firms (EBRD 2005). This is partly because foreign owners from developed market economies bring in new technology, working practices and access to markets, and partly because they tend to focus on acquiring firms which are strong or have growth potential. Foreign ownership is also likely to lead to lower reported business constraints because firms are able to draw on the substantial resources that foreign owners can make available.

Export activity plays an important role in the growth process, and exporting firms can face strong competition in international markets. Competition has also been identified as a factor determining the growth of firms in transition countries. Export activity and competition are associated with a number of constraints – for example, exporters naturally complain more about the burdens of customs regulations than non-exporters. The analysis therefore looks at various aspects of export activity and whether or not a firm faces strong competition (defined in this chapter as four or more competitors).

The size of firms is particularly significant. This is because of the role of small firms in promoting economic growth and creating employment, and the importance that policy-makers and international financial institutions assign to lending to and supporting micro, small and medium-sized firms. The analysis creates a separate category for micro or small firms (employing fewer than 50 people).[2] The location of a firm can also represent a constraint. The

[1] The statistical analysis includes controls (country dummy variables or fixed effects) for each country. These capture all country-specific aspects of the business environment, and do not vary systematically within the country. In effect, they capture the country-average constraints as rated by firms. The variation in the data that remains after these country-level effects are removed is the variation across firms within countries. The analysis links this variation to the characteristics of the surveyed firms. All constraint regressions also include industry dummy variables.

[2] The results of the analysis are unchanged if medium-sized firms are included with small and micro firms.

growth process in transition countries is typically uneven, in so far as economic activity and growth picks up quickly in the capital cities and then gradually spreads to the regions. Lastly, whether a firm is reinvesting its profits is a direct indicator of growth and investment activity and of the existence of private capital that is potentially at risk of expropriation by the state.[3]

Table 3 summarises the relationship between these characteristics and the constraints reported by firms as being the most problematic. The table shows that firms with characteristics associated with strong performance – private ownership, export activity and reinvesting profits – tend to be particularly constrained by their business environment. This is consistent with state-owned firms having privileged access to resources – lower taxes, cheap credit and lighter regulation – and less fear of state interference. The typical difference between new private firms and state-owned firms is 0.10 to 0.30 on the BEEPS scale from 1 to 4. To put this into context, the scale is about the same as the difference between the average response of a firm in a transition country and its equivalent in a mature market economy**.**

Not surprisingly, firms facing high levels of competition report that they face tougher constraints in terms of their business environment. Majority foreign-owned firms, by contrast, consider themselves to be substantially less financially constrained, either in terms of access to, or cost of, credit (a difference of about 0.30 on the BEEPS scale) or in terms of their tax burden (a difference of 0.12). The likely explanation is their ability to draw on the financial resources of the parent firm and their lack of dependence on local financial institutions for financing. Location in a capital city loosens some constraints. Infrastructure is better and finance is more accessible, either because lending institutions are more sophisticated or because buoyant local demand means firms can generate profits instead of having to borrow. However, other constraints can be more evident, especially business regulation and access to land. Smaller firms are more constrained than others in terms of obtaining finance (reporting higher obstacles of about 0.13 on the BEEPS scale).

Table 4 gives comparable aggregate results for the market economies surveyed in BEEPS. Because there were virtually no privatised firms in the survey, only “private firms” are reported. The table shows that private firms, exporters and firms that reinvest profit generally report higher constraints than state-owned enterprises, reflecting the pattern in the transition countries. However, in the “institutions” category private firms and firms with profits to reinvest do not report higher constraints for property rights. Secondly, even more so than in transition countries, foreign ownership is associated with lower constraints. Thirdly, smaller firms in mature market economies do not face financial constraints to the same extent as those in transition countries. This implies that financial systems in transition countries are still facing problems in identifying and lending to creditworthy smaller firms. Lastly, the geographical pattern of constraints is more even in the mature market economies, as indicated by the near absence of any relationship between location in a capital city and reported constraints. This probably reflects a smaller geographical variation in the level of economic activity and development in these countries compared with transition countries, where capital cities often lead in economic activity and in the introduction of new technologies.

The remainder of this section looks at individual business constraints in more detail.

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[3] The results for re-investing profit come from a separate regression that omits the private ownership variables; including them generates qualitatively similar results. These results should be interpreted with some caution because of possible endogeneity: the re-investment of profits is an outcome rather than a characteristic of the firm (as with the other variables used).

Business regulation

Regulations are typically designed to limit any negative impact of firm behaviour and are enforced by state authorities through law. However, excessive business regulations can increase transaction costs in an economy and often become a major source of corruption and inefficiency. Arbitrary regulatory changes can be discriminatory, weakening the incentives for long-term planning that firms have in stable markets.

