ANDRZEJ KONDRATOWICZ
& WOJCIECH MACIEJEWSKI

SMALL AND MEDIUM PRIVATE ENTERPRISES IN POLAND

ADAM SMITH RESEARCH CENTRE, WARSAW
&
INTERNATIONAL CENTER FOR ECONOMIC GROWTH, SAN FRANCISCO

WARSAW 1991

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and
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Small and Medium Private Enterprises in Poland

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BASED ON FINAL REPORT OF A RESEARCH PROJECT
PRIVATE ENTERPRISES IN POLAND:
THEIR DYNAMICS AND INSTITUTIONAL ENVIROMENT

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To our children: Ewa, Joasia, Jan, and Pawel
small (and medium) size entrepreneurs of Eastern Europe

The Adam Smith Research Centre (ASRC) is a private non-profit and non-partisan institution, whose statutory goals are strongly associated with the ideals of free market economy. Three fundamental principles are stressed:

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ASRC was established as a foundation in Warsaw in 1989. Its operation is based on direct involvement of a group of highly skilled professionals employed full time elsewhere in academia, business, and politics. The organization is using their professionalism to efficiently promote its statutory goals.

ASRC is especially active in the fields of research, education, and publishing.

The present book adds to a growing list of our publications. Selected other endeavors in this field are as follows.

- The ASRC Occasional Papers have been published since 1990.
- In 1993 we started issuing Bulletins on economic situation and trends in Polish economy (Koniunktura Gospodarcza Polski, in Polish): they are out every six months.
- Also in 1993 the Routledge of London published an ASRC-prepared book: The Macroeconomics of Transition - Developments in East Central Europe (J.Winiecki & A.Kondratowicz, eds.)
- Another important event was the publication (in co-production with PressPublica) of the ASRC-produced Polish translation of Milton Friedman's Capitalism and Freedom. The latter was the first in our new series of economic and political classics adopted for wide audience of Polish readers.

In all the activities ASRC remains unequivocally committed not only to its statutory goals, but also to high quality of work and objectivity. We spare no effort to maintain our hard-earned position of a leading free-market oriented think-tank in Poland.

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1. Introduction

The 1990s saw the beginning of sustained efforts aimed at systemic economic transformation in Eastern and Central Europe. One of the striking features of these economies was a near absence of small business. Even in Poland, known for its tradition of private sector activity, the latter did not come to much more than private farms and very small craft shops.[1]

Yet, during the first years of transition the private sector has displayed considerable dynamism. The process of privatizing the Polish economy has been assisted much more by indigenous growth of small and medium enterprises (SMEs) in the private sector than by privatization of the often gigantic state-owned enterprises (SOEs).

Despite this undeniable success, commentators both inside and outside of Poland pointed to a number of obstacles hampering growth of SMEs. Identifying these stumbling blocks, and providing recommendations as to appropriate steps and policies to be taken by the Government and the Legislature in order to

1 The former, given its size and structure, is considered a substantial burden on the process of transformation rather than an asset. The latter can hardly be viewed as a group of "Schumpeterian entrepreneurs" who survived the "communist night" in order to spread their wings in the dawn of market (capitalist) society. Unfortunately, craft shop operators often behave more as successful rent seekers than in any other capacity.

promote the growth of SMEs, quickly became one of the major challenges facing both practitioners and academics.

The idea of launching a larger, long-run research project taking up the above challenge was born simultaneously at the ICEG New York bureau and the ASRC in Warsaw at the beginning of 1992. As a result of several weeks of planning and discussion between the two institutions a detailed research framework was worked out.

In May 1992 ICEG contracted ASRC as a local coordinator of the project, also providing the major financial support for its execution. Additional contributions came from ASRC itself and the University of Warsaw, Department of Economics, where the research team completed most of the work.

The project lasted for over one year, stretching till September 1993. It was composed of the following building blocks, or modules: Description, Analysis, and Prescription.

Description is based on a questionnaire of over one hundred questions answered by a representative nationwide sample of one hundred owners/managers of private SMEs.[2] The questionnaire was designed in Warsaw by A. Kondratowicz and W. Maciejewski[3], and the field survey was carried out by the PBS Sopot [Sopot Social Surveys Lab]. The complete set of raw data was obtained in September 1992.

Analysis is based on the results of this survey. Apart from a standard analysis of the closed-ended questions, an effort has been made to study the open-ended questions as well. Answers to the latter questions have been recoded, aggregated, and analyzed.[4] In this task, we benefited from the assistance of Ms. E. Slusarczyk of OBOP [Central Polling Station of Polish TV).

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2 See Sections 3 and 4.

3 English translation of Questionnaire is enclosed - cf Appendix 1.

4 See Section 5.

In forming final prescriptions, we also carried out certain additional analyses which were not based on the survey results.

1. A comparative analysis of the results of previous studies on Polish private SMEs has been done. This analysis went beyond the originally planned scrutiny of the work done at GIME [Gdansk Institute for Market Economics], although their results turned out to be of utmost interest and importance. These results also largely overlapped with our own results. The comparative analysis was performed by Ms. M. Jozefowska and Ms. G. Pruban (members of the PPRG UW - Polish Policy Research Group at the University of Warsaw and then graduate students at the Department of Economics).[5] It has been prepared in two versions: a full-length (Polish) text and an abridged version containing the main findings. A selected list of third-party studies, statistical sources, and other references used in compiling this part of the report is enclosed in Section 6.
2. A comprehensive analysis concerning legal aspects of the operation of SMEs in Poland has also been carried out. This analysis consists of selection of mini-reports covering the most important rules pertaining to SME start-up and operation. It has been compiled by Ms. D. Niedzielska-Jakubczyk (legal press analyst, formerly journalist and editor of the biweekly Firma [The Enterprise], currently a legal analyst at the daily newspaper Rzeczpospolita. Main background papers and technical notes have been contributed by Ms. D. Niedzielska-Jakubczyk, Mr. T.Kacymirow, and Mr. J. Kulicki. The last two contributors are financial law specialists in Warsaw. Selected findings of this analysis are included in Section 7. Legal analysis reflects the state of affairs as of September 1993. Since then certain changes, es-

5 See Section 6.

pecially in the realm of financial law, have inevitably occurred.

Both the comparative and legal analyses were completed in August 1993.

Prescriptions, given in Section 8, are based on three major elements:

1. Analysis of Survey Results,
2. Study of Other Existing Surveys,
3. Legal Analysis.

The prescription given in this report has been and will continue to be the basis for what may be described as an advocacy action carried out by the ASRC. In accordance with the goals of the project, this action is aimed at fulfillment of the goal shared by ASRC and the major sponsor ICEG: namely, the promotion of real-life changes in the economic and legal environment in Poland.

Formally, the whole project was completed in September 1993 with a publication of Final Report. The Report has been circulating in a processed (mimeo) form, thus reaching a very limited audience. Now, we are able to present it in a more appropriate book form, hoping that it will reach a larger number of readers. The authors hope to receive some critical feedback. This is especially important, since ICEG, ASRC, and the University of Warsaw have just launched a new, much larger study of Polish SMEs. When designing it we have tried to incorporate comments and criticism received so far from reviewers and readers of the Final report. Still, there is ample room for further improvement.

As major researchers and authors of this book we are in many ways indebted, first of all, to all the three institutions active in implementing the project: ICEG, ASRC, and UW.

Special thanks go to Dr Nicholas Ardito-Barletta, ICEG General Director, for his long standing commitment and support,

as well as to Mr. George Truitt, ICEG Director of Central Europe Program, without whom the project would have never started and, perhaps, would have never been completed. His insight into East European affairs is extraordinary.
Mr. Andrzej Sadowski, Vice-President of ASRC, provided us with logistics - and personal stimulation - both necessary for having the work done.
The first author also acknowledges individual financial support of the NATO Research Fellowship (Project # 92/PL-20-186) used in preparation and analysis of the SMEs Questionnaire in its part concerning *currency convertibility and exchange rate regime.*
Last, but not least, we should mention three ladies whose work and presence - though only fractionally visible in the final product - contributed a great deal to the whole enterprise: Ms. Dobromila Niedzielska-Jakubczyk, who guided us through the meanders of Polish Law; Ms. Ewa Slusarczyk, who crunched the numbers; and Ms.Irena Kondratowicz, who was there when the Project needed her the most.
The original text has been written in Chi-Writer Scientific Editor (v.3.12). All editorial work has been done by the authors themselves, while English language has been corrected by a native speaker, who wishes to remain anonymous. All remaining errors are ours.

