

The impact of the public sector on the quality of the business environment in the SME segment

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Abstract: *Small and medium-sized enterprises (SMEs) are an essential part of every country's economic system. The quality of the business environment plays an important role in this regard. The aim of the paper was to define and quantify important public sector factors influencing the quality of the business environment in the SME segment and to compare the intensity of the defined factors between the Czech Republic (CR) and the Slovak Republic (SR). In regards to the defined aim, a survey-based research was conducted with enterprises operating in the SME segment. 312 enterprises in CR and 329 enterprises in SR were approached during this research. The scientific hypotheses were verified using the methods of Pearson statistics. The evaluation of political factors is quite negative in both countries. Only 15% of Czech and 20% of Slovak entrepreneurs positively evaluated the level of legislation in business. Both Czech and Slovak entrepreneurs see state's support of export quite positively. Only 12% of Czech and 22% of Slovak entrepreneurs positively evaluated the administrative burden on enterprises. Entrepreneurs in both countries claim that the state is unable to provide qualified workforce for businesses. Most significant differences between the two countries were found in the evaluation of state bureaucracy which the Slovak entrepreneurs evaluated more positively than their Czech counterparts. The results of the research show the need to deal with urgent issues, or create a better system of public factors influencing the business environment.*

Keywords: public sector, business environment, small and medium-sized enterprises, quality of business environment

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Introduction

Entrepreneurship is a significant part of the economic system of every country, having important effects on the growth of the entire society. Therefore, many authors put emphasis on the role of small and medium-sized enterprises (SMEs) in the effective functioning of an economic system (Dobeš et al., 2017; Kozubíková et al., 2017; Virglerova et al., 2017; Czarniewski, 2016; Dubravská et al., 2015).

This paper examines significant political factors of the quality of the business environment and quantifies their significance in the Czech Republic and Slovakia. The originality of this research lies in the definition and quantification of the public sector factors shaping the quality of the business environment in the SME sector, as well as the comparison of business conditions in both countries based on entrepreneurs' views.

The structure of the paper is the following: The theoretical part presents the research results on public sector's influence on the quality of the business environment. The second part defines the aim of the research, the methodology, and the descriptions of the data used. The third part presents the results of the research and the discussion about the issue. The conclusion offers a final summary of the research.

1. Theoretical part

Public sector's influence on the quality of the business environment can be seen through political factors (legal environment, state regulation and support of entrepreneurship, state bureaucracy, and quality of education).

Countries' political environments shape the behavior of entrepreneurs. High quality *legal environment* characterized by stability of the legal system and good enforceability of the law motivates people to conduct business. Many authors are interested in this topic.

Autio and Fu (2015) studied this relationship, using panel data consisting of 67 countries across the world. Their analysis showed that the quality of political institutions fosters firms' entry into formal entrepreneurship and discourages firms' entry into informal entrepreneurship. Moreover, this study examined the moderation effect of political institutions on the relation between economic institutions and the population prevalence of entry into entrepreneurship. They found evidence that the effect of this moderation is positive on formal entrepreneurship and negative (but insignificant) on informal one. According Lim et al. (2010), business start-up is driven by entrepreneurial cognitions consisting of venture arrangements, venture willingness, and venture ability, while entrepreneurial cognition is predicted by institutional environment including legal, financial, education, and trust systems. Among the institutional factors that constitute a business system, the legal environment was found to influence venture arrangements and willingness.

The impact of government policies on firms' entrepreneurial orientation is an issue that scholars have explored. In general, the domestic political condition and the activity of the government is seen as a factor which affect business environment (Grosanu and Bota-Avram, 2015; Kadocsa and Francsovcics, 2011). Dai and Si (2018) examined this relationship and concluded by supporting it. So, the perceived effectiveness of new policies positively influences firms' entrepreneurial orientation. Moreover, according to Economidou et al. (2018), formal institution index positively impacts venture capital activity. In this research, the formal institution index is a composite variable which is generated by factorization from several indicators including governmental effectiveness, rule of law, political stability, voice and accountability, regulatory quality, and control of corruption. Thereby, business environment is associated with the level of the formal institutions in a country.