Table 3 suggests that new private firms and privatised companies are more likely to be affected adversely by regulations than state-owned firms, which are used as the benchmark. The regulatory burden on private firms is more pronounced for customs, trade, licensing and permit regulation but it is also present in terms of regulatory uncertainty as well. Dynamic firms that reinvest profits find regulation more costly than stagnant firms while start-up and privatised firms find it difficult to build solid business plans in the absence of regulatory predictability. State-owned firms in transition countries, by contrast, often lack long-term strategies and operate on short-term objectives which are less affected by regulatory instability.

Another factor is the fear of arbitrary redistribution or seizure of profits by the state through regulatory action. It is not clear, however, if this represents a greater constraint in transition countries than in mature market economies. The results from the BEEPS comparison countries show that private firms and reinvesting firms are more likely to find regulation a major constraint to doing business. Compared with the average private firm, foreign firms and especially exporting firms are more concerned about customs and trade regulations. Micro and small firms are less concerned about customs regulations and regulatory policy uncertainty in both transition and mature market economies.

Labour

Job creation, supported directly by labour market reforms and indirectly by other transition reforms, is an important issue in almost all transition countries. Firms are mostly concerned about the flexibility and quality of the labour force. The BEEPS therefore asked firms about labour regulation and the skill levels of the available workforce as potential obstacles to their activities.

Many characteristics of a firm influence the perceptions of labour market flexibility and the skills of the workforce (see Table 3). It is mainly new private firms, and to a lesser extent privatised firms, that see labour regulations as significant business obstacles. Many state-owned firms have largely completed an initial round of cutting jobs and are less concerned about regulations. Other state-owned firms, for which labour restructuring remains an issue, include large enterprises in strategically important sectors that fall outside the BEEPS sample. Foreign-owned firms do not assess local labour markets any differently from local firms, as labour regulations and workforce limitations apply equally to both categories.
Since employment growth is higher in new private firms compared with state-owned and privatised firms, labour market obstacles are felt more keenly by firms creating new jobs, notably new private firms. It is therefore not surprising that more dynamic companies are more concerned about labour regulations and the skills of the available workforce.

Concern about the skills of available workers is a more important issue for firms with the highest share of unskilled labour. Firms with a higher proportion of professional and skilled staff, as well as firms with a lower ratio of workers who completed only primary education, view skills of available workers as a lesser concern. The relatively high quality of the educational systems in transition countries is an important factor. A much larger proportion of their population completes secondary and formal vocational training compared with other middle-income countries. As a result, unskilled workers with only a primary level of education make up a much smaller part of the working age population. The difference between their skills level and the average skills level is therefore much more pronounced. Nevertheless, it is the firms that have greater difficulties in hiring skilled labour that complain more about the availability of a sufficiently skilled workforce.

Taxation

Tax systems in transition countries have undergone major changes, and the institutional set-up has often led to distortions. In some developing and transition countries, tax administrations are a major source of corruption and inefficiency. The BEEPS provides some insights into how firms perceive tax systems, in terms of the effect of tax rates and the efficiency of tax administration.

The taxation burden is perceived to be more costly by private firms than by state-owned firms, both in transition countries and in mature market economies (Table 3). This has at least two explanations. First, private firms are the growing segment of the economy and therefore want to retain more funds for investment or paying dividends. Secondly, state-owned firms often benefit, implicitly or explicitly, from state support in the form of tax breaks, toleration of non-payment of taxes, or operating subsidies. Nevertheless, in transition and mature market economies, foreign ownership mitigates the effects of taxation, in particular with respect to tax rates. This is because foreign multinationals are able to reduce their tax obligations through transfer pricing and often get significant tax breaks from the authorities for large investment projects.

Not surprisingly, firms that reinvest their profits assess taxation as a major burden, because bigger, more profitable firms pay more in corporation tax. Moreover, companies that reinvest profits complain more about the tax administration as they are subject to tax controls more often than other firms. The incidence of tax administration on exporters is also greater, and these companies report more administrative constraints. Unlike their counterparts in mature market economies, micro and small firms in transition countries complain more than large firms about tax rates. This suggests that the tax regime for smaller firms may still be burdensome in some transition countries, in particular in the absence of adequate access to finance.

Institutions and property rights

The experience transition countries since the beginning of market reforms in 1989-91 together with new research on developing countries and historical data on world economic evolution suggest that properly functioning economic institutions are essential for the protection of private property rights and for economic growth more generally.

