Unleashing entrepreneurial potential in transition economies: a comparative analysis of the impact of macro and micro policies

Fadil Sahiti 1, *

1 RIT Kosovo (AUK), Rochester Institute of Technology, Prishtina, Republic of Kosovo
*Correspondence: fsahiti@mail.rit.edu

Abstract. This study investigates the relationship between macroeconomic and microeconomic policies and entrepreneurial dynamics in two economies transitioning from planned economies to free markets, comparing them to a developed economy. Macroeconomic policies, despite not directly targeting entrepreneurship, significantly impact entrepreneurial dynamics. Conversely, microeconomic policies specifically aim to promote and enhance entrepreneurial activity. The analysis links policy quality to key entrepreneurial indicators: new firm creation, incumbent firm survival, and overall firm stock. Findings reveal that while transition economies often adopt entrepreneurship policies similar to developed nations, some remain country-specific. These policy variations manifest in distinct entrepreneurial dynamics across the economies.

Keywords: entrepreneurship policy; transition economies, start-up

JEL classification: L53; P20; O57; L26

1. Introduction

Entrepreneurship is widely recognized as an important factor affecting economic growth (Acs & Sanders, 2013; Koski & Pajarinen, 2013; Acs & Szerb, 2007). Empirical evidence suggests that reduced entrepreneurial activity is likely to lead to reduced economic growth (Audretsch et al., 2007). Therefore, governments around the world try to create policies that lead to a greater dynamism of entrepreneurial activities. This is more visible in developed economies, in which economic policies help not only in the growth of entrepreneurial activities, but also in the growth of those enterprises that manage to survive the market (Bartelsman et al., 2013). This phenomenon is less visible in developing economies and especially in those in transition, where the growth and expansion of firms is less visible, as many of them struggle to grow, age and remain small throughout their life cycle (Estrin & Mickiewicz, 2011; Hsieh & Klenow, 2014). Kosovo and North Macedonia are characterized by an enterprise population consisting mainly of small firms, which employ less than five employees. In contrast, advanced economies are characterized by a pronounced "up-or-out" culture, where a large proportion of new businesses are also small, but over time, many of them
either develop and grow or are forced to exit the market (Eslava et al., 2019).

This paper investigates the interaction between macro and microeconomic policies geared towards entrepreneurial activity. Macroeconomic policies refer to those that have a general impact on entrepreneurship, such as fiscal and monetary policies, tax policies, business regulations, and mechanisms aimed at regulating market competition, among others. Microeconomic policies refer to policies that are more directly related to enhancing entrepreneurship, such as creating an entrepreneurial culture in society, facilitating access to financial funds, focusing on the development of technology and innovation, and advisory and assistance entrepreneurship policies. Indicators for measuring entrepreneurial activity include the number of new market entrants, the stock of active firms and the survival rate of firms over five years.

In the focus of the analysis of this paper are three countries that were once socialist economies and part of the same state - the former Yugoslavia. Two of these economies (Kosovo and North Macedonia) are still in the process of transition from a socialist to a capitalist economy, while the benchmarking economy (Slovenia) is now part of the EU. The comparative analysis was carried out with the aim of identifying those entrepreneurial policies that can explain the differences in entrepreneurship indicators and thus explain the different levels of economic development. This topic is motivated by a growing body of empirical evidence on the reduced level of entrepreneurship in less developed economies (Bento & Restuccia, 2020).

The findings presented in this paper suggest that both economic policies and entrepreneurial activities in transition economies have experienced intense dynamics. Specifically, our data suggest that some economic policies and entrepreneurship indicators of transition countries resemble advanced economies, but many others are idiosyncratic to these economies. Unlike the Slovenian economy, the economies of the transition countries are mainly populated with very small, non-innovative enterprises that survive for many years but fail to grow. As a result, the contribution of these companies to the economic development of these countries is very low. The data presented in this paper suggest that many new entrants do not survive and exit the market too early. However, provided that they manage to survive up to year four, the probability of surviving after five years is significantly higher, leading to reduced firm dynamism and market selection.

Although there are empirical works that have investigated the role of economic policies in entrepreneurial activities. However, their focus is concentrated either on a single country or the study is carried out from the perspective of a single policy or institution (Cole et al., 2016). In the entrepreneurship literature, there are relatively few empirical studies that investigate the relationship between government policies and level of entrepreneurial activities in the context of late transition economies. Therefore, the contribution of this paper is not only to provide new empirical evidence on government policies that aim to promote higher entrepreneurship in late transition countries, but also to improve our understanding of the role of these policies in the overall development of national economies. Moreover, previous research studies rarely included such comprehensive indicators of economic policies and entrepreneurial activities, so this study is also a contribution to the diversification of research methodologies available in this field. Finally, the results presented in this paper should provide a basis for further research on this important topic.

The paper is organized as follows. Section 2 reviews the literature and provides the theoretical background of the paper, followed by section 3, where we discuss the data and the
Unleashing entrepreneurial potential in transition economies

methodology employed in the study. In section 4, we provide a short profile of transition economies. Section 5 summarizes the main findings. Section 6 provides concluding remarks.