Andrzej Kondratowicz
&
Wojciech Maciejewski

2. A Rationale for Small Business

It is usually taken for granted that SMEs should assume an important place in a nation's economy. Yet, it is instructive to give a little thought to the theoretical underpinnings of this widespread belief. On the one hand, this will render our whole project more credible, providing any critically inclined reader with some arguments, instead of asking him or her simply to believe in the merits of SMEs. On the other hand, it serves also the more practical and immediate goal of providing the present researchers with a point of reference. This will be useful for analyzing the survey results, and developing recommendations for policy-makers and legislators.

Out of the sizable literature on the subject of SMEs, we have chosen the line of reasoning presented by Bart Nooteboom.[6] His approach seems especially useful here, since it uses arguments from different streams of economic thought,[7] thus making itself more applicable to the underdeveloped market economies in Eastern Europe, including Poland's.

6 The following short outline draws largely on his paper "Small Business, Institutions and Economic Systems," presented to the Second EACES Conference in Groningen, Holland, September 24–27, 1992, as well as discussion at the Conference.

7 Including institutional and evolutionary economics.

Nooteboom considers three main sources of prosperity:

1. Investment,
2. Specialization and Division of Labor,
3. Innovation.

All three sources of prosperity involve transactions. But the exchange of consumer and investment goods, of technology, finance, etc., is not costless. To the contrary, certain transaction costs exist.

(1) Investment requires a supply of finance, as well as the existence of legal and financial institutions allowing for the necessary limitation of personal liability, and risk diversification. This, in turn, creates transaction costs.

(2) Specialization and division of labor mean trade, and therefore generate transaction costs directly. (There are also indirect transactions costs associated with finance and insurance that is required for trade.)

(3) Innovation requires both sources of finance (Schumpeterian venture capital) and institutional measures which carry costs.[8] The diffusion and application of innovations add to those costs.

Overall, we see that prosperity is enhanced by investment, specialization, and innovation, but that each of these necessitates costly transactions. Thus, transactions costs inhibit prosperity. The same is true for all sorts of (passive and active) institutional impediments to transactions. This becomes especially important in the context of transforming the economies of East and Central Europe.

Drawing on the line of argument originated by Schumpeter[9] and extending to the most recent work of D.C. North,[10] Nooteboom expresses the view that certain institutions, in the larg-

8 These compensate for the fact that the social value of innovation exceeds the profit accruing to the private innovator.

ost sense, are required to keep these transactions costs within acceptable bounds.

To counterbalance Nooteboom's view we will add, however, that it does not require a strict follower of Havek's to see that institutions may also impose additional costs on market operators. Such additional costs impede investment, division of labor, and innovation, thus causing prosperity to stagnate or decline.

Thus, the fundamental questions are:

1. Do existing institutions promote prosperity by reducing transaction costs; or rather, do they increase transaction costs?
2. What changes are needed to develop institutions that permit lower transaction costs.[11]

These questions should be answered in the context of the SMEs. First, let us look at the issue of transaction costs in SMEs. Nooteboom analyzes how the firm's size may affect these costs. On the whole, they are higher for smaller firms. Of course, the relationship between firms' size and the magnitude of their costs depends on other characteristics of the firm, but the overall effect of size is "systematic and pervasive".

Having established that SMEs face characteristic difficulties with transaction costs, let us examine how they contribute to prosperity. A useful framework for this analysis comes from evolutionary economics. Socioeconomic evolution is seen to require three basic components:

9 J. Schumpeter, Capitalism, Socialism and Democracy, Harper. New York 1942.

10 D.C. North, Institutions, Institutional Change, and Economic Performance, CUP, Cambridge 1990 and D.C. North, Transaction Costs, Institutions, and Economic Performance, Occasional Paper No 30, International Center for Economic Growth, San Francisco 1992.

11 Institutional transformation seems to be one of the basic difficulties of economic transformation in Eastern and Central Europe.

1. Sources of Variety,
2. An Environment for Selection,
3. A Mechanism for Transmitting Characteristics through Time ("Across Generations").

Science, technology, and entrepreneurship provide sources of variety. Markets and other institutions offer an environment for selection. Intertemporal transmission mechanisms are education, institutionalization, and growth of firms. The value of SMEs touches all three of these elements.

(1) SMEs are a source of variety in innovation. The vision and perseverance of an independent (small) entrepreneur leads in most cases to failure, but on some occasions to tremendous success.
(2) The fragmented world of SMEs serves to maintain market competition.
(3) SMEs diffuse new (high) technologies and knowledge.

Given these merits of SMEs, let us look at how they can enhance the three sources of prosperity mentioned earlier. SMEs are least fit for carrying out the task of investment; but division of labor and the resulting effective specialization should be considered the domain of SMEs, this is the area in which they can best contribute. A similar observation applies to innovation, where the contribution of small business seems to be indispensable.

Yet, this invaluable contribution of SMEs to the enhancement of prosperity and to the evolution and transformation of the economic system is not automatic. As we have seen, SMEs face the obstacles described above, in particular a higher level of transaction costs.

Thus, since SMEs play a central role in enhancing prosperity, an effort should be made to lower their transactions costs. This may be done in several ways: by the SMEs themselves, either individually or collectively; and through public policy. In any

event, success in reducing transaction costs, and thus in allowing SMEs to survive and contribute to prosperity, depends on the existence and efficiency of both formal and informal institutions. Similarly, inappropriateness or even lack of such institutions would be a decisive factor in the failure of SMEs.

It must be added that the validity of this conclusion is independent of the particular political and ideological stance of Government. If Government is inclined to be more laissez-faire or liberal, then institutions are needed only to enhance[12] the individual and collective action of SMEs in order to lower their transaction costs and survive.

If the government is inclined to be more activist (in essence, Keynesian) in designing institutions, then it also becomes necessary to provide a framework for implementing Government's economic policies with respect to SMEs.

Let us give at least a cursory overview of different possible individual, collective, and Government actions aimed at lowering transaction costs of SMEs. We quote Nooteboom:

> "(1.) Individually [SMEs] can try to compensate for transactional weaknesses by mobilizing the typical strengths of small business identified in literature: market flexibility, motivation, entrepreneurial drive, unorthodox ventures, niche markets, being "lean and mean". They may have to find compensation, in particular, in the offer of a unique product or competence. (...)"
>
> "(2.) Collectively, small firms can try to achieve advantages by cooperation. These may lie in joint economies of scale, scope or knowledge in production or transaction costs. (...)"
>
> "(3.) Government, political parties or small firms collectively can try to reduce transaction costs or the costs of gov-

12 Or at least not to inhibit.

> ernance schemes by furthering norms that restrict opportunistic business conduct; by stabilizing market conditions to reduce exogenous uncertainty; by furthering technical standards or standardized procedures that reduce in particular the threshold costs of search, evaluation, contracting, monitoring and arbitration. They can also strive to maintain or improve norms or standards of ethical conduct more in general."[13]

In the context of economic transformation in Eastern and Central Europe, and with reference to the particular role of SMEs in this process, the two previously mentioned fundamental questions, namely:

1. Do existing institutions promote prosperity by reducing transaction costs; or to the contrary, do they tend to increase transaction costs? and
2. What institutional reforms are needed to lower transaction costs?

should be now re-read as having a particularly important meaning. It is hoped that answering these two questions could, and perhaps should, stimulate the efforts to devise and implement in Poland appropriate institutions and policies.

13 B. Nooteboom, Small Business, op.cit. pp. 11-12.

3. Survey Design and Sampling Procedure

3.1 The Questionnaire

The starting point and frame of reference for our questionnaire was the form used in the World Bank field study that was carried out in Poland during April and May 1991. The World Bank form contained about 150 questions.

For continuity, some questions from the World Bank study also appear in our questionnaire after proper modification. In addition, we consulted a number of outsiders in preparing our questionnaire.[14]

The survey was carried out by PBS Sopot[15]. As a result of discussions with PBS Sopot, four consecutive versions of the questionnaire were produced. The structure of the final version containing 102 questions is outlined below.

Outline of Questionnaire
on Polish Small and Medium Size Private Enterprises

Description	Questions
1. Basic Information	1–9,
2. The Entrepreneur	10–12
2.1 Profile	10–11
2.2 The Beginning of Activity	12
3. Profile of the Firm	13–83
3.1 Labor and Labor Cost	13–41
3.1.1 Labor Structure	13–30
3.1.2 Labor Cost	31–41

14 Particularly valuable were the contributions of Marjorie Lyles of Indiana University, and John Earle and Bob Flanagan of Stanford University.