Table 3 shows that new private firms consider that the institutions responsible for protecting their property rights are failing to do so. This is evident from the extent to which the judiciary and corruption are seen as important business obstacles, and from the degree that street crime and especially organised crime are seen as problems.

Privatised firms, by contrast, either have more experience in dealing with these obstacles, or are preyed on to a lesser extent by criminals. Like new private firms, however, privatised firms are very concerned about interference from the state, as evidenced by the high score registered by corruption as a business obstacle. Foreign-owned firms cope better with organised and street crime (or perhaps, as foreign investors, they avoid sectors and firms that are prone to these problems). Nevertheless, they are just as impeded as domestically owned firms by the failure of state institutions to protect their property rights and to enforce the rule of law. The size of the firm appears to make little difference; small and large firms alike complain about constraints arising from weak institutions. The exception is the functioning of the judiciary, which generates far fewer complaints from micro and small firms. This is probably because more of their activity takes place in the informal sector

Exporters are particularly constrained by poor property rights protection. They are less prone to encounter problems with organised or street crime but the state presents obstacles in the form of corruption and a poorly functioning legal system. Possibly because of the nature of their business activity, exporters are more likely to be exposed to these institutional failures, particularly in the form of corrupt customs officials and a corrupt legal system. Firms reinvesting their profits are also more likely to regard the legal system and especially corruption as costly constraints for their business operations. In other words, firms reinvesting their profits are more concerned about protecting their property rights in the future. The clear implication is that poor protection of property rights is a disincentive to investment and a hindrance to growth.

In developed market economies, protection of private property rights is extensive. Therefore growing, profitable or privately owned firms should not differ from poor performers or state-owned firms in terms of how they perceive institutions as obstacles. This is confirmed by the analysis. Private firms and those reinvesting their profits in mature market economies generally do not complain significantly more than other firms about institutions and property rights. There are, however, exceptions to this pattern. Just as in transition countries, exporters in mature economies are more likely to report corruption and the workings of the legal system as costly constraints on their operations. Also, private firms and firms reinvesting their profits report bigger problems with corruption. Mature market economies suffer less from these constraints but are not immune to them.

Infrastructure

The last few years have seen significant improvements in the infrastructure of the transition region (power, telecommunications, transport services and land access). On average, electrical power cuts across the region were reduced from 12.4 days in 2002 to 7.7 days in 2005, and outages in fixed-line telecommunications from 6.6 days in 2002 to 1.6 days in 2005. Despite these improvements, infrastructure services in many transition countries still lag behind the levels achieved in modern economies.

Table 3 suggests that private and state-owned firms are equally likely to be constrained by poor infrastructure. Detailed analysis reveals that power, telecommunications and road infrastructure affect all firms regardless of ownership, whereas new private firms are most constrained by access to land. Unlike their mature market counterparts, foreign-owned firms in transition economies complain about transport infrastructure, largely because as exporters they expect international standards of transportation. A highly competitive environment increases the cost incurred by firms constrained by poor infrastructure and increases concerns about access to land in the transition region. This result is consistent with findings in mature market economies. In transition economies, locating in the capital city (typically the most dynamic economic area in the country) mitigates the constraints relating to power infrastructure but significantly increases the perceived cost of land access. By contrast, in mature market economies location in the capital city does not appear to generate any particular infrastructure benefits.

Finance

Finance is reported by many firms as one of the major constraints on their entrepreneurial activities. The 2005 BEEPS asked firms about access to finance in general (for example, the need to provide collateral) and also about the cost of finance (interest rates and charges). In some cases, enterprises may be offered the option of external financing but decline to take it up because the financial terms make the loan uneconomic.[4] Firms that use external finance for working capital feel more constrained in their access to finance; firms using it for investment purposes, on the other hand, feel more constrained by the cost of finance. This may be explained by the relative ease of collateralising fixed assets as opposed to inventory.

Table 3 shows that the ownership of enterprises has a significant impact on the assessment of access to finance within a country. Local firms see access to finance as a more important obstacle than foreign-owned firms. Foreign-owned firms may have implicit or explicit parent company guarantees;[5] they may use the parent company's financial providers or shareholder funds if external finance is not available to them directly; or they may have greater internal sources of finance due to strong business performance. Of course, reinvested earnings are also important for foreign-owned companies. In more advanced countries, such as the Czech Republic or Hungary, a large part of foreign direct investment inflows are not new inflows but reinvested earnings generated by local subsidiaries.

Implicit or explicit state guarantees for state-owned companies may partly explain why private companies report greater difficulties in accessing finance compared with state-owned firms. The cost of finance is a bigger problem for privatised companies, many of which need extensive restructuring, including write-offs of substantial financial obligations.