2. Literature review and theoretical perspective

The theories and indicators used to explain the relationship between economic policies and entrepreneurship began to develop early, especially after the publications of Schumpeter (1950), or Kirzner (1973). The results presented so far show that the design of good policies and especially their successful implementation in practice can have a significant impact on increasing the level of entrepreneurship (Figueroa-Armijos & Johnson, 2016). In almost all stages of entrepreneurship, from the entry of firms during the process of expansion or exit, the design of effective and efficient policies is crucial (OECD, 2017). Some combination and similarity of these policies exist in almost all economies, advanced and less advanced (Estrin and Mickiewicz, 2011). In fact, why is it so important for governments to design specific policies that promote entrepreneurship?

Promotion of entrepreneurship through economic policies began at the end of the last century, especially after the 70s. According to Audretsch and Thurik (2000), until the 1980s, governments were focused on designing economic policies aimed at protecting the interests of large firms. There are reasons behind this. First, through the application of economies of scale, large firms were able to produce standardized products and thus successfully meet market needs. Another reason had to do with the fact that during this period, the cooperation between unions, governments and firms was greater and more effective and thus, firms offered permanent employment to their employees (Audretsch & Thurik, 2000). Meanwhile, small firms were considered out of fashion; with a small contribution to employment; less efficient than large firms; and not very innovative (Baswell, 1973; Audretsch, 2002; Robson & Haigh, 2008). Audretsch and Thurik call this period the period of the 'managed economy', in which business ownership is concentrated and the main concern of firms was how to mass produce products.

At the end of the 70s of the last century, the view and attitude of policymakers towards the role of entrepreneurship in the economic development of a country began to change. The world economy was undergoing a significant transformation; it was undergoing a transformation process from a "managed" economy to an "entrepreneurial" economy. Governments, especially in the most advanced countries, began to see entrepreneurship as an important factor influencing economic and social development (Baumol, 1990). Policymakers had already begun to look for the best ways to promote entrepreneurial activities. According to Storey and Green (2010) there are three reasons why this transformation has occurred.

First, the impact of smaller firms on employment growth began to be supported both theoretically and empirically, particularly by empirical studies published by Birch in 1981 and 1987. Second, in addition to employment, the contribution of small firms began to be seen in other areas, especially in the contribution that these firms make to economic development (Romer, 1990; Audretsch et al., 2006). Findings from various studies suggested that by increasing market competition, small firms affect a country's economic growth (Autio et al., 1999; Disney et al., 2003; Bartelsman et al., 2013). The third reason is related to other sustainable benefits. For example, the products and services of small firms have the capacity to offer customers a wider range of solutions
and variations for their needs; forming a small firm is a good alternative and solution in situations when people lose employment from other firms; small firms can also act as agents of social change by integrating environmental and social concerns into their business operations, for example (Tracey & Jarvis, 2007).

There are other reasons why governments seek to design and implement policies that stimulate entrepreneurship. A reason that is often mentioned in the economic and business literature has to do with what is known as 'market failures'. The need for the creation and implementation of specific economic and entrepreneurial policies arises especially when there is evidence of a lack of fair competition in the market; when customers and suppliers are not properly informed about market conditions; when there is the presence of externalities, etc. According to the political economy approach, the number of reasons why policymakers formulate policies can be larger, including government elections, power relations, bureaucracy, equity, and distributional issues, and so on (Coen & Dannreuther, 2002).

2.1 The theoretical perspective

There are two interconnected economic perspectives which this paper is based upon: development economics and neo-institutional economics. Both theories argue that regardless of the level of development of an economy, the influence of the institutional factor on entrepreneurship is fundamental. According to the perspective of development economics, the process of entrepreneurship develops even in countries with unstable institutions, i.e., the process of entrepreneurship continues despite the lack of effective protection of business property (see e.g., Nenova, 2004; Powell et al., 2008). Meanwhile, according to the perspective of neo-institutional economics, laws, rules, and social norms have a fundamental influence on the development of entrepreneurship and, consequently on the economic development of a country (see, e.g., North, 1990; Keefer & Shirley, 2000; Rodrik et al., 2002). Proponents of the neo-institutional economics perspective believe that institutions are an important driver of the distribution of entrepreneurial talent in any society, including transition economies.

The term economy in transition in this paper refers to countries that are in the process of macroeconomic reform and that are changing from a state-led economy to a more market-led economy (Svejnar, 2002). This transition process is comprehensive, as it covers the main aspects of society, such as market liberalization, macroeconomic stabilization, privatization of state economic assets, as well as legal and institutional reforms (Kornai, 2008; Berend, 2003). The term "late transition economy" refers to Kosovo and North Macedonia, which, even after more than 20 years as independent states, still have not managed to complete the transition process from socialist to capitalist economies (EBRD, 2018).