In European countries, policy formation regarding SMEs administrative burden and the way of fostering start-up and entrepreneurial activities are gaining attention. Literature in this field suggests that improvement in the quality of the legal environment leads to improvement in the efficiency of the economy (Aristovnik and Obadic, 2015). Marinescu (2013) found that the low economic performance among the European countries is due to the "excessive" production of European legislation. Thus, the legal and regulatory framework and public administration are important for both entrepreneurship and SME growth.

Government regulation is perceived by entrepreneurs as a major obstacle to entry in the market (Lutz et al., 2010). The influences of regulation on business start-up and entrepreneurial activities are not always direct, predictable or constraining (Mallett et al., 2018). Sambharya and Musteen (2014) studied the relationship between institutional environment and entrepreneurship across counties. Contrary to expectations, this research concluded that regulatory quality was negatively associated with entrepreneurship. Further, according to Valdez and Richardson's (2013) study, regulative institutional support for entrepreneurship is positively associated with the level of opportunity-motivated entrepreneurial activity and negatively related to the level of necessary entrepreneurial activity at the national level. So, concerning the regulatory effect, a distinction between necessity- and opportunity-motivated entrepreneurship should be made. Levie and Autio's (2011) research shed light on the relationship of regulatory burden and entrepreneurial activity. They concluded that the lighter the regulatory burden, the higher the relative prevalence of non- and strategic entrepreneurial entry. This is considered a good evidence to be noticed by policymakers who design policies aimed at fostering entrepreneurship.

It is of a particular interest for policymakers to find a way to foster entrepreneurial activity by taking into account variations on the education, regulation, and financial systems. However, Economidou et al. (2018) argue that more fundamental reforms are required to improve the business system. Peck et al. (2018) studied the ways in which growth-oriented SMEs are affected by regulations based on case studies from North-West England. Their analysis found that regulatory burden shapes entrepreneurs' behavior. Nevertheless, growth-oriented firms are aware of the advantages in seeking regulatory knowledge.

Bosma et al. (2018) found positive association between entrepreneurship and regulation of credit, labor, and business. However, they did not find enough evidence to support the statistical significance of this relationship. Kljucnikov et al. (2016) found that only a part of the entrepreneurs positively evaluated the applicable forms of state financial support. There is some ambiguity in empirical studies on the linkage between public support and firm growth (Ipinnaiye et al., 2017). However, a more recent study conducted by Chowdhury et al. (2018) found empirical evidence that government programs aimed at stimulating entrepreneurship have a positive impact on the quality and quantity of entrepreneurship. Based on the above discussion and evidence, it is clear that government regulation and its support toward entrepreneurship influence the quality of business environment.

Viturka et al. (2013) and Nicolescu and Nicolescu (2013) suggest to use public administration as a factor to assess the quality of the business environment. The influence of the quality of governance on entrepreneurship was shown by Thai and Turkina (2014). Aristovnik and Obadić (2015) investigated the impact and efficiency of bureaucracy (public administration) on fostering SMEs in EU countries by employing data envelopment analysis. According to them, the main goal for the large majority of EU member states remains a further reduction of bureaucracy that could be useful for improving the regulatory environment of SMEs. There is an ambiguity in empirical studies on the link between public support and firm growth (Ipinnaiye et al., 2017). However, a more recent study conducted by Chowdhury et al. (2018) found empirical evidence that government programs aimed at stimulating entrepreneurship have a positive impact on the quality of entrepreneurship.

The impact of government on the rate of entrepreneurship is not only through legislation, but also through the *educational system* (Verheul et al., 2002). The government can impact the quality of education through spending and exposure to quality assessments. Educational system is important for stimulating entrepreneurship for several reasons. First, education can give individuals a sense of autonomy, independence, and self-confidence. These elements play crucial roles when individuals want to engage in a business start-up process. Next, education makes people aware of alternative career choices. In addition, education increases the possibilities of individuals, thereby making people better prepared to perceive opportunities; and finally, educated individuals have knowledge that can be used to develop their new entrepreneurial opportunities. Education could be an important factor that might improve the quality of the business environment. Education system influences the entrepreneurial cognition (venture ability component), which in turn affects business start-up (Lim et al., 2010). Tertiary education positively effects the perceived opportunity and knowledge-intensive business sector activity (Dilli & Westerhuis, 2018). Viturka et al. (2013) support its importance in this relationship and included it as a factor to account for a new index. Also, Mubarik et al. (2017) suggest an index, involving education as a core dimension, and acknowledge its importance. Universities could play a key role in the development of a new business culture by increasing the quality of entrepreneurial training (Grigore & Dragan, 2015). In a different point of view, Rostam-Afschar (2014)