Table 3 also shows that the size of firms has a direct impact on their access to finance. In line with other studies on SME finance, the BEEPS data indicate that smaller firms face greater obstacles than large enterprises in accessing finance. The larger the company, the more likely it is to use external financing. There are many different reasons for this finding. These include the cost of processing loans (which makes larger loans more cost effective for financial institutions), the lack of fixed assets available for smaller companies to offer as collateral for loans, and the higher proportion of newly established SMEs without a business track record.

An analysis of the BEEPS data for mature market economies shows that SMEs in these countries are less likely to report financial constraints, especially the cost of finance, as major obstacles for their businesses. Evidence of the difficulties that SMEs face in access to finance in transition countries indicates the need for supportive measures, including SME credit lines, the establishment of specialised micro-credit institutions and technical assistance for the financial sector with the explicit aim of increasing lending to SMEs.

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[4] The answers to the two questions are, however, highly correlated, with a correlation coefficient of 0.93.

[5] Indeed, foreign-owned firms are less likely to need collateral for loans than local firms.

Enterprises based in capital cities feel less constrained by access to finance than firms in other regions. Most financial institutions have their headquarters and a denser branch network in the capitals, and the number of banks is also highest in these cities. The more developed financial environment consequently promotes easier access to finance. In the mature market economies, by contrast, access to finance is more uniformly available throughout the country. This explains why in the BEEPS results for these countries, firms located in a capital city do not report easier access to finance than firms operating elsewhere.

There is a strong link between the performance of companies and access to finance, although which factor leads to the other is unclear. More dynamic companies that reinvest profits report smaller constraints in terms of access to finance and cost of finance. Firms performing strongly also use external finance more often than less dynamic enterprises, the maturity of their loans is longer and their actual cost of finance is lower. One possible explanation is the rational allocation of credit in the financial sector, which leads to poorly performing companies having greater difficulties in obtaining external finance. Another explanation is that firms which have more difficulties in accessing finance perform less well as a consequence. Easing their financial constraints would therefore lead to improved performance.

Macroeconomic environment

Macroeconomic conditions are an important aspect of the business environment for firms. The BEEPS asks the participating firms whether they consider macroeconomic instability (for example, high inflation or exchange rate instability) to be a serious obstacle to their activities. This evaluation of the perceived cost of macroeconomic instability is closely associated with objective macroeconomic indicators, such as GDP growth and inflation.[6] During economic downturns, the performance of enterprises is likely to deteriorate and they may be prone to relate their own performance to the macroeconomic situation. Nevertheless, enterprise characteristics also influence the perception of macroeconomic instability.

Table 3 shows that state-owned firms (the benchmark category) are less concerned about macroeconomic instability than new private and privatised firms (although there is no impact for foreign ownership). The concern about macroeconomic instability does not change in relation to the location of the firms or the size of firms. Enterprises based in capital cities feel that they are affected by macroeconomic instability in the same way as firms based elsewhere, and there is similarly no difference between smaller and larger firms.

The vast majority of constraints, except those regarding licensing, labour regulation and street crime, are perceived as more significant by firms located in countries with lower GDP growth. These results emphasise the importance of achieving and maintaining macroeconomic stability, particularly for non-state enterprises operating in competitive sectors and facing international competition.

5. Conclusion

[6] Enterprises based in countries with higher growth rates or lower inflation rates are less concerned about macroeconomic instability than firms in slow-growing, high-inflation countries.

This paper presents evidence on the business environment and enterprise performance from a new survey of over 9,500 firms in 26 transition countries (plus Turkey). The survey – known as the Business Environment and Enterprise Performance Survey, or BEEPS – was conducted jointly by the EBRD and the World Bank and follows similar surveys in 1999 and 2002.
The BEEPS shows clear differences in the way that business obstacles are perceived by firms across the transition region. This can be explained largely by variations in the business environment between countries. In fact, approximately 60 to 90 per cent of the variation in reported constraints can be attributed to specific country characteristics. However, there are also differences in the way that particular types of firms are affected by certain business constraints. The identification of these differences allows policy-makers to focus on the constraints that are particularly limiting the firms with the strongest potential for growth.

The analysis shows that the firms most affected by business constraints are those that are most likely to generate growth and new jobs – private firms, exporting companies, profitable firms that re-invest profits, and micro and small firms.

The costs of business regulation, poor-quality institutions, weak property rights and an unstable macroeconomic environment all emerge from the survey as major obstacles to businesses in transition countries. Access to finance is most difficult for smaller firms and enterprises located outside major cities – a finding that supports the need for financing programmes aimed at these firms. Foreign-owned firms tend to access finance more easily, suggesting that policies encouraging foreign direct investment may boost overall growth.