The concept of entrepreneurship is taken from Lundström and Stevenson (2005, p. 42), who define entrepreneurship "... as a process where individuals become aware of business ownership as a possible option or alternative, develop business ideas, learn business processes of business to become an entrepreneur, and undertake the start-up and development of a business... Entrepreneurship can be found in both start-ups and growing businesses".
It is worth noting that the focus of this study is the policies that affect entrepreneurial activities before and after the start of the business activity. Pre-entrepreneurial policies address issues such as motivation, opportunities, and skills, with the aim of creating an encouraging institutional base for people to start their own businesses. Moreover, entrepreneurship policies are designed to influence a wide range of areas, including education (primary, secondary, and tertiary), promotion of entrepreneurship in the media and society, reduction of administrative, legislative and regulations for the creation of a financial firm, and support for young entrepreneurs, for example (Stevenson & Lundström 2007, p. 105). On the other hand, the purpose of policies after the start of business activity includes issues related to the process of survival and growth of firms.

Among several theoretical frameworks that are applied today to investigate policies that limit or enable entrepreneurial activities, the economic variables adapted for this study are taken from the framework provided by OECD (2008) and UNCTAD (2012). In addition, in our framework, we have also included empirical indicators of entrepreneurial performance (see Figure 2). This framework assumes that the more advanced and contextual a country's entrepreneurship policies are, especially the more efficient their institutionalization in practice, the higher the level of entrepreneurial activities is expected to be.
3. Data and methodology

The data used in this study were provided by official sources, such as the Kosovo Statistics Agency (KSA), the Kosovo Business Registration Agency (KBRA), and the State Statistics Office (SSO) for North Macedonia. Data for Slovenia are mainly provided by Eurostat and other government agencies.

The main entrepreneurship indicators used in the analysis include the population of active firms, the number of firms entering the market for the first time, the number of firms leaving the market, the distribution of firms by size, the distribution of employment across firms, and the survival of firms up to 10 years. The data provided enable the identification of indicators related to firms’ birth rates, firms exit rates, survival, and risk probabilities, as well as employment rates. The definition of these indicators is based on international business demographic standards (OECD/Eurostat, 2007: p 12 and 77). The data provided by KBRA contains a sample of 73,206 new entrants to the business sector during this period, and 12,354 firms that have left the market during the same period.

The method of comparative analysis used in the paper is widely used in scientific studies, especially in the social sciences (Collier, 1990). This method is particularly useful when applied to identify and evaluate similarities and differences between different countries, as is the case in this paper where it is intended to identify differences in the field of policies and entrepreneurship dynamics between countries with different levels of economic development. However, this type of analysis is not easy, as it is not easy to obtain relevant data from relevant countries. Therefore, the data used in this study have their limitations.

Thus, although our data are relatively comprehensive, they nevertheless contain some limitations. For example, from the data on entrepreneurship, we cannot distinguish firms that voluntarily exit the market or have gone bankrupt. The other data limit is related to the identification of the change of ownership of the firm during the activity if the firm has changed owners. On this last point, the data provided by KBRA suggest that changes in firm ownership are nevertheless very rare and, in this respect, this does not constitute a major limitation. Another disadvantage associated with the data includes the inability to identify mergers, or the fact that the only reliable measure of firm size is the number of employees, i.e., we do not possess other indicators of firm size.

4. A short profile of economies in transition

Both Kosovo and North Macedonia have been centrally planned economies and emerged as independent countries from the breakup of the former Yugoslavia (Estrin & Uvalic, 2008). Due to the war that happened in these countries, the economic transition process, compared to other former socialist countries, was longer and not easy (Bartlett, 2008; Uvalic, 2012; EBRD, 2018). Both economies are classified by the World Bank in the group of upper-middle-income countries.

Kosovo and North Macedonia have come a long way since independence (N. Macedonia in 1991 and Kosovo in 2008) and have achieved remarkable successes in certain areas. The latter has been an EU candidate since 2005, while the former in 1916 has signed the ‘stabilisation and association agreement’ with the EU. Despite the progress made in the transition process, the problems these economies still face are different and mainly inherited from the previous economic
system (Uvalic, 2012; EBRD, 2018). Both economies are characterized by relatively low productivity and slower growth prospects. Compared to European Union (EU) members, labour productivity in both economies is lower than almost a quarter of the average of EU member countries (World Bank, 2021; ILO, 2021; Makstat, 2019).

Due to the limited functioning of market mechanisms, the reallocation of resources from less productive sectors and firms to more productive ones has decreased (European Commission, 2021). This shows the impotence of market mechanisms in allocating investment through the reallocation of capital and other inputs from unproductive sectors and firms to more productive sectors and firms (World Bank, 2020). Furthermore, the findings presented in this paper suggest that the level of entrepreneurship in transition countries is significantly lower than in the reference country - Slovenia. The entry rates are lower, and the stock of incumbent firms is significantly low compared to EU countries. The lack of strong dynamism in the economy is due to numerous structural challenges and problems, including insufficient access to finance, significant gaps in infrastructure, insufficient competition, a large informal economic sector, high levels of corruption, etc. (Sahiti & Smith, 2017).