15 Pracownia Badan Spolecznych (PBS Sopot) Social Surveys Lab], Tatrzanska St. 19, 81-814 Sopot.

3.2 Fixed Capital 42–51
3.2.1 Land and Structures 42–45
3.2.2 Plant and Equipment 46–51
3.3 Finance and Cost of Capital 52–57
3.4 Raw Materials, Semi-Products and Energy Consumption 58
3.5 Technology and Productive Capacity 59–70
3.5.1 Production 59–64
3.5.2 Changes in Production 65–70
3.6 Sales and Marketing 71–83
3.6.1 Profits 71–72
3.6.2 Sales an Market Structure 73–76
3.6.3 Export 77–80
3.6.4 Competition 81–83
4. Government Policy 84–96
4.1 Facts about Firm's Registration Process 84–85
4.2 Taxation 86–87
4.3 Domestic Currency Convertibility and Exchange Rate 88–96
5. Conclusions 97–102

3.2 Study Design and Sampling

3.2.1 Discussion of options

Selection of a representative sample of Polish small businesses poses a number of serious problems. This is especially pertinent for our small sample of only 100 firms.

As always, one should start by defining the population which is to be the subject of the study. Adoption of one or another definition depends on the ultimate goals to be accomplished by the study. Studies with different goals require different kinds of representative samples. One may, for example, be interested in

selecting a sample that represents the general population of Polish small private firms with regard to their size (one chosen variable). And indeed, this sort of representativeness could be a viable choice in a study such as ours. However, let us consider what would be the consequences of adopting this particular procedure. We would obtain a sample over-dominated by very small firms, since such is the structure of the general population. Thus, the sample would over-represent small, economically weak, mostly one-person firms or simply self-employed persons.

Thus, a sample that accurately represents the size distribution of small businesses in Poland, as measured by employment, would produce a highly skewed picture of the Polish small-and-medium-size enterprise (SME) sector as regards to, for example, their respective economic strength, as measured by output or sales.

It seems, therefore, that a more sensible solution would be to divide the general population of all private firms into categories, according to firm size as measured by employment. For example, we might classify firm sizes into the following five categories: less than 5 employees; 5 to 9 employees; 10 to 19 employees; 20 to 49 employees; and 50 to 100 employees. Firms from each size category would then be sampled in proportion to that category's share in the total output of Poland's private sector.

It has turned out that such a sample design cannot be accomplished in reality. Existing statistics on the Polish private sector are insufficient to permit implementation of the sampling technique described above. In addition, given the dynamics of the Polish private sector, existing statistics are to a large extent outdated at the moment of their publication. Missing statistical data could be collected in a separate survey, but the cost would be prohibitive.

In view of these considerations, we adopted a sampling plan based on random stratification (proportionate stratification).

3.2.2 Sampling Plan

First, we divided Poland into nine macro-regions based on, but not identical to, the nine classical macro-regions from economic geography. We strove to demarcate areas characterized by relative homogeneity in espect to a number of important socio-economic features. The same geographic division had already been used by PBS Sopot in several past surveys with satisfactory results.

Each macro-region consists of several administrative provinces voivodeships). There follows a list of macro-regions' constituent provinces (provinces are named according to their capitals).

1. Szczecin, Koszalin, Slupsk, Pila, Gorzow Wielkopolski.,
2. Poznan, Konin, Kalisz, Sieradz.
3. Zielona Gora, Leszno, Legnica, Wroclaw, Jelenia Gora, Walbrzych.
4. Opole, Czestochowa, Katowice.
5. Bielsko-Biala, Krakow, Nowy Sacz, Tarnow, Rzeszow, Krosno, Przemysl.
6. Ostroleka, Lomza, Białystok, Siedlce, Biala Podlaska, Lublin, Chelm, Tarnobrzeg, Zamosc.,
7. Kielce, Radom, Piotrkow Trybunalski, Lodz, Skierniewice, Warszawa.
8. Torun, Bydgoszcz, Wloclawek, Plock, Ciechanow.
9. Gdansk, Elblag, Olsztyn, Suwalki.

The number of firms in the sample representing each region is proportionate to the population of that region.

Next, each macro-region was further stratified according to community size as follows: (A) cities of 200 thousand or more inhabitants; (B) towns of 50 to 200 thousand inhabitants; (C) localities of less than 50 thousand inhabitants. Each of these

subcategories constituted a collection of primary sampling units for random inclusion in the sample. The number of firms drawn into the sample from each collection of primary sampling units depended on the share of people living in (A), (B), (C) in each particular macro-region.

Further selection of firms into the sample was based on the following rule. In the selected communities, firms were chosen according to their type of production and the number of the workers employed. To classify firms as to type of production, we followed the conventions of the Polish Statistical Yearbook (Central Statistical Office). Thus, we distinguished four types of firms: industrial, construction, retail trade, and service firms. The share of firms from each of those four categories in the total sample was determined by using CSO data on changes in the structure of the private sector by types of firms in 1991 and in first half of 1992 (see Table 1). By this technique, we obtained a sample comprising 24 industrial firms, 21 firms in construction, 35 firms in retail and wholesale trade, and 20 firms in other services.[16]

Table 1

Numbers of Firms in Private Sector
as per December 31, 1991, in thousand

Industry	349
Construction & Transport	234
Retail Trade (incl. Restaurants)	588
Other Services	249
Total	1420

16 For 'technical' reasons to be discussed later, the structure of the actual sample differs slightly from our initial design. One of the major reasons was unavailability of firms from certain types of production in some localities.

There is is no unique, absolutely correct measure of firm size. As we noted earlier, the method adopted here reflects the goals of our survey. One goal is to analyze small firms other than the very small, mostly traditional establishments of self-employed artisans; another goal is to analyze medium-size firms which do not yet employ hundreds of workers or require large capital outlays. Thus, the survey is designed to sample that part of private sector consisting of well-established firms which employ from several to several dozen workers, which are characterized by high flexibility and adaptability to ever-changing market conditions, and which play an important role in generating new employment opportunities.

Table 2

Structure of Actual Sample.

	size of firm *) by size —number of workers		
Type of Firm	1—10	11+	total
Industrial	4	20	24
Construction	7	14	21
Retail & whole-sale trade	20	15	35
Other services	13	7	20
Grand total	44	56	100

Note *): grouping intervals same as in the analysis in Section 5 of the present Report

3.2.3 Implementation

The survey was administered in September 1992. The initial survey data, as well as the first processed results, were delivered

to ASRC in two tranches in early and mid-October. The major problem we encountered in administering the survey was the rejection rate by prospective respondents. More precisely, we found it impossible to contact some of firms we had selected, mostly because a suspiciously large number of them did not actually exist, although they were legally registered. (A frequent explanation for this phenomenon is that these firms were created "in advance" to take advantage of temporary tax holidays available to new firms.) It also sometimes happened that firms with certain characteristics (meeting sample specifications) did not exist in some localities.[17]

Survey results were checked for completeness and basic correctness, generally with good results. However, it should be mentioned that due to the sampling difficulties noted in the preceding paragraph, some substitutions had to be made. In the end, 100 firms were included.

4. *Results of the Field Study*

Data collected from questionnaires were processed using SPSS/PC+ Statistical Package. All statistical procedures were performed at OBOP (Central Polling Station of Polish TV) and at the Department of Economics, University of Warsaw.

Analysis of the results which is presented in Section 5 below uses only a fraction of large amount of information obtained. Parties having legitimate interest in the subject may be given access to the original, not truncated set of raw data and to the final set of statistically processed data (see information on the inside cover of the book).

17 See the note to Table 1.

5. Analysis of the Results

In analyzing the results we preserve the order of questions as they appeared in the original questionnaire[18].

5.1 Basic Information ..... (Questions 1-9)

This part gives particulars about the firm. They are omitted here for obvious reasons.

5.2 The Entrepreneur ..... (Questions 10-12)
5.2.1 Profile ..... (Questions 10-11)
5.2.2 The Beginning of Activity ..... (Question 12)

From the questionnaires we find that, on average, firms in our sample are owned (managed) by men aged between 35 and 45 years old (more than 80%). About half of the respondents (44%) have university diplomas or the equivalent.

High school graduates (as well as persons with some high school education) are more likely to operate in retail and wholesale trade than in other sectors (for example, manufacturing, construction, and other services). Positive correlation between the level of education achieved by the owner/manager and the size of his/her firm was substantiated.

The questionnaire contained no explicit query about the previous job/occupation of the entrepreneur. However, judging from the results of other similar studies that have been carried out in Poland, one may hypothesize that in more than 50 percent of these enterprises the "new" private entrepreneurs had been formerly employed as (top) managers in state-owned enterprises (SOE s).[19] Also, the questionnaire did not explicitly

18 See Section 3 for the outline and Appendix 1 for full version of the questionnaire.

19 See our summary of other studies in Section 6, and particularly those by Grabowski and Kulawczuk (1992); Grabowski, Kulawczuk, Sak (1992); and Webster (1992).

ask for the reasons why the respondent started his or her own business. Nevertheless, some limited conclusions about those motives may be inferred from the answers to the open question P12, which asks the respondent to describe the firm's beginnings. In analyzing these answers we found the following reasons for starting an independent business.