studied the relationship between entry and entrepreneurship and concluded that the exclusion of the educational entry requirement has encouraged self-employment. More recently, Dai and Si (2018) found evidence that education positively influences entrepreneurial orientation. Considering the above discussion, it can be assumed that the quality of education leads to the quality of business environment.

2. Aim, methodology and data

The aim of the paper was to define and quantify significant political factors that shape the quality of the business environment in the SME segment. A part of this aim was a comparison of defined factors in the Czech and the Slovak Republic. In regards to the defined aim, a survey-based research was conducted with enterprises operating in the SME segment. 312 enterprises in CR and 329 enterprises in SR were approached during this research. Data collection took place in 2018. The method of random choice using the “Randbetween“ mathematical function was used to select enterprises from the “Albertina“ database comprising enterprises in the Czech Republic. Slovak enterprises were randomly selected from the “Cribis” database containing the list of enterprises, organizations, and entrepreneurs. The enterprises were approached via email asking them to fill out the online questionnaire. The questionnaire was intended for business owners or top management (hereinafter entrepreneurs).

The response rate in the Czech Republic was approximately 4 % (out of over 7800 enterprises). The number of approached enterprises in the Slovak Republic was more than 9400, and the response rate was approximately 3.5 %. The structure of respondents within the Czech Republic (312 enterprises) was the following: Business area: services 109 enterprises, retail 73 enterprises, manufacturing 53 enterprises, construction 29 enterprises, agriculture 9 enterprises, transportation 19 enterprises, other business area 23 enterprises. Time period of operating a business: 56 enterprises 1 – 5 years, 48 enterprises 5 – 10 years, 208 enterprises more than 10 years. Size of business: 258 micro-enterprises (up to 10 employees), 43 small enterprises (up to 50 employees), and 11 medium-sized enterprises (up to 250 employees). Highest attained education level of the entrepreneur: 50 high school without diploma, 135 high school with diploma, and 127 college education. Gender of entrepreneurs: 236 men, 76 women.

The structure of respondents within the Slovak Republic (329 enterprises) was the following: Business area: services 122 enterprises, retail 69 enterprises, manufacturing 51 enterprises, construction 39 enterprises, agriculture 20 enterprises, transportation 11 enterprises, other business area 17 enterprises. Time period of operating a business: 104 enterprises 1 – 5 years, 78 enterprises 5 – 10 years, and 147 enterprises more than 10 years. Size of business: 234 micro-enterprises (up to 10 employees), 71 small enterprises (up to 50 employees), and 24 medium-sized enterprises (up to 250 employees). Highest attained education level of the entrepreneur: 10 high school without diploma, 95 high school with diploma, and 224 college education. Gender of entrepreneurs: 251 men, 78 women. In accordance with the approach by Conorto et al. (2014), individual constructs were defined using the following statements:

Political factors: (PF)

PF1: Legal environment

PF11: I positively rate the level of legislation in business.

PF12: The judicial system in the area of business law works well.

PF13: The enforceability of law in my country is good.

PF14: The legal environment in my country is stable.

PF2: State regulation and support of entrepreneurship

PF21: The state's tax and levy policy supports entrepreneurship.

PF22: The state politics supports the export of our products and services.

PF23: The state supports entrepreneurship financially.

PF24: The state has a positive impact on the quality of business environment.

PF3: State bureaucracy

PF31: The administrative burden on businesses is adequate.

PF32: The administrative burden on entrepreneurs has decreased in the past five years.

PF33: The state bureaucracy does not negatively influence the business environment.

PF34: The state bureaucracy does not influence entrepreneurship.

PF4: Quality of education

PF41: I view university education as that of a high quality.