**Table 1.** Economic indicators, 2021.

<table>
<thead>
<tr>
<th></th>
<th>SVN</th>
<th>MKD</th>
<th>KOS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size of population (million)</td>
<td>2.1</td>
<td>2.06</td>
<td>1.7</td>
</tr>
<tr>
<td>GNI per capita (US$) (thousand)</td>
<td>28.3</td>
<td>6.2</td>
<td>5.1</td>
</tr>
<tr>
<td>GDP in $ (billion)</td>
<td>61.75</td>
<td>13.83</td>
<td>9.41</td>
</tr>
<tr>
<td>Rate of unemployment (%)</td>
<td>4.74</td>
<td>16.2</td>
<td>20.7</td>
</tr>
<tr>
<td>Informal economy (%)</td>
<td>_</td>
<td>17</td>
<td>31.0</td>
</tr>
<tr>
<td>Interest landing rates</td>
<td>2.13</td>
<td>4.4</td>
<td>4.7</td>
</tr>
<tr>
<td>Profit tax (% of commercial profits)</td>
<td>9.3</td>
<td>11</td>
<td>12.7</td>
</tr>
<tr>
<td>Number of active firms (thousand)</td>
<td>150.5</td>
<td>72.9</td>
<td>40.6</td>
</tr>
<tr>
<td>Number of firm entry (thousand)</td>
<td>17.3</td>
<td>6.3</td>
<td>10.2</td>
</tr>
</tbody>
</table>

*Source: World Bank, EUROSTAT and official statistical agencies*

### 5. Empirical findings

#### 5.1 Macroeconomic policies

In this section we examine macroeconomic policies that may not have entrepreneurs as their primary focus, but their impact at the level of entrepreneurship can be considerable. The analysis includes traditional macroeconomic policies such as fiscal and monetary policies, policies that affect macroeconomic stability, political and institutional instability in the country, as well as other high-impact policies such as business regulations and infrastructure.

Monetary policies, especially policies implemented by the government in setting the lending rate base (the rates at which the central bank lends), can significantly affect entrepreneurial activities
This influence is also suggested by our findings. The cost of loans is in correlation with the rates of new market entries as well as with the stock of existing firms. In other words, the lower the cost of credit, the higher the entry rates and the number of incumbent firms - see Figure 2. Another factor that affects entrepreneurial activity is the stability of the macroeconomics (Parker, 1996; Stiglitz, 2000). The level of income is an indicator of this stability, as it can affect the total demand for goods and services and thus affect the level of entrepreneurship in an economy. This correlation between the level of income and the level of entrepreneurial activity is shown in our findings - see Figure 2. Political instability can also affect entrepreneurship. Previous findings (Klapper et al., 2008) show how business entry is related to political instability. Data provided by international organizations suggest that in terms of the rule of law, political stability, violence, and corruption, transition countries perform significantly lower than developed countries such as Slovenia.

The lower taxes applied in transition countries do not seem to influence the development of entrepreneurship in countries in transition - see table 1 above. Even in terms of business regulations, countries in transition can be compared with developed countries. In the 2020 World Bank Doing Business Index, both economies rank quite high: North Macedonia is 17th and Kosovo 57th (World Bank, 2022). However, both economies face several problems that continue to undermine fair competition, private investment, and the growth of firms in general. In the recent BEEPS survey, 43% of firms identified courts as a major barrier to doing business (World Bank, 2020a). Another important problem has to do with unfair competition in the market, especially with business informality. In the World Bank survey (BEEPS), respectively 63.4% and 54.5% of managers interviewed in the two countries see economic informality as a major obstacle to the growth of their business.

![Figure 2. Macroeconomic indicators and entrepreneurship. Source: World Bank (2021).](image-url)
The quality of infrastructure - roads, telecommunications, energy, and water supply - also affects the level of entrepreneurial activity. Our findings suggest that, despite some progress, countries in transition still lack some key infrastructure services. This is particularly evident in Kosovo, which still faces unreliable electricity supply. In one of the World Bank studies (BEEPS), 63% of all firms and 78% of manufacturing firms consider electricity supply to be a major problem (World Bank, 2020).

5.2 Microeconomic policies

In this section, we examine government policies aimed at promoting higher entrepreneurial activity. Four specific policies are the focus of our examination, which correspond to the micropolicy components provided in the framework presented earlier in Figure 1.

Entrepreneurship culture. It is assumed that, through specific policies, governments try to promote 'entrepreneurial culture', because the expectation is that an individual with an 'entrepreneurial mindset' is more likely to one day start their own private business (European Commission, 2003). The most traditional way to develop an entrepreneurial culture in people is when entrepreneurship as a subject is included in formal education curricula. This enables the development of more entrepreneurial skills and abilities in the younger generations and prepares them for the world of work. Our findings indicate that policies that focus on entrepreneurship education are not coherent. For example, data provided by GEM shows that the inclusion of entrepreneurship education in school curricula in transition countries is significantly lower than in schools in developed countries - see Table 2. Also, the number and quality of training programs aiming to prepare young people to start
a private business is significantly lower compared to Slovenia, whose government finances a specific program called SPOT Point (OECD, 2017). Other organizations, such as the IBRD, report that economies in transition lag behind developed countries in the provision of systematic training of the workforce and in the index of the knowledge economy, among other factors - see table below.