The majority of respondents stated that their decision to start a new business resulted from the need to secure a decent standard of living for himself (or herself) and his (her) family. In many instances the situation of employment in SOE's was described as hopeless, for example, due to low pay, bad organization of work, and mismanagement. A group of respondents pointed out that they were forced to start their own businesses by the threat of becoming unemployed. In many other instances, respondents cited the need to test their abilities or to face a new challenge. These reasons for starting one's own business are consistent with results obtained in most other surveys.

Despite a relatively high level of formal education the managers of the enterprises declared that they would like to participate in courses aimed at increasing their skills or knowledge in areas directly related to firm management: accounting, marketing, and banking.

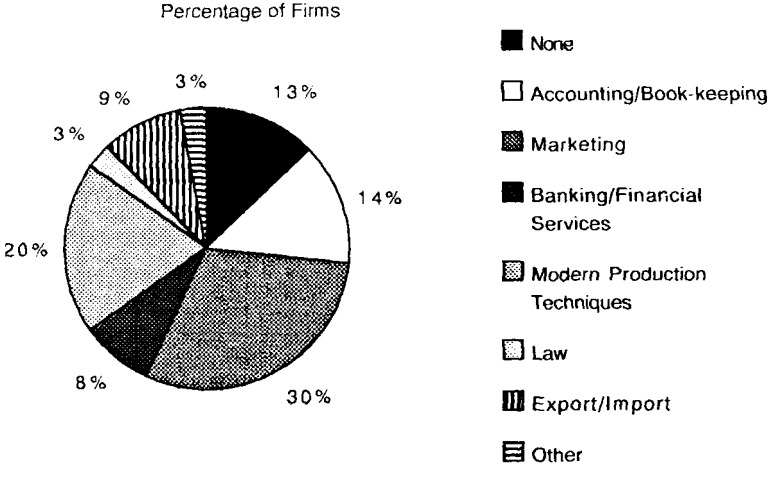
In addition, managers of firms operating in industry are interested in courses or seminars about the newest technologies in their particular fields. This response may indicate that entrepreneurs want to increase their competitiveness by introducing new products.

Table 3
Type of Short-Term Training Considered Useful

Type of Training	Percentage of Firms
None	13
Accounting/Book-keeping	14
Marketing	30
Banking/Financial Services	8
Modern Production Techniques	20
Law	3
Export/Import	9
Other	3

Source: Question P11

Graph 3



Source: Table 3

The majority of firms in our sample were registered (70%), and actually began operation in the period between 1989 and 1992 (69%). A substantial gap was observed between the time of registration and time at which business activity actually commenced.

The sample is dominated by firms which have been private since their inception (86%). Firms established as a result of privatization of formerly state-owned commercial or service organizations (for example: PSS "Spolem" - a giant consumers' co-op; SPHW and WPHW - wholesale trade oligopolists; ZURT - a network of radio & TV repair shops) accounted for 12% (Question P12). Only one firm was founded as a result of re-privatization. No relationship is apparent between a firm's size and its method of origination.

More than half of the businesses are either civil law partnerships (34%) or limited liability companies (19%). None of these businesses reported any minority ownership share held by the State. In only in two cases were foreign investors named as (co-) owners.

5.3 Profile of the Firm . . . . . (Questions 13-83)
5.3.1 Labor and Labor Cost . . . . . (Questions 13-41)
5.3.1.1 Labor Structure . . . . . (Questions 13-30)
5.3.1.2 Labor Cost . . . . . (Questions 31-41)

Most firms in this survey are either very small enterprises (VSEs) or small enterprises (for our purposes, a VSE is one with no more than five full-time employees). Very small enterprises account for 25% of the survey.

Our original aim was not to include VSEs into the survey. In reality, however, we got a relatively large proportion of them in the actual sample. This may be attributed to the following factors:

- time discrepancy between the moment of including a firm into the sample and the moment the firm was surveyed;
- possible error or misrepresentation by the management;
- pollster's error;
- misunderstanding as to the meaning of the concept of "full-time employee" and "total number of full-time employees".

The latter is obvious when one analyzes questions P13-P16: some responses obviously lack consistency when numbers of (full-time) hired workers, apprentices, working owners and their family, and total of full-time employees are given.

At the other end of the size spectrum, there are only five firms that employ more than 50 workers. 75% of the businesses in the survey employ 20 persons or fewer.

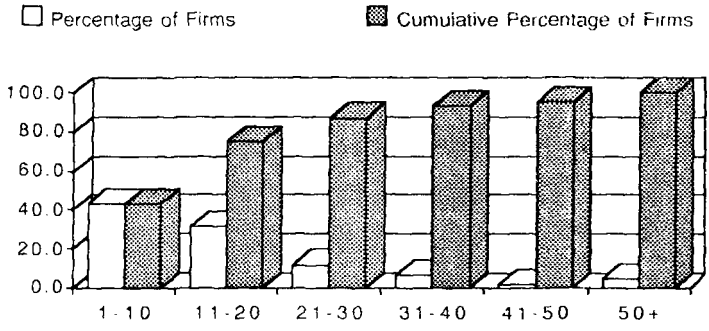
Table 4

Number of Full-Time Employees at a Firm

Number of Employees	1-10	11-20	21-30	31-40	41-50	50+
Percentage of Firms	43.5	31.5	12.0	6.5	1.5	5.0
Cumulative Percentage of Firms	43.5	75.0	87.0	93.5	95.0	100.0

Source: Question P16

Graph 4
Number of Full-Time Employees at a Firm



Source: Table 4

Firm owners frequently work in their own businesses and also employ their family members. This is particularly true of very small enterprises. Owners and/or family members were employed in 89 firms.

Table 5

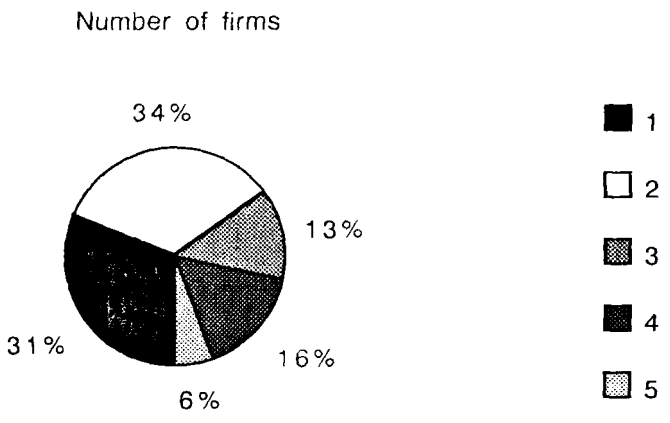
Employment of Family Members

Number of family members (incl.the owner)	1	2	3	4	5
Number of firms	28	30	12	14	5

Source: Question P13

Graph 5

Employment of Family Members



Source: Table 5

Part-time workers were employed in 51 firms. Six firms employed ten or more persons working less than full-time. In two firms the number of part-time workers exceeded 20. Given the small size of the firms, these observations may allow us to conclude that part-time workers constitute the major part of the work force in such enterprises.

Only 12 firms employed any apprentices. In 18 firms the work force was entirely male, while in two it was entirely female.

The majority of employees perform tasks connected with the firm's basic line of business. More than 55% of the firms employ no more than two persons in administration. In 24 firms there are no administrative or office workers.

Despite the growth of unemployment in most regions of Poland it is not easy for enterprises to find well qualified workers.

Opinions reported on this issue were split evenly (question P26). However, contradictory evidence appears in the answers to question P25, where 66% of respondents declared that newly recruited workers do have adequate skills.

Entrepreneurs in 30 firms (more than 23%) stated that it is hardest to find employees with expertise in marketing, computers, and foreign languages. Also, 11.5% of respondents cited a lack of proper skills among job candidates who were formerly unemployed.

15.4% percent of respondents stated that the inability to find workers with proper skills is a regional problem.

In more than half the firms (56%) some form of worker training is organized. This is frequently on-the-job training supervised or carried out by a senior employee.

Training organized outside the firm relates to foreign languages (in service businesses) and basic computer skills. In five cases (all manufacturers) the outside training was required because of exigencies of technological change occurring in these firms. Only one respondent stated that the decision to provide worker training was undertaken (purely) to obtain tax breaks.