PF42: I view high school education as that of a high quality.

PF43: The state is able to provide a qualified workforce for businesses.

PF44: Graduates have high quality knowledge and skills.

In developing this paper, four scientific hypotheses were established:

H1: There are statistically significant differences in the evaluation of the legal environment by Czech and Slovak enterprises.

H2: There are statistically significant differences in the evaluation of the state regulation and support of entrepreneurship by Czech and Slovak enterprises.

H3: There are statistically significant differences in the evaluation of state bureaucracy by Czech and Slovak enterprises.

H4: There are statistically significant differences in the evaluation of the quality of education by Czech and Slovak enterprises.

To evaluate the defined scientific hypotheses, the method of descriptive statistics (percentage, means) and the Z score method were used. Statistically significant differences between positive answers of the designated social groups were compared through Pearson statistics at the significance level of 5%. If the calculated p-value was lower than 5%, the null hypothesis was rejected, and the alternative hypothesis was adopted. The calculations were made through the free software available at <http://www.socscistatistics.com/tests/ztest/Default2.aspx>.

3. Results and discussion

The research results are listed in the tables below.

Table 1. Evaluation of PF1: Legal environment

| Factor | Number of positive answers CR/% out of the total number of 312 | Number of positive answers SR/% out of the total number of 329 | Z-score: p-value CR/SR |
|--------|--|--|------------------------|
| PF11 | 48/15.4 | 66/20.1 | 0.121 |
| PF12 | 34/ 10.9 | 62/18.8 | 0.005 |
| PF13 | 45/14.4 | 49/ 14.9 | 0.704 |
| PF14 | 57/ 18.3 | 79/ 24.0 | 0.075 |

(Source: Authors results, 2019)

15.4% of Czech entrepreneurs gave the level of business legislation a positive rating. In Slovakia, it was 20.1% of entrepreneurs.

The highest positive rating in Czech Republic was discovered in factor PF14 which is the stability of the legal environment, while the lowest was achieved in factor PF12: The judicial system in the area of business law works well.

In Slovakia, entrepreneurs gave the highest rating to the stability of the legal environment (24%), while the lowest satisfaction was achieved in the enforceability of the law (only 14.9% agreed with the statement on the enforceability of the law).

The average value of positive ratings in the Czech Republic was 14.75% and 19.45% in Slovakia.

The p-values (0.121; 0.704; 0.075) confirm that in the evaluation of 3 factors out of the total number of 4, there are no statistically significant differences in respondents' positive ratings in both countries. Statistically significant differences were discovered in the evaluation of the quality of the judicial system in the area of business law (Slovak entrepreneurs gave this factor a better rating).

H1 was not confirmed.

Table 2. Evaluation of PF2: State regulation and support of entrepreneurship

| Factor | Number of positive answers CR/% out of the total number of 312 | Number of positive answers SR/% out of the total number of 329 | Z-score: p-value CR/SR |
|--------|--|--|------------------------|
| PF21 | 24/ 7.7 | 30/ 9.1 | 0.516 |
| PF22 | 94/ 30.1 | 101/ 30.7 | 0.873 |
| PF23 | 35/11.2 | 51/15.5 | 0.112 |
| PF24 | 33/10.6 | 53/16.1 | 0.040 |

(Source: Authors results, 2019)

Entrepreneurs in both countries gave the most positive rating to state's support of export. The state's tax and levy policy received the worst rating.

The average value of positive ratings in the Czech Republic was 15% and 18% in Slovakia.

Statistically significant differences were discovered in the evaluation of factor PF24.

Slovak entrepreneurs rated state's influence on the quality of the business environment more positively.

H2 was not confirmed.

Table 3. Evaluation of PF3: State bureaucracy

| Factor | Number of positive answers CR/% out of the total number of 312 | Number of positive answers SR/% out of the total number of 329 | Z-score: p-value CR/SR |
|--------|--|--|------------------------|
| PF31 | 37/11.9 | 73/22.2 | <0.001 |
| PF32 | 18/5.8 | 54/16.4 | <0.001 |
| PF33 | 65/20.8 | 70/21.3 | <0.001 |
| PF34 | 15/4.8 | 38/11.6 | <0.001 |

(Source: Authors results, 2019)

Entrepreneurs in both countries rated PF33 (State bureaucracy does not negatively influence the business environment) most positively, while PF34 (State bureaucracy does not influence entrepreneurship) received the worst rating.