Theoretically, in both transition economies, vocational schools and training (VET) have been integrated into the education system, especially at the level of upper-secondary education. About 53% in Kosovo and 60.2% in North Macedonia of secondary school students choose vocational education – which is above the EU average of 47.8% (OECD, 2019). However, the VET systems in both countries suffer from numerous problems, such as the mismatch of curricula with market needs, the poor quality of teaching and learning, the lack of practical teaching materials, and especially the lack of practical work (internship) (OECD, 2017; European Commission, 2019). Unlike countries in transition, in Slovenia, in addition to theoretical education, vocational schools are obliged to ensure that each student attends practical work education - internship. Slovenian law defines the status of students attending vocational schools, according to which each student is obliged to spend 50% of the time in school and the rest in practical work (SBA Fact Sheet, 2019). The employment of VET graduates in Slovenia is very high - 84.5%, while there is no data for Kosovo and North Macedonia.

Access and provision of finance. For firms operating in transition economies, bank loans remain the main source of external financing, as project financing through equity capital is still negligible (OECD, 2017). In addition, due to difficulties in meeting loan collateral requirements, access to bank funds for startups and small firms is significantly more difficult. To facilitate access to credit, countries in transition have created loan guarantee schemes, which are financed by public funds and external donors. However, compared to similar schemes operating in developed countries, their number and financial capacity are significantly limited. Another source of funding is business grants, which enable entrepreneurs to invest in equipment or training and consulting support for their managers and employees (Storey and Greene, 2010). There are institutions that offer business grants to entrepreneurs in transition countries, but their number and especially the financial capacity is much smaller compared to developed countries - see the table below.

Supporting technology and innovation. Entrepreneurship is often associated with technology and innovation. Policymakers may see advantages in promoting the innovative skills of entrepreneurs, as in this way, they boost their country's economic growth. Acs and Audretsch (2003) emphasize that policy intervention in this area is necessary due to the advantages of spillover effects. This is why policymakers try to create mechanisms and allocate specific financial funds that promote the development of technology and innovation. The expectation is that through the diffusion of innovative ideas and technology, innovative entrepreneurs will positively influence other businesses and customers. In this section, we examine two examples of government policies: business incubators, as well as budget funds allocated for RandD financing.
### Table 2. Microeconomic policies.

<table>
<thead>
<tr>
<th></th>
<th>KOS</th>
<th>MKD</th>
<th>SLO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entrepreneurship culture</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entrepreneurship education at basic school (1-5)*1</td>
<td>1.8</td>
<td>2.06</td>
<td>2.07</td>
</tr>
<tr>
<td>Entrepreneurship education at post secondary levels (1 - 5)*1</td>
<td>2.87</td>
<td>2.51</td>
<td>2.66</td>
</tr>
<tr>
<td>VET (% of total secondary education enrolment)</td>
<td>53</td>
<td>60.2</td>
<td>70.8</td>
</tr>
<tr>
<td>Tertiary education (aged 30-34) (%) *2</td>
<td>20.8</td>
<td>35.7</td>
<td>44.9</td>
</tr>
<tr>
<td>Knowledge Economy Index (total score out of 10)*3</td>
<td>3.22</td>
<td>4.5</td>
<td>6.65</td>
</tr>
<tr>
<td>Staff training 1 - 7 (best)*4</td>
<td>2.7</td>
<td>3.2</td>
<td>4.5</td>
</tr>
<tr>
<td>Finance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan-guarantee schemes</td>
<td>Kosovo Credit Guarantee Fund</td>
<td>Development Bank of North Macedonia</td>
<td>Slovene Enterprise Fund (SEF)</td>
</tr>
<tr>
<td>Business grants</td>
<td>The millennium Foundation Kosovo</td>
<td>SEF, Employment Service of Slovenia, SPIRIT Slovenia</td>
<td></td>
</tr>
<tr>
<td>Equity financing from business angles</td>
<td>Gjirafa Lab</td>
<td>ENIF - Supported Enterprise Innovation Fund</td>
<td></td>
</tr>
<tr>
<td>Technology and Innovation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business incubators</td>
<td>Innovation Center Kosovo (ICK), Gjirafa Lab, The Jakova Innovation Center, Innovation and Training Park (ITP)</td>
<td>YES Foundation, TechPark which operates within the South East European University, CED Hub in Skopje, Center for Technology Transfer and Innovation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>ABC Accelerator (200 start-ups in 6 years), Reveris, Kovačnica - business incubator Kranj Hekovnik Startup School, Incubator Sežana, Ljubljana University Incubator, SAŠA Incubator</td>
<td></td>
</tr>
<tr>
<td>Share of budget in R&amp;D</td>
<td>0.1</td>
<td>0.36</td>
<td>1.86</td>
</tr>
<tr>
<td>Entrepreneurship awareness and networking</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agencies</td>
<td>Enterprise Support Agency (KIESA)</td>
<td>Agency for the Promotion of Entrepreneurship (APPRM)</td>
<td>Slovenian public agency for entrepreneurship, innovation, development, investment and tourism (SPIRIT)</td>
</tr>
</tbody>
</table>

**Sources:** Entrepreneurship culture sources: *1 Source: GEM for Kosovo (2014), World Bank for N. Macedonia & EU countries. *2 Source: for Kosovo European training foundation, for other countries Eurostat. *3 Source: EBRD Knowledge Economy Index. *4 Source: for Kosovo European training foundation, for other countries WEF.