Respondents frequently statedthat the absence of organized training programs outside of their firms is mainly due to lack of time for such (re)training, as well as the lack of funds to finance it.

Job skills possessed by workers come primarily from their former and current employment. To a lesser degree, these skills have been acquired in school.

A trade union existed in only one firm. This union was one of several participants in wage bargaining with management. In 90% of the firms, wages are fixed by a director or by the owner. Usually, the owner sets the wage level of the firm's director (80%). Less than half of the firms conduct an active wage policy aimed at attracting personnel with adequate skills. Howev-

er, there is a distinct group of firms where such a policy has been regularly implemented (20%).
Most respondents agreed that the level of a worker's wages depends predominantly and directly on the worker's individual effort, and to a much lesser degree on group performance or other external factors. More than 60 percent of the respondents stated that the wage level is an important factor in motivating effort and achieving higher labor efficiency. More than half of the firms practice such a policy.
Generally, there is an impression that workers should feel relatively secure in their jobs, provided that they work hard and achieve high productivity. Only one third of the firms experienced adverse external economic conditions which resulting in employment reductions. In these cases, group redundancies were made in 10 firms, while in six firms workers were furloughed without pay (this happened mostly among smaller firms, and can be attributed to the seasonal nature of their business activities).

5.3.2 Fixed Capital . . . . . (Questions 42-51)
5.3.2.1 Land and Structures . . . . . (Questions 42-45)
5.3.2.1 Plant and Equipment . . . . . (Questions 46-51)

Most frequently, firms in the survey group held the land on which they operated under leaseholds of several years duration (39%). However, 14% of the firms had annual leases, which substantially reduced their development potential by discouraging investment. Only 13% of the firms had purchased the land on which their operations were sited.
A similar distribution of answers was obtained with respect to the method of acquisition of physical structures occupied by the firm. However, the third most important way of acquiring physical structures was as gifts from family members, rather

than via arms-length market transactions as in the case of land. Almost 50% of firms stated that both the land and the structures they used were adequate, given the current needs of their enterprises. 38% stated that their land and structures in use were inadequate (too small) and limited the firm's growth potential. 11% stated that their land and structures were too large, markedly surpassing the current needs of the firm.

Plant and equipment used by firms seems to be relatively new. More than 50% of core machinery and equipment is less than two years old.

Table 6

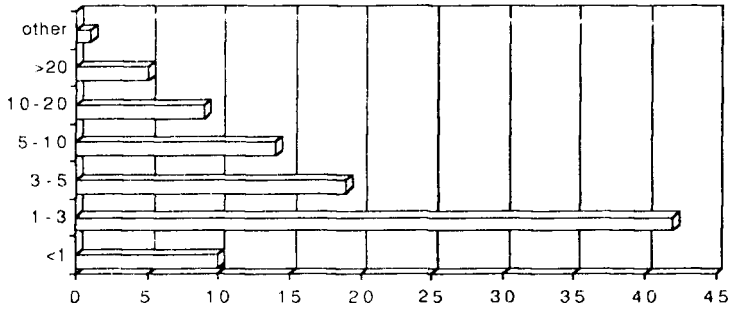
Average Age of Firm's Core Equipment

Age (Years)	Percentage of Firms
<1	10
1-3	42
3-5	19
5-10	14
10-20	9
>20	5
other	1

Source: Question P46

Graph 6

Average Age of Firm's Core Equipment



Percentage of Firms

Source: Table 6

Almost all firms have either added to or replaced their stock of machinery since the time they began operation (96%). Most new machinery is domestically produced (68%) or imported from the West (24%).

Table 7

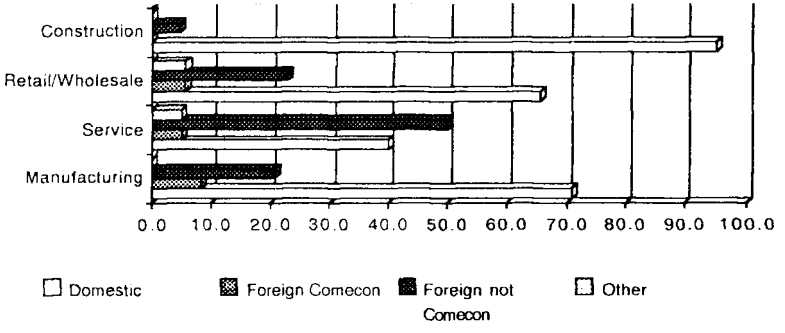
Sources of Purchased Equipment
(Percentage in Each Line of Activity)

Purchaser's Business Activity	Source of Equipment: Domestic	Foreign Comecon	Foreign not Comecon	Other
Manufacturing	70.8	8.3	20.8	-
Service	40.0	5.0	50.0	5.0
Retail/Wholesale	65.7	5.7	22.9	5.7
Construction	95.2	-	4.8	-

Source: Questions P48, P8

Graph 7

Sources of Purchased Equipment
(Percentage in Each Line of Activity)



Source: Table 7

The most frequently cited problem with domestically produced machinery is low quality (39.8 %).

Table 8

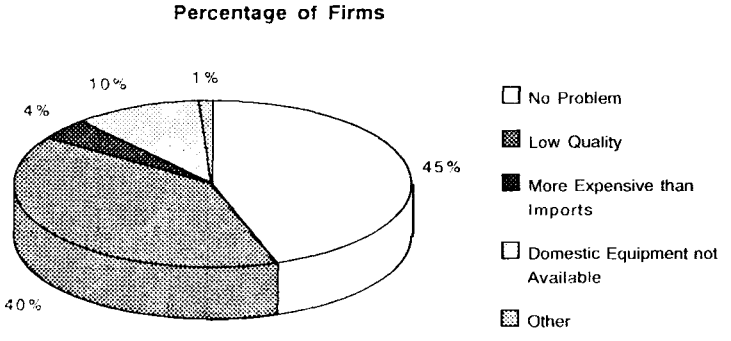
Problems with Domestically Produced Equipment

Problem	Percentage of Firms
No Problem	44.9
Low Quality	39.8
More Expensive than Imports	4.1
Domestic Equipment not Available	10.2
Other	1.0

Source: Question P50

Graph 8

Problems with Domestically Produced Equipment



Source: Table 8

Most firms did not report difficulties in buying imported machinery and equipment (77%).

5.3.3 Finance and Cost of Capital (Questions 52-57)

Our analysis of the sources of finance used to start and sustain the firms' activities has yielded some interesting results. At the beginning of its existence, a typical firm from our sample was financed mainly by the owner's savings as well as funds borrowed from family and friends. Borrowing from commercial banking institutions was of secondary importance. Nearly 45% of respondents did not even bother to apply for loans at commercial banks, while a further 7% did apply and were rejected. However, among older firms, reinvested earnings were the major source of finance, followed by loans from commercial banks. This process is shown in Table 9.

Table 9

Changing Sources of Founds as Firms Mature
(Percentage of Firms Reporting a Given Source in Each Age Category)

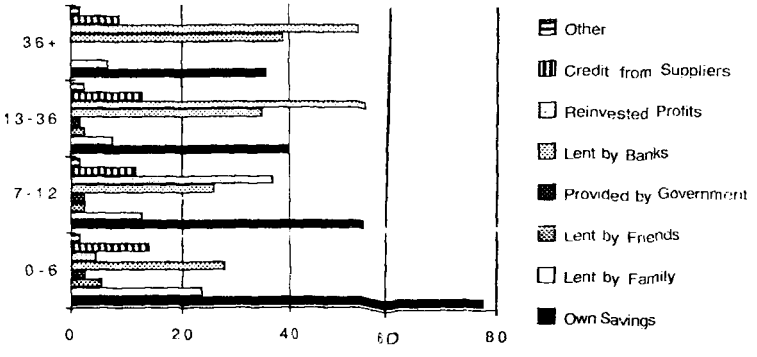
Source of Funds	Age of the Firm in the Months 0-6	7-12	13-36	36+
Own Savings	78	54	40	36
Lent by Family	24	13	8	7
Lent by Friends	6	3	3	0
Provided by Government	3	3	2	0
Lent by Banks	28	26	35	39
Reinvested Profits	5	37	55	53
Credit from Suppliers	14	12	13	9
Other	2	2	3	2

Note: Firms were allowed to report more than one source of founds, therefore columns do not add up to 100

Source: Question P52 (codes K67-70)

Graph 9

Changing Sources of Founds as Firm Mature



Source: Table 9

Our results are consistent with those obtained in the survey of Polish small businesses conducted by GIME[20]. In the GIME survey, 77.4% of total financing came from the entrepreneur's savings, while 20.3% percent represented monies borrowed from family and friends. Another important source of funds was money earned from working abroad (14%). Thus, in both the GIME survey and the present survey, bank credit is not the source of the start-up capital.