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Table 1
Firms participating in the BEEPS

Characteristics	Percentage
Sector	
Manufacturing	39
Services	61
Firm size (number of employees)	
Small (2 to 49)	70
Medium (50 to 249)	20
Large (250 to 9,999)	10
Ownership	
Privatised	75
New private	16
Foreign-owned	10
State-owned	9
Location	
Capital	32
Large cities (excluding the capital)	21
Small cities	23
Rural areas	24

Source: EBRD 2005
Note: Privatised firms were formerly state-controlled and are majority-owned by private domestic investors.
New private firms were never under state control and are majority-owned by domestic investors.
Foreign firms may be privatised or new private firms that are majority-owned by foreign individuals/ companies/ organisations.

Table 2

BEEPS firms by country

Country	**Total number of firms participating in BEEPS 2005**	**Panel firms participating in BEEPS 2002 and 2005**	**Additional manufacturing enterprises participating in BEEPS 2005**
Albania	204	65	-
Armenia	351	49	150
Azerbaijan	350	68	150
Belarus	325	46	-
Bosnia and Herzegovina	200	16	-
Bulgaria	300	89	-
Croatia	236	61	-
Czech Republic	343	36	-
Estonia	219	69	-
FYR Macedonia	200	34	-
Georgia	200	58	-
Hungary	610	59	298
Kazakhstan	585	60	285
Kyrgyz Republic	202	40	-
Latvia	205	54	-
Lithuania	205	56	-
Moldova	350	32	150
Poland	975	78	395
Romania	600	64	285
Russia	601	41	-
Serbia and Montenegro	300	43	-
Slovak Republic	220	29	-
Slovenia	223	75	-
Tajikistan	200	18	-
Turkey	559	47	-
Ukraine	594	147	-
Uzbekistan	300	28	-
Total	**9,657**	**1,462**	**1,713**

Sources: EBRD 2005.

Table 3

Business constraints and firm characteristics in transition countries

	New private firms	Privatised firms	Foreign-owned firms	Exporting firms	Firms facing high competition	Micro and small firms	Firms located in capitals	Firms reinvesting profit
Business regulation	**0.215**	**0.136**	**0.074**	**0.135**	**0.103**	**-0.077**	**0.053**	**0.081**
Title or leasing of land	**0.203**	0.092			0.049		**0.105**	**0.066**
Customs and trade regulations	**0.288**	**0.185**	**0.146**	**0.359**	**0.106**	**-0.125**	**0.072**	**0.090**
Business licensing and permits	**0.284**	**0.203**		0.071	**0.128**			**0.135**
Regulatory policy uncertainty	**0.130**	**0.124**		**0.092**	**0.128**	-0.052	-0.053	
Labour	**0.097**			**0.079**	**0.103**	**-0.100**		**0.060**
Labour regulations	**0.150**	0.083		**0.086**	**0.113**	**-0.108**		**0.062**
Skills of available workforce				**0.077**	**0.087**	**-0.088**		0.058
Taxation	**0.315**	**0.250**	**-0.117**	0.045	**0.173**			0.045
Tax rates	**0.317**	**0.296**	**-0.169**		**0.176**			
Tax administration	**0.321**	**0.213**	-0.068	**0.082**	**0.164**			**0.066**
Institutions and property rights	**0.144**	0.078		**0.062**	**0.111**			**0.054**
Judiciary	**0.119**	0.088		**0.137**	**0.139**	**-0.091**		0.063
Corruption	**0.273**	**0.198**		**0.109**	**0.178**			**0.101**
Street crime	0.093		**-0.087**		**0.083**			
Organised crime	**0.130**		-0.075		**0.071**			
Infrastructure					0.032		-0.030	0.027
Telecommunications				-0.040				
Electricity				-0.045			**-0.120**	
Transport			0.057					
Access to land	**0.139**				0.051		**0.085**	**0.098**
Finance	0.099	0.092	**-0.290**		**0.124**	**0.129**	**-0.110**	-0.053
Access to finance			**-0.308**		**0.097**	**0.152**	-0.053	**-0.088**
Cost of finance	**0.165**	**0.197**	**-0.275**		**0.145**	**0.108**	**-0.159**	
Macroeconomic environment	**0.191**	**0.159**		**0.157**	**0.098**			

Source: EBRD 2005.

Note: Reported figures are regression co-efficients statistically significant at the 10 per cent level and 1 per cent level (marked in bold).

Gaps denote regression coefficients that were not statistically significant at the ten per cent level.