**Source for finance data:** National Banks and World Bank. **Source for technology and innovation:** Government agencies for transition economies, and Eurostat for EU countries. **Source for Entrepreneurship awareness and networking:** Government agencies.

The purpose of business incubators is to provide various conditions and services for start-ups and small firms, such as accommodation in shared offices, shared support services, professional business support and advice, network provision, etc. (Messeghem et al., 2013). Incubators offering similar services have also developed in transition countries. However, the number and specifically the scope and scale of their activities, compared to developed countries, is significantly smaller (OECD, 2017). Another shortcoming of incubators in these countries is the lack of mechanisms that monitor and measure their practical impact, such as the number of start-up businesses supported or the
evaluation of their innovative products or services. Investment in RandD encourages the
development of new products and new business opportunities. Our findings suggest that the amount
of funding allocated to RandD in transition countries is significantly lower compared to developed
economies - see Table 2.

**Entrepreneurship awareness and networking.** Both transition countries are in the initial stage of
creating policies and institutions that promote entrepreneurial culture, as well as policies and other
institutional mechanisms in providing business advice to young entrepreneurs. Although North
Macedonia seems more advanced in this regard, Kosovo lacks clear policies aimed at promoting
entrepreneurship. Agencies involved in promoting entrepreneurship are predominantly financed by
donations (USAID, EU, GIZ, etc.), and less by public funds (OECD, 2017).

5.3 Entrepreneurship performance

The previous section has shown that macroeconomic policies (e.g., interest rates, national income,
etc.) as well as microeconomic policies (entrepreneurial culture, access to finance, etc.), significantly
affect entrepreneurial activities. This influence is manifested in specific indicators of
entrepreneurship. For example, the stock of incumbent firms in transition countries is considerably
lower compared to Slovenia - see Table 1. Moreover, for 5 years (2017 - 2021) this stock has not
evolved at all. On the contrary, the number of existing firms in Slovenia has increased by 4 thousand
firms. Another specific entrepreneurship feature of transition economies is the firm population
structure. The proportion of firms with fewer than five employees is significantly higher in transition
economies - see Table 2. This also applies to employment rates, with many small firms accounting
for a higher proportion of employment. Also, the data suggest that the structure of firms entering the
market for the first time in transition economies is clearly dominated by micro-firms.

These figures are not surprising given that - as argued by many authors - small firms are
more prone to external uncertainties (Geroski, 1995; Rajan & Zingales, 2003; Bartelsman et al.,
2013). Firms operating in transition economies face significant political and economic uncertainty,
and especially unfair competition (EBRD, 2018). It is evident that the quality, continuity, and
orientation of the political regimes of transition economies affect the investment climate for many
businesses. With regard to business regulations, evidence indicates that these economies have made
important progress. However, based on the entrepreneurship indicators, it can be inferred that their
impact is overestimated, just as it can be said about the impact of taxes. In both these areas, the
economies in transition are not far behind the Slovenian economy - see Table 1 and Figure 3. Data on
micropolicies aimed at improving the business culture among younger generations show that
countries in transition have made some progress. However, despite the large number of educational
programs and their inclusion in the formal education system, there is little convincing evidence
showing their effectiveness in improving the level of entrepreneurship. Access to finance, whether
through loans or equity, has also improved. Yet, the data shows that access to external finance
remains one of the main challenges of startups and small firms operating in these economies.
Lack of qualified human capital can also be one of the reasons for the low entry rate of large firms. According to OECD (2017) reports, entrepreneurs in Kosovo and Northern Macedonia see the lack of a skilled workforce as one of the biggest obstacles to business growth. It is worth noting that most business firms in both transition countries are family-owned firms and are managed by family members, characterized by limited managerial and organizational skills (Bloom & Van Reenen 2011; Riinvest 2015; Sahiti 2019). One of the reasons why these firms continue to be run by family members is related to the lack of trust and the rule of law, which makes owners reluctant to delegate management tasks or hire more capable and experienced managers (Akcigit et al., 2021). Finally, when the challenges and problems related to physical infrastructure are added to the mosaic of constraints described above, then it can be more clearly understood why entrepreneurs in transition countries tend to enter the market as small, or why the evolution of incumbent firms is almost non-existent, and particularly why micro-firms dominate the economy.