It is worth noting in this context that the entrepreneur's own financial resources, together with those of family and friends, also play a very important role in new business formation in developed market economies. In a 1989 survey of 9106 small private firms in Ohio (USA), 78.9% of respondents reported their own savings as a main source of start-up capital, and 19.7% used funds borrowed from family and friends. In the same survey, however, 30.4% of respondents obtained bank loans.[21]

With respect to loans obtained from commercial banks, respondents in our survey reported a continuing decrease in interest rates, together with a simultaneous (slight) decrease in the term of the loans. The main reason given for not applying for long term credit was a high nominal rate of interest (85%). 53% of respondents reported no difficulties concerning the availability of long-term bank credit.

[20] GIME (Gdansk Institute for Market Economics) M. Grabowski and P. Kuliwczuk, eds., 1992. See Section 6 of this report for details.

[21] Results of the Ohio survey are quoted from Finansowe Wspieranie Rozwoju Malych Przedsiebiorstw [Financial Support for Development of Small Enterprises], IGIBGR [GIME], Gdansk, 1991, pp. 31-32.

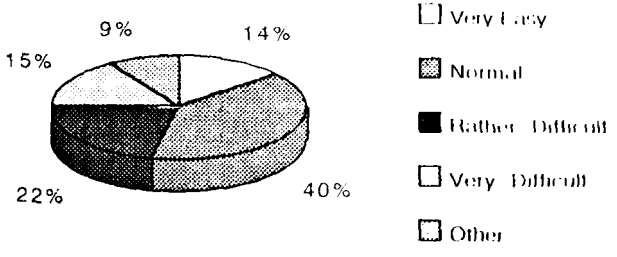
Table 10

Difficulty in Obtaining Long-Term Credit

Level of Difficulty	Percentage of Firms
Very Easy	14.1
Normal	39.4
Rather Difficult	22.2
Very Difficult	15.2
Other	9.1

Source: Question P56

Graph 10



Source: Table 10

Analysis of variance does not allow us to conclude that credit availability is dependent on the firm's line of business or its size. In reported instances where banks refused to grant long term credit, the reasons doing so typically involved either the firm's low capitalization level or high collateral requirements. These two reasons accounted for nearly 60% of the problems reported with obtaining long-term commercial bank credit.

Entrepreneurs perceive the following major obstacles to obtaining bank loans: Creditors require excessive guarantees or collateral (31.4%); The firm is too undercapitalized to obtain

an outside loan (16.5%); A lot of paper work (11.6%); Creditors prefer their established customers, especially those with large current accounts or deposits at the creditor's institution (9.9%); Available credit lines are too small anyway (4.2%); Other (26.4%). Thus, the major problem in obtaining a bank loan is the bank's perception that the potential borrower is untrustworthy.

Among major banks lending to small businesses, respondents indicated the following as most important: Cooperative banks (35%), PBKS (20%), and Bank Rzemieslniczy (21%).

Respondents were also asked to enumerate their most serious problems relating to financial matters (open questions P53). They cited the following problems:

1. Loan interest rate too high	28.2%
2. Overdue payments from buyers	16.6%
3. Lack of capital	15.6%
4. Lack of new orders, excess inventories of finished goods, low consumer purchasing power	10.8%
5. High taxes	9.0%
6. Problems with banking services, "insolvency chains"	4.9%
7. Inflation	3.3%
8. Social Security premium is too high	3.3%
9. High cost of energy and raw materials	3.3%
10. High Rent	3.3%
11. No major problems	1.7%

We conclude from these results that the major problems encountered by entrepreneurs in financial matters are due to these causes: The present economic situation (69.4%) [1,2,3,5]; The present economic policy (20.7%) [4,6,8,10]; Systemic transformation (6.6%) [7,9].

Analysis of variance indicated that larger firms in particular reported problems linked to inefficiencies in the banking sector, high Social Security contributions, high energy costs, and high rents.

5.3.4 Raw Materials, Semi-Products,and Energy Consumption . . . . . (Question 58)
5.3.5 Technology and Productive Capacity . . . . (Questions 59-70)
5.3.5.1 Production . . . . . (Questions 59-64)
5.3.5.2 Changes in Production . . . . . (Questions 65-70)

Due to limited size of the questionnaire, issues concerning the use of raw materials and semi-products are treated in only one question (P58), which asked, "What is the proportion of imported raw materials and semi-products in the total of raw materials and semi-products now as opposed to the beginnings of the firm's operation." Of 82 firms using imported raw materials and other intermediate goods, 35 stated that the proportion did not change, another 35 stated that it increased, and only 12 reported that it fell.
Among crucial reasons for the increased use of imported raw materials and semi-products, firms noted:

Imported raw materials offer better quality at comparable prices	46.9%
Easier access to imported goods	18.8%
Technology requires imported goods	12.5%
Allows possibility to offer new products	12.5%
Demand for "Western products" is increasing	9.3%

Among crucial reasons for the decreased use of imported raw materials and semi-products, firms noted:

- A shift in market demand favoring domestic products
- Cost is too high
- Quality of domestic products is increasing.

A decreased in the proportion of imported raw materials and other intermediate goods was especially pronounced in retail and wholesale trade. No decrease was recorded among manufacturing firms.

Table 11

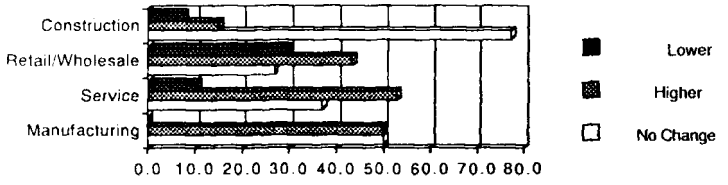
Share of Imported Raw Materials
(Percentage in Each Line of Activity)

Business Activity	Current Share of Imported Raw Materials		
	No Change	Higher	Lower
Manufacturing	50.0	50.0	-
Service	36.8	52.8	10.4
Retail/Wholesale	26.7	43.3	30.0
Construction	77.2	15.1	7.6

Source : Questions P8, P58

Graph 11

Share of Important Raw Materials
(Percentage in Each Line of Activity)



Source: Table 11

The average rate of capacity utilization, measured by man-hours worked, was about 80% — nearly 20 percentage points higher than the average rate of capacity utilization over all Polish industrial firms.

Questions P59 and P60 asked how many hours per week the firm actually operated, and also how many hours it could operate if it used its productive capacity to the fullest. The difference between the potential and the actual number of hours worked appears to us to be less than expected. We consider this to be a promising sign.

In view of current capacity utilization levels, 50% of firms reported that they already felt constrained by inadequate market demand at their present output level. 25% stated that they could increase their rate of output substantially in short run if demand were higher.

In order to increase their sales, almost 50% of firms decreased the prices of their products. Price decreases were especially pronounced for services, and to lesser degree for manufactured goods.

Table 12

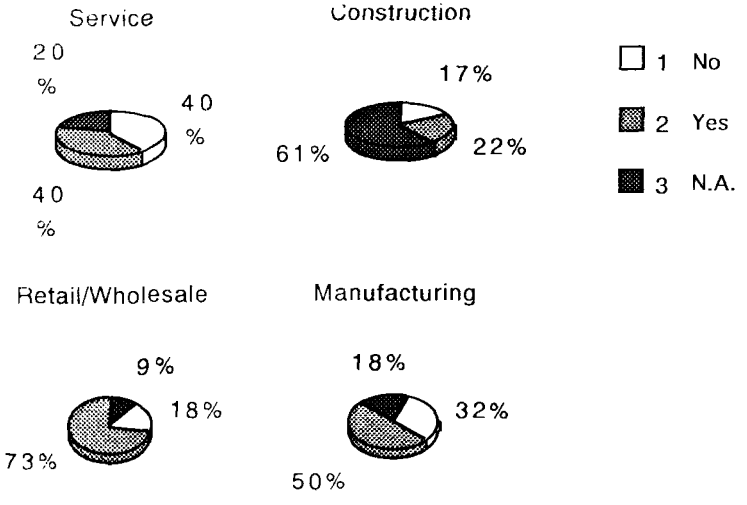
Patterns of Price Adjustment Behavior
(Percentage in Each Line of Activity)

Business Activity	Lower Prices to Increase Sales?		
	No	Yes	N.A.
Manufacturing	31.8	50.0	18.2
Service	40.0	40.0	20.0
Retail/Wholesale	18.3	72.7	9.0
Construction	16.6	22.3	61.1

Source: Questions P8 ,P63

... 12b, 12c, 12d.