The average value of positive ratings in Czech Republic was 11% and 18% in Slovakia.

The p-values (<0.001) confirm that there are statistically significant differences in respondents' positive ratings in all defined factors. It can be said that Slovak entrepreneurs view the influence of state's bureaucracy on entrepreneurship more positively.

H3 was confirmed.

Table 4. Evaluation of PF4: Quality of education

| Factor | Number of positive answers CR/% out of the total number of 312 | Number of positive answers SR/% out of the total number of 329 | Z-score: p-value CR/SR |
|--------|--|--|------------------------|
| PF41 | 129/41.3 | 116/35.3 | 0.112 |
| PF42 | 101/32.4 | 97/29.5 | 0.429 |
| PF43 | 31/9.9 | 57/17.3 | 0.006 |
| PF44 | 76/24.4 | 76/23.1 | 0.712 |

(Source: Authors results, 2019)

It was interesting to discover that entrepreneurs in both countries view the quality of college education as quite positive (41.3% of entrepreneurs in Czech Republic and 35.3% in Slovakia). Only 9.9% of entrepreneurs in Czech Republic

and 17.3% in Slovakia agreed with the statement that the state is able to provide a qualified workforce for businesses.

The average value of positive ratings in Czech Republic was 27% and 26% in Slovakia.

There were statistically significant differences in entrepreneurs' positive answers in PF43.

H4 was not confirmed.

It was discovered in the research that the overall satisfaction rate with the influence of the public sector in shaping the business environment is relatively low, as on average, only 17% of the Czech and 20% of the Slovak entrepreneurs positively rated this area.

In this context, Kadocsa and Francsovcics (2011) bring interesting results that emphasize the importance of political factors in shaping the quality of the business environment. According to them, SMEs consider the domestic political situation (68.75%), the domestic economic environment (62.5%), and the activity of the government (62.5%) as key factors affecting their business activities. The political factor, followed by domestic markets and social changes were identified as the most important reason for uncertainty in corporate operations.

State bureaucracy proved as the biggest area of dissatisfaction in both countries. The quality of education, on the contrary, received the lowest dissatisfaction rate in both countries.

State bureaucracy presents a problem not only in the Czech Republic and Slovakia. Based on a research by Price Waterhouse Coopers (2018) conducted in 2447 private companies in 31 European countries, this problem is typical for the entire continent of Europe. It was interesting to discover during the research that despite the general notion of regulative and bureaucratic actions of the European Union suppressing entrepreneurs' initiatives and complicating their lives, the entrepreneurs did not share this opinion. 39% of the respondents in the research stated that the domestic bureaucracy represents a problem, compared to the 29% of those who see the main problem in the European bureaucracy. This result is apparently unfavorable for the European Union, as there has been a rise in the number of various protests and populist movements in many European countries.

One of the possible explanations of this effect is the existence of the "gold plating effect" (EU member countries exceed Brussel's requirements when implementing European guidelines into their national legislation). This problem is mentioned by e.g. Marinescu (2013). A typical example is the General data protection regulation (GDPR) that puts a bureaucratic burden on Czech and Slovak entrepreneurs. The GDPR started a "bureaucratic frenzy" in both countries. New enterprises were established that prepare documentation for other enterprises and institutions. People in companies, public institutions, and universities spend a large amount of time performing various activities (document preparation, trainings, etc.), while their contribution to the society is disputable (many experts suggest that

this regulation has its limitations). In Slovakia, it increases the administrative burden on entrepreneurs by 16 hours a year (Beracka, 2018).