<table>
<thead>
<tr>
<th>Size-class breakdown and number of employed individuals.</th>
<th>SVN</th>
<th>MKD</th>
<th>KOS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active firms: proportion of each size-class in total (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-4 employees</td>
<td>77.0</td>
<td>90</td>
<td>93.9</td>
</tr>
<tr>
<td>5-9 employees</td>
<td>11.8</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>10+ employees</td>
<td>11.2</td>
<td>10</td>
<td>1.1</td>
</tr>
<tr>
<td>Persons employed: proportion of each size-class in total (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-4 employees</td>
<td>16.9</td>
<td>31.6</td>
<td>75.3</td>
</tr>
<tr>
<td>5-9 employees</td>
<td>9.1</td>
<td>10.89</td>
<td>10.89</td>
</tr>
<tr>
<td>10+ employees</td>
<td>74.0</td>
<td>68.4</td>
<td>13.81</td>
</tr>
<tr>
<td>Firm entry: proportion of each size-class in total (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-4 employees</td>
<td>93.0</td>
<td></td>
<td>96.4</td>
</tr>
<tr>
<td>5-9 employees</td>
<td>5.2</td>
<td></td>
<td>3.0</td>
</tr>
<tr>
<td>10+ employees</td>
<td>1.8</td>
<td></td>
<td>0.6</td>
</tr>
<tr>
<td>Firm exit: proportion of each size-class in total (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-4 employees</td>
<td>94.8</td>
<td></td>
<td>97.5</td>
</tr>
<tr>
<td>5-9 employees</td>
<td>3.5</td>
<td></td>
<td>2.3</td>
</tr>
<tr>
<td>10+ employees</td>
<td>1.7</td>
<td></td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: KSA for Kosovo, SSO for N. Macedonia and Eurostat for Slovenia

5.4 Survival patterns: cross-country comparison

In this section, we provide an overview of survival rates for firms entering the market for the first time and their probability of survival over a 5-year period, i.e., for the period 2014 - 2019. A firm born in year \( t \) is considered that managed to survive until \( t + 1 \) only if it is active. Activity is measured through turnover and employment indicators in each part of the year \( t + 1 \).

The results in Figure 4 show that the survival rates of firms in economies in transition for a three-year period are very similar to the survival rates of the reference country. However, if firms manage to survive or are active in the market for five years, the prospects of survival in transition economies improve significantly. This is especially true for the companies operating in the Kosovo...
market, where about 53% manage to survive the market pressure, this percentage is significantly higher than that of Slovenia, with about 46%. These findings show that market forces in transition countries are much weaker. These findings also suggest that the purpose of business operations for several firms in transition countries is survival, and not necessarily profit seeking (de Soto, 2000; Naudé et al., 2014).

Overall, this finding confirms one of the stylized facts proposed by Bartelsman et al. (2013), that firms in transition economies, tend to experience better survival rates, which confirms the hypothesis that new entrants enjoy a period of relatively low market pressure - especially in new, sparsely populated markets.

![Figure 4. Firm survival, age 1-5. Source: Eurostat and statistical agencies for Kosovo and N. Macedonia.](image)

5.5 The determinants of new entrant firm survival in Kosovo

This section explores what determines the post-entry performance of firms in Kosovo firms. We examine patterns of survival and explore the impact of explanatory variables in a non-parametric analysis. In this section are estimated Kaplan-Meier survival functions and tested for significant differences among survival functions across groups of firms, according to the different values for firm size, legal status and ownership, industry, and region. We conduct log-rank tests with no assumption of a particular survival time distribution. The weights are equal to 1 at all points in time; the focus is on large time values (Hosmer & Lemeshow, 2000). Landau and Everitt (2004) argue that this method (Kaplan-Meier) is the most common non-parametric one used to estimate the survival function. The Kaplan-Meier estimator of the survival function (or survival probability) $S(t) = \Pr(T \geq t)$ is:

$$\hat{S}(t) = \prod_{j \leq \frac{T}{t}} \frac{n_j - d_j}{n_j}$$  \[1\]

where $n_j$ indicated the number of firms ‘at risk’ immediately before the $j$-th exit time (for every exit, business entities are censored at or after that time) and $d_j$ is the number of firm failures. Overall, observed failure age is less than or equal to $t$.

Table 4 provides descriptive statistics, as well as the results of non-parametric survival
Unleashing entrepreneurial potential in transition economies

analysis. The whole analysis is based on 73,206 new-born firms during the period 2010-2019. In this total, 12,354 firms had exited the market by the end of the period. Column 4 shows that most new-born firms are very small (97.5% have 1-5 employees), of the individual owner type (84.5%), in the services sector (80.9%) and located mainly in the capital of the transition countries (56.4%).

<table>
<thead>
<tr>
<th>Spell Length (years)</th>
<th>Kaplan-Meier survival rate</th>
<th>Spells</th>
<th>Failure</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean*</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Firm's age</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1 - 4)</td>
<td>5.2</td>
<td>25.6</td>
<td>0.954</td>
</tr>
<tr>
<td>(5 - 9)</td>
<td>5.1</td>
<td>25.9</td>
<td>0.939</td>
</tr>
<tr>
<td>(+ 10)</td>
<td>5.5</td>
<td>44.8</td>
<td>0.988</td>
</tr>
<tr>
<td>Ownership</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sole proprietor</td>
<td>5.3</td>
<td>24.1</td>
<td>0.944</td>
</tr>
<tr>
<td>Ltd</td>
<td>5.7</td>
<td>88.1</td>
<td>0.989</td>
</tr>
<tr>
<td>General partnership</td>
<td>5.1</td>
<td>20.09</td>
<td>0.930</td>
</tr>
<tr>
<td>Foreign company</td>
<td>5.5</td>
<td>46</td>
<td>0.986</td>
</tr>
<tr>
<td>Sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>5.6</td>
<td>32.1</td>
<td>0.974</td>
</tr>
<tr>
<td>Service</td>
<td>5.4</td>
<td>26.1</td>
<td>0.959</td>
</tr>
<tr>
<td>Construction</td>
<td>5.5</td>
<td>39.2</td>
<td>0.988</td>
</tr>
<tr>
<td>Region</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital</td>
<td>5.5</td>
<td>32.1</td>
<td>0.964</td>
</tr>
<tr>
<td>Dummy 1</td>
<td>5.2</td>
<td>23.1</td>
<td>0.949</td>
</tr>
<tr>
<td>Dummy 2</td>
<td>5.4</td>
<td>34.9</td>
<td>0.968</td>
</tr>
<tr>
<td>Dummy 3</td>
<td>5.2</td>
<td>16.9</td>
<td>0.946</td>
</tr>
<tr>
<td>Dummy 4</td>
<td>5.4</td>
<td>25.1</td>
<td>0.952</td>
</tr>
<tr>
<td>Total</td>
<td>5.4</td>
<td>27.4</td>
<td>0.963</td>
</tr>
</tbody>
</table>