Patterns of Price Adjustment Behavior
(Percentage in Each Line of Activity)



Source: Table 12

For the 12 month period preceding the survey, 75% of the firms increased their prices, 19% did not change prices, and 6% decreased prices. The main reason given for price increases was higher production costs. We are unable to conclude that the observed changes in absolute prices vary significantly according to type of business activity.

Table 13

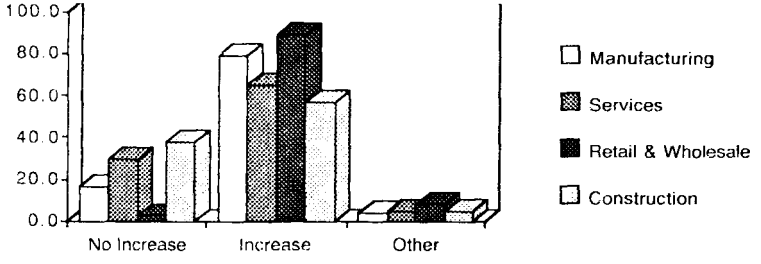
Price Level of Firm's Principal Product
(Percentage in Each Line of Activity)

Business Activity	Change in Price		
	No Increase	Increase	Other
Manufacturing	16.7	79.2	4.2
Services	30.0	65.0	5.0
Retail & Wholesale	2.9	88.6	8.5
Construction	38.1	57.1	4.8

Source: Questions P8, P61

Graph 13

(Percentage in Each Line of Activity)



Source: Table 13

Over the 12 month period preceding the survey, the output level increased in one-third of the enterprises, and decreased in another one-third. As a result of adjustments undertaken in 36% of the firms, the assortment of goods and services produced was changed radically in comparison with what was produced at the time of the firm's start-up.

More than 45% of firms expect to maintain their current level of output in the near future, while nearly 30% foresee the necessity of changing the assortment of goods and services that they produce. Another 46% foresee a possibility of substantially increasing their output without changing its structure. One respondent foresaw a need to decrease future output. These observations give a very optimistic picture of the sector's outlook.

Those firms which consider future production increases as impossible, most frequently name insufficient demand as the reason (21%). However, many also declare that their present level of output is optimal (10% of all firms). In 27% of firms, the owner or director plans to start another new business (or several new businesses) in the next 12 months.

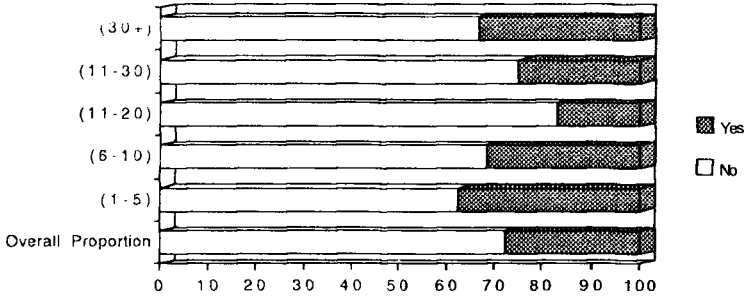
Table 14

Businessmen Attitudes Toward Starting a New Business
(Overall Percentage and Percentage in Each Size Group)

Do you intend to start a new business in the next 12 months?	Overall	By Size of Current Firm				
	Proportion	(1-5)	(6-10)	(11-20)	(11-30)	(30+)
No	72.2	62.5	68.4	83.2	75.0	66.7
Yes	27.8	37.7	31.6	16.8	25.0	33.3

Source: Questions P16, P69

Graph 14
Businessmen Attitudes Toward Starting a New Business
(Overall Percentage and Percentage in Each Size Group)



Source: Table 14

70% of these new firms operate in construction and trade. With respect to their legal structure, 48% of these new firms are established as civil law partnerships, and 16% are limited liability companies.

5.3.6 Sales and Marketing . . . . . (Questions 71-83)
5.3.6.1 Profits . . . . . (Questions 71-72)
5.3.6.2 Sales and Market Structure . . . (Questions 73-76)
5.3.6.3 Export . . . . . (Questions 77-80)
5.3.6.4 Competition . . . . . (Questions 81-83)

The majority of firms stated that they received positive profits (65%), while only 4% admitted losses. The rest reported that they just broke even.
In comparison with the time at which they began operation, 51% of firms stated that their profitability had decreased. On the other hand, 30% admitted to achieving substantially higher profitability. Decreases in profitability were especially noticeable among firms involved in services and construction.

Table 15

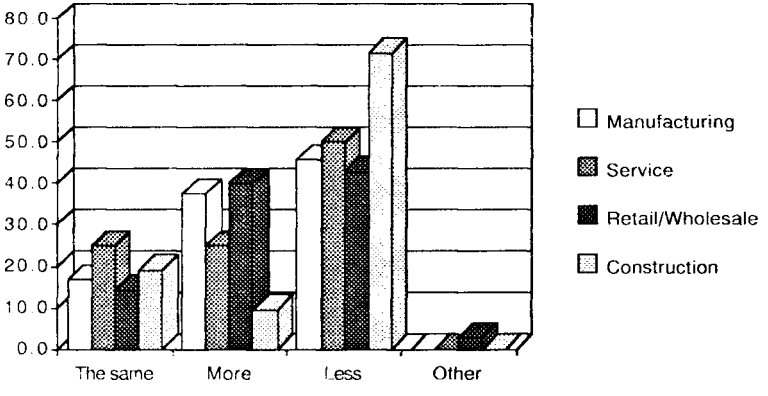
Current Profitability as Compared with Firm's Beginnings
(Percentage in Each Line of Activity)

Type of Activity Conducted	*Is firm now more profitable or less*			
	The same	More	Less	Other
Manufacturing	16.7	37.5	45.8	-
Service	25.0	25.0	50.0	-
Retail/Wholesale	14.3	40.0	42.9	2.8
Construction	19.1	9.5	71.4	-

Source: Questions P8, P72

Graph 15

Current Profitability as Compared with Firm's Beginnings



Source: Table 15

Major channels through which firms sell are other retailers and their own stores. A substantial number of firms are still dependent on distributing their produce through state-owned organizations, but this proportion is much lower than in the late 1980s.

The development of regular interrelations as well as cooperative networks among private enterprises is becoming more visible. Almost 70% of firms, and particularly wholesalers, stated that they had regular, relatively permanent channels of distribution.

Table 16

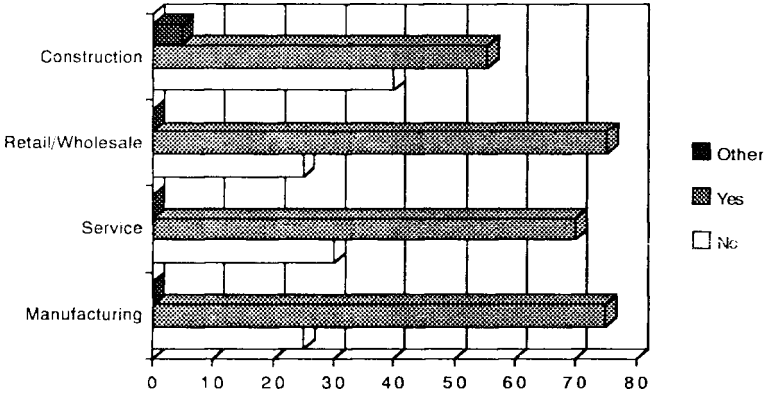
Output Distribution Channels Firms Use
(Percentage in Each Line of Activity)

Type of Activity Conducted	Regular Channels of Distribution?		
	No	Yes	Other
Manufacturing	25.1	74.9	-
Service	30.1	69.9	-
Retail/Wholesale	24.9	75.1	-
Construction	39.9	55.3	4.8

Source: Questions P8, P76

Graph 16

Output Distribution Channels Firms Use
(Percentage in Each Line, of Activity)



Source: Table 16

The distribution channels are also quite diverse.