Regression coefficients signify by how much more the business constraint is felt as an obstacle for a firm with a given characteristic compared to a firm without that characteristic.
Other controls in the regressions include industry and country dummies (country-fixed effects).
(NB: new private and privatised ownership is compared to state ownership)

Table 4

Business constraints and firm characteristics in mature market economies (Germany, Greece, Portugal)

	Private firms	Foreign-owned firms	Exporting firms	Firms facing high competition	Micro and small firms	Firms located in capitals	Firms reinvesting profit
Business regulation	**0.209**	**-0.177**	**0.220**		**-0.146**		**0.119**
Labour		-0.149	0.123		**-0.253**		
Taxation	**0.475**	**-0.318**		**0.157**		0.146	0.140
Institutions and property rights		**-0.183**	0.090	0.064			
Infrastructure	**0.198**	**-0.218**					**0.122**
Finance	**0.386**	**-0.363**		**0.219**			
Macroeconomic environment	**0.299**	**-0.332**	**0.226**	0.118	**-0.231**		

Source: EBRD 2005.

Note: Reported figures are regression co-efficients statistically significant at the 10 per cent level and 1 per cent level (marked in bold).

Gaps denote regression coefficients that were not statistically significant at the ten per cent level.

Regression coefficients signify by how much more the business constraint is felt as an obstacle for a firm with a given characteristic compared to a firm without that characteristic.

Other controls in the regressions include industry and country dummies (country-fixed effects).

(NB: new private and privatised ownership is compared to state ownership)