Notes: *If the longest follow-up time is censored, extended mean computes the mean survival by exponentially extending the survival curve to zero, and restricted mean computes the means survival time restricted to the longest follow-up time. If the longest follow-up time is a failure, the restricted mean survival time and the extended mean survival time are equal. **Log rank test for the equality of the survival functions for each explanatory variable.

Source: KBRA, KSA and SSO.

At first glance, it seems that the survival rate of new-born companies in transition economies is relatively high. This may be due to an effect of the market selection process or high sunk entry costs, which become high barriers to exit if re-entry is possible. On the other hand, it may also be due to the high unemployment rate that pushes people towards entrepreneurship and motivates them to fight for survival after entering the market. Reynolds et al. (2005) suggest that a lack of job
opportunities can make creating and maintaining a firm, important for personal survival. Therefore, regardless of revenue levels, the entrepreneur’s personal circumstances might be one of the main reasons for the firm continuing in the market.

6. Conclusions

The purpose of this paper was to examine government macroeconomic and microeconomic policies and assess the impact they have on entrepreneurial activities in two transition economies. Findings from these economies are compared with the Slovenian economy. The assessment was conducted through three main indicators of entrepreneurship, namely market entry rates, the stock of incumbent firms, and the firm’s survival prospects.

The results presented in this paper show that economies in late transition have managed to draft a large number of policies at the macro and micro level, which promote entrepreneurial activities. The findings suggest that factors related to political and economic stability and especially the quality of institutional and governance factors have a strong influence on the level of entrepreneurial activity. This is not surprising given that entrepreneurs are more sensitive to external environmental uncertainties. Although not directly, our findings suggest that the quality, consistency, and direction of a country’s macro policies influence entrepreneurs’ business investment decisions. Faced with these difficulties, the level of entrepreneurial activity in transition economies is significantly lower compared to reference countries. Significant progress has also been made in the drafting of micro policies aimed especially at increasing the level of entrepreneurship. However, entrepreneurship in transition countries faces challenges and problems related to the greater inclusion of entrepreneurship in educational programs of all three levels, the improvement of policies related to the easier access of small firms to financial funds, and the creation of policies aiming to enhance the development of technology and innovation, among others.

The paper shows that some indicators of entrepreneurship in transition countries are similar to those of the reference economy. However, there are differences in at least two important indicators. First, the evolution of incumbent firms in transition countries is relatively stagnant, which means that the number of incumbent firms evolves significantly slowly. Second, the data suggest that the population of firms in transition countries consists of very small firms, which remain small and relatively inefficient throughout their lifetime. Most new entrants are small, and most do not grow above four employees. Even in Slovenia, most start-ups are small, but once they enter the market, they either exit or grow. Interestingly, we found that the contribution of small firms to employment in transition countries is significantly higher compared to the reference country.

In conclusion, countries in transition have managed to design entrepreneurship policies that are largely in line with those of developed countries. However, their impact on increasing the level of entrepreneurship for many reasons does not seem to be very pronounced. One possible reason may be that the design of these policies is based on a "me too" approach rather than any rigorous analysis of how these policies fit a specific business environment. This shows that entrepreneurship policies, no matter how good they are on paper, if they are not adapted to the specifics of an economy, are not enough to promote higher levels of entrepreneurship. Other macroeconomic factors, such as
Unleashing entrepreneurial potential in transition economies

the political and economic stability of a country, and especially the political regime, have a strong influence on regulating the investment climate for many entrepreneurs. Therefore, entrepreneurial activities are not exclusively matters of macro or micro policies but are based on the interaction they have between them.

Finally, public policymakers can put entrepreneurs at the centre of their interest, but this may not be enough, as the entrepreneurial community is heterogeneous and has different interests. Our humble recommendation is that policymakers, in this case those in transition countries, when designing entrepreneurship policies, should try to address the specific and real problems of entrepreneurs. The best approach is to create common forums where different business issues and perspectives can be discussed and incorporated. This approach would enable more integrated entrepreneurial policy choices.

References