The current status of bureaucracy in the Czech and the Slovak Republic is perceived as a serious problem and experts are urging governments to start acting resolutely. The bureaucratic index of the Institute of Economic and Social Studies indicates that a Slovak entrepreneur has to perform 64 bureaucratic tasks annually, requiring 222 hours, i.e. 28 workdays (data from 2017). The situation in the Czech Republic is even worse (233 hours per year), but far better than in Ukraine where an entrepreneur spends 469 hours a year doing bureaucratic work, which represents 59 workdays (Hrušovská, 2018). It is obvious that the current state of bureaucracy can present a serious threat in case the macroeconomic environment in Europe deteriorates. One of the negative effects of today's bureaucratic burden on entrepreneurs is restricted business development and decrease in young people's propensity for entrepreneurship (EURO, 2017). Duvanová (2012) also draws attention to the fact that heavy regulatory burden leads to more corruption.

It may be said that these findings are highly compatible with conclusions by Víturka et al. (2013), Nicolescu and Nicolescu (2013), and Thai and Turkina (2014). In this context, Aristovnik and Obadić (2015) also mention positive examples of this issue. According to the authors, the empirical results show that Luxembourg, Malta and, in particular, Sweden serve as a good benchmark for the efficient transformation of public administration excellence into the growth of SMEs' outputs.

One of the much discussed questions in the Czech and Slovak Republic's business environment is the quality of the education system in regards to enterprises' business needs. According to the results of this research, the quality of college education had the largest satisfaction rate, as 41% of the Czech and 35% of the Slovak entrepreneurs confirmed. The entrepreneurs claim that the state is unable to provide a qualified workforce for businesses (10% of the Czech and 17% of the Slovak entrepreneurs positively rated this factor).

Lack of qualified workforce is considered one of the major obstacles of entrepreneurship's development in Czech Republic (ParlamentníListy.cz, 2017) and Slovakia, therefore, experts urge the governments of both countries to simplify and accelerate the process of granting work permits to international workers. This approach is considered a short-term solution. Entrepreneurs in both countries expect governments to bring education reforms on all levels in order for graduates to be able to fulfil job market requirements.

Dallago (2011) views human resources as the most significant barriers of SMEs' development. Many authors (e.g. Bergh et al., 2011; Barreneche García, 2014; Sirbu et al., 2015; and Garcia-Perez-de-Lema et al., 2017) emphasize the importance of close cooperation between entrepreneurs and educational institutions. Castano et al. (2016) also highlights the need to increase public education spending.

The legal environment in both countries received a negative rating. The average value of positive ratings (PF11, PF12, PF13, and PF14) in Czech Republic

was 14.75% and 19.45% in Slovakia. It is apparent that building a better legal environment is an important task for the governments of both countries. It should be noted that this problem is significant in all of Europe. Yasar et al. (2011) offer interesting conclusions in this matter. They claim that there are positive associations between firm performance (productivity profits) and the perceived quality of the legal system. Better property right institutions are important for firms' performance and competitiveness. High quality institutions create an environment in which firms can organize their activities more efficiently and invest more confidently.

The evaluation of state regulation and support of entrepreneurship via factors PF21, PF22, PF23, and PF24 was quite negative which was apparent mainly in factor PF21, as only 8% of Czech and 9% of Slovak entrepreneurs agreed with the statement that the state's tax and levy policy supports entrepreneurship. The evaluation of other factors was also negative.

These findings are compatible with results of other studies, e.g. Levie and Autio (2011), Economidou et al. (2018), Bosma et al. (2018), and Chowdhury et al. (2018).

4. Conclusions

The aim of the paper was to define and quantify important political factors shaping the quality of the business environment in the SME segment and to compare the defined factors between the Czech and the Slovak Republic.

The evaluation of political factors is relatively negative in both countries. Only 15% of Czech and 20% of Slovak entrepreneurs positively evaluated the level of legislation in business. Entrepreneurs in both countries gave the state's support of export a quite positive rating. Only 12% of Czech and 22% of Slovak entrepreneurs positively evaluated the administrative burden on enterprises. Both Czech and Slovak entrepreneurs claim that the state is unable to provide a qualified workforce for businesses. The most significant differences between the two evaluated countries were found in the area of state bureaucracy. Slovak entrepreneurs evaluated the current situation more positively than their Czech counterparts. The research results indicate that there is need to deal with urgent issues, or create a better system of public factors influencing the business environment. The research has its limitations, but also brought interesting findings and a potential inspiration for further research on the quality of the business environment in the SME segment.

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