Chart 1

Changes in the business environment in transition countries, 2002-05

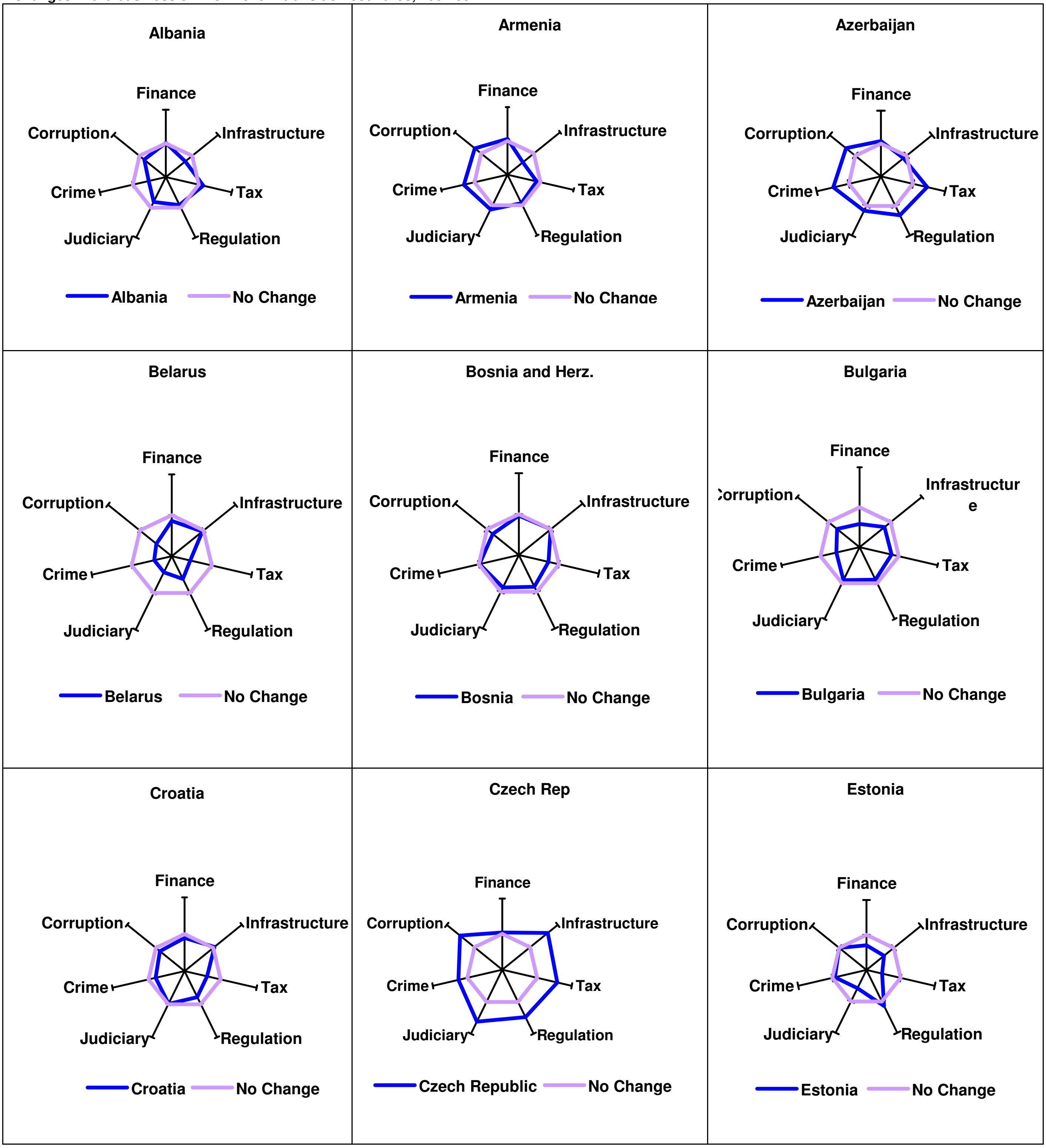


Chart 1

Changes in the business environment in transition countries, 2002-05

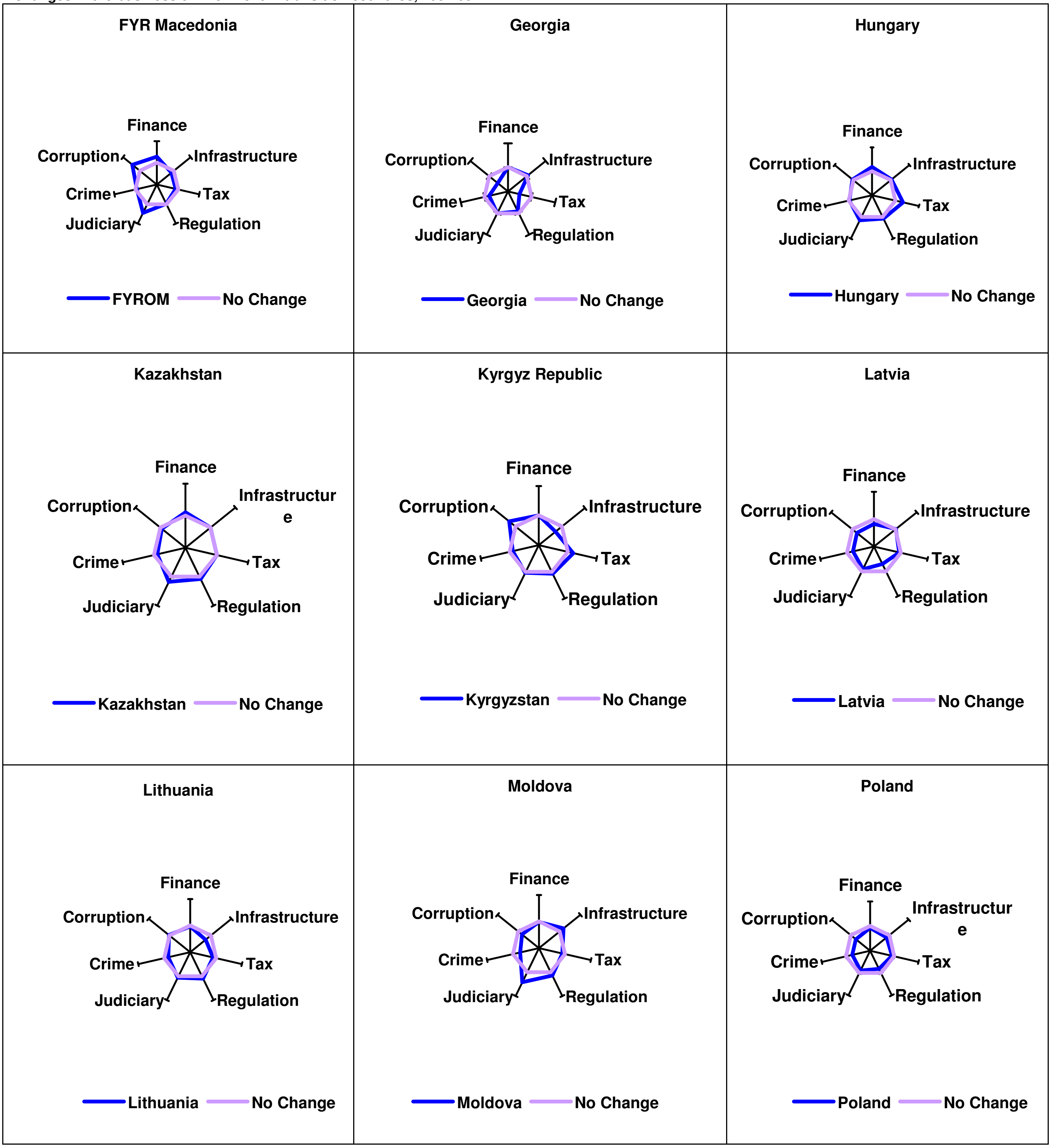
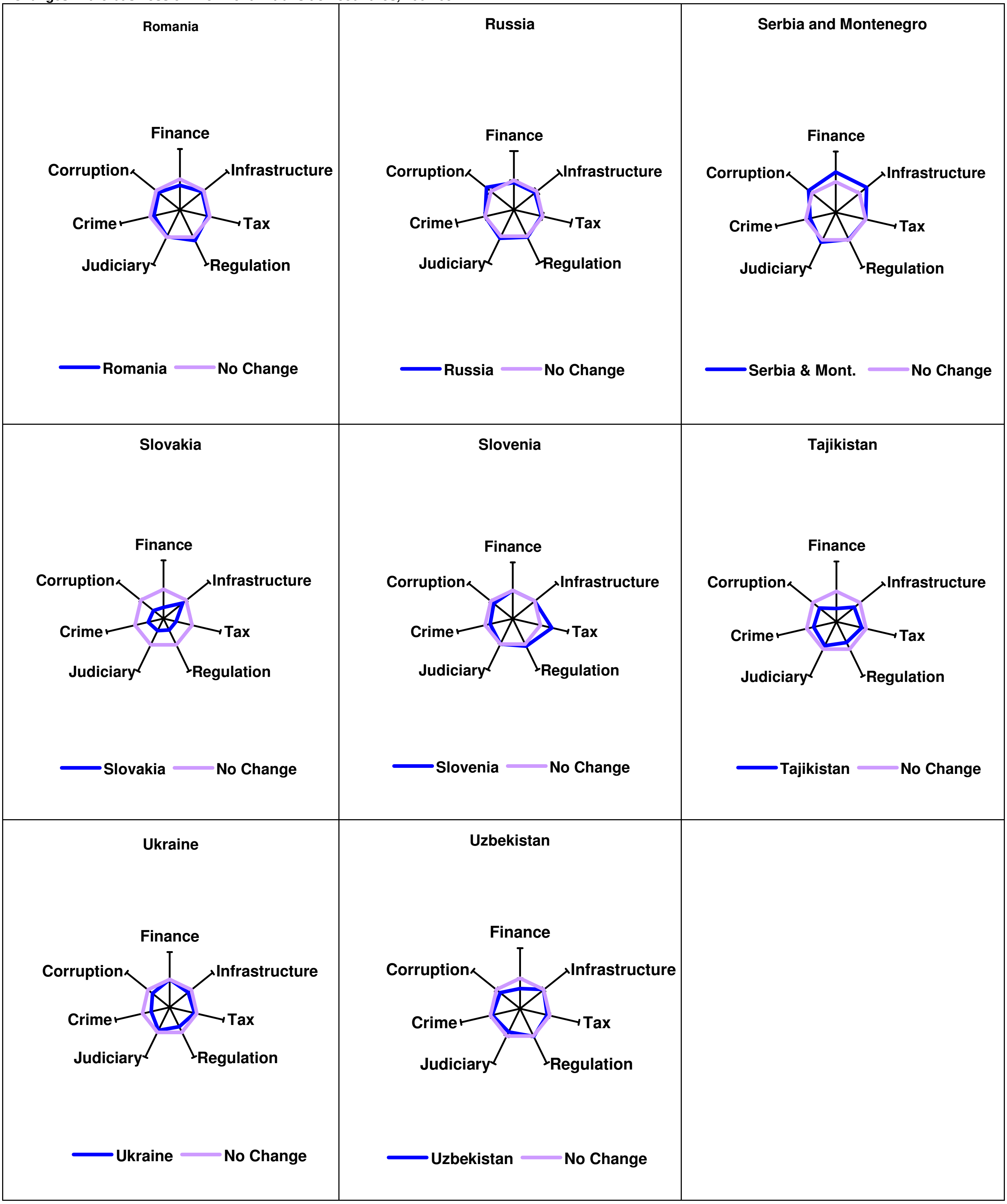


Chart 1, cont.

Changes in the business environment in transition countries, 2002-05



Sources: EBRD 2005.

Notes: The spider charts show changes in seven aspect of the business environment between 2002 and 2005.
The 2002 data represent a benchmark of no change. Where the line falls inside the benchmark, this
represents an improvement in that aspect of the business environment. Where the line falls outside of the benchmark, this
represents a deterioration in the business environment. Wherever the changes are statistically significant,
the relevant categories are marked with an asterisk. The business environment was assessed on a scale from 1 (no obstacle) to 4 (major obstacle).