Table 17

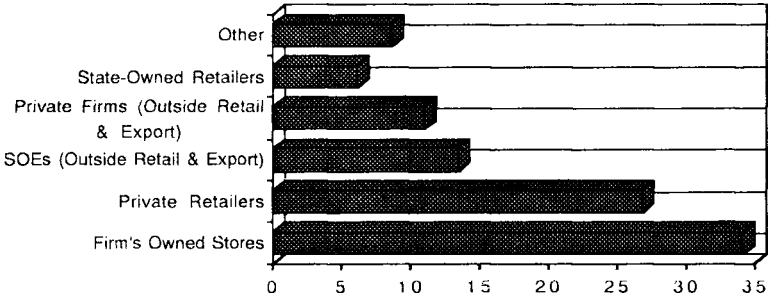
Firm's Major Sales Channel
(One per Firm)

Channel	Percentage of Firms
Firm's Own Stores	34.1
Private Retailers	26.8
SOEs (Outside Retail & Export)	13.4
Private Firms (Outside Retail & Export)	11.0
State-Owned Retailers	6.1
Other	8.6

Source: Question P73 (code K96)

Graph 17

Firm's Major Sales Channel
(One per Firm)



Source: Table 17

Firms sell the major part of their output on local markets (53%) and in nearby towns and cities (14%). Only 6% export. Export-

ers report that their major problems are excessive customs duties and the poor quality of international payments serviced by domestic banks. One fourth of the respondents see no need to engage in foreign trade.

Buyers of the surveyed firms' products are typically city dwellers with medium or high income levels.

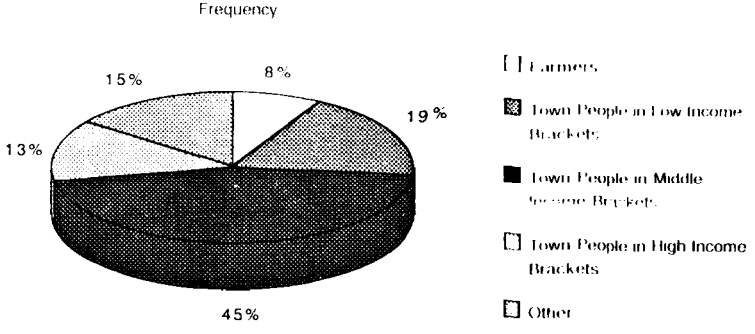
Table 18

Typical Recipients of Firm Output
(No More than Two Answers)

Category of Recipient	Frequency
Farmers	11
Town People in Low Income Brackets	75
Town People in Middle Income Brackets	61
Town People in High Income Brackets	18
Other	90

Source : Question P75

Graph 18
Typical Recipients of Firm Output
(No More than Two Answers)



Source: Table 18

The respondents' main competitors are other private enterprises (56%). Only 7% considered imports to be their major competitor.

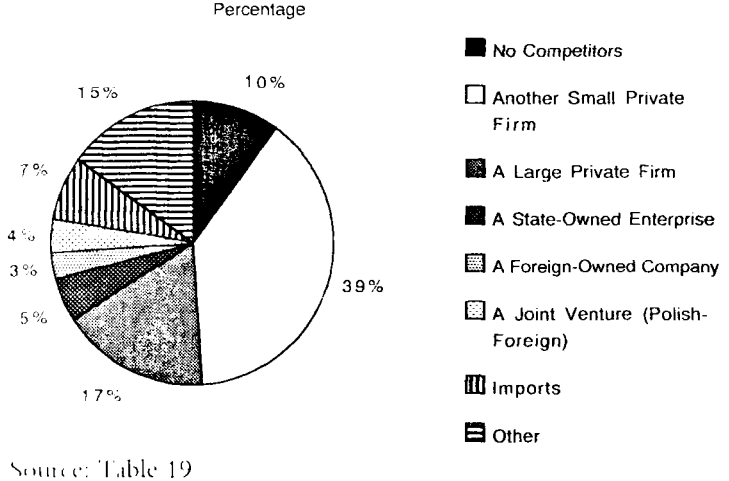
Table 19

Main Competitors of the Firm
(by Types of Firm)

Categories of Competitors	Percentage
No Competitors	10.0
Another Small Private Firm	39.0
A Large Private Firm	17.0
A State-Owned Enterprise	5.0
A Foreign-Owned Company	3.0
A Joint Venture (Polish-Foreign)	4.0
Imports	7.0
Other	15.0

Source: Question P81

Graph 19
Main Competitors of the Firm



Source: Table 19

Location of major competitors is closely connected with the type of activity of the firm in question. Thus, for manufacturers the major source of competition are other importing firms, while for firms other than manufacturers, major competitors happen to be other domestic firms.

Table 20

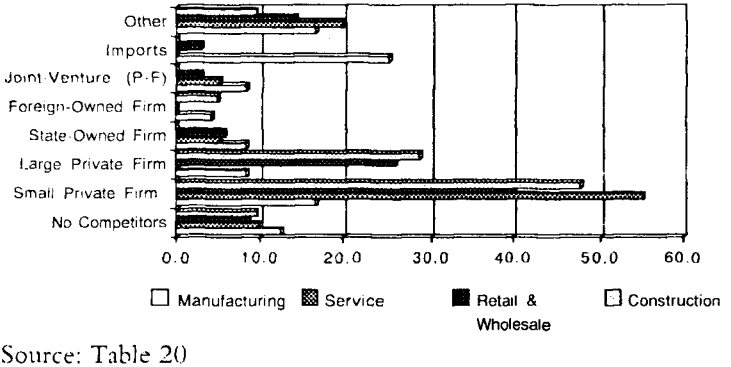
Main Competitors of the Firm
(Percentage in Each Line of Activity)

Main Competitor of Firm	Type of Activity Conducted			
	Manufacturing	Service	Retail & Wholesale	Construction
No Competitors	12.5	10.0	8.6	9.5
Small Private Firm	16.7	55.0	40.0	47.6
Large Private Firm	8.3	-	25.7	28.6
State-Owned Firm	8.3	5.0	5.7	-
Foreign-Owned Firm	4.1	5.0	-	4.8
Joint-Venture (P-F)	8.3	5.0	2.9	-
Imports	25.0	-	2.9	-
Other	16.7	20.0	14.3	9.5

Source: Questions P81, P8

Graph 20

Main Competitors of the Firm



Source: Table 20

More than 75% of the firms noticed a substantial increase of competition in their product market. This is especially true among construction services and wholesale traders. 20% of respondents estimated that there were 100 firms similar to their own in the market.

Table 21

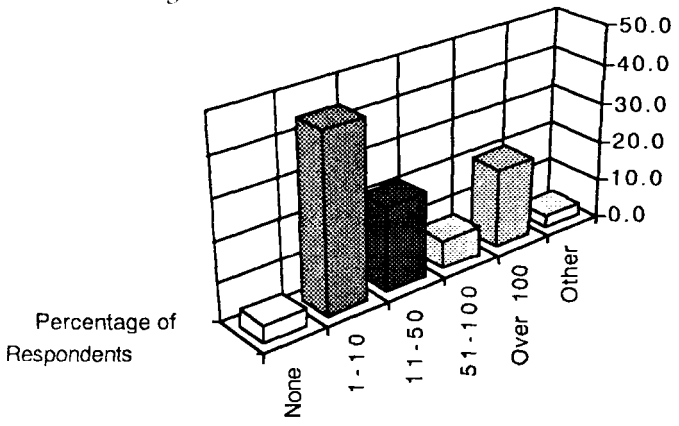
Other Firms Selling the Same Product

Number of Firms	Percentage of Respondents
None	4.0
1-10	44.4
11-50	21.2
51-100	7.1
Over 100	20.2
Other	3.0

Source : Question P83

Graph 21

Other Firms Selling the Same Product



Source: Table 21

5.4 Government Policy . . . . . (Questions 84-96)
5.4.1 Facts about Firm's Registration Process . (Questions 84-85)
5.4.2 Taxation . . . . . (Questions 86-87)
5.4.3 Domestic Currency Convertibility and Exchange Rate . . . . . (Questions 88-96)

The vast majority of firms did not see any problems with registering a new enterprise (86%). Despite the recorded delay between the date of registration and actual start-up (see Section 2.2 above) 56% of respondents stated the delay for them was shorter than one month.

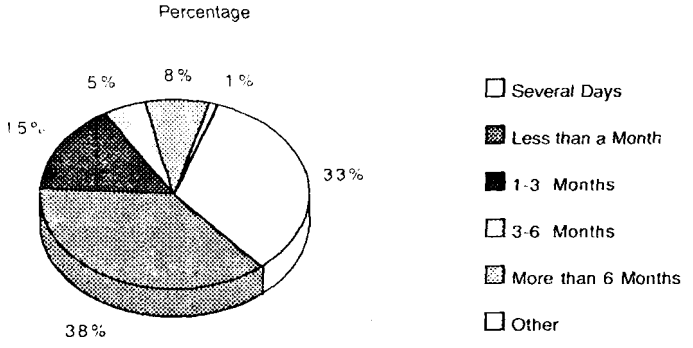
Table 22

Length of Waiting for Permits to Start Firm's Operation

Period	Percentage
Several Days	33.3
Less than a Month	37.4
1-3 Months	15.2
3-6 Months	5.1
More than 6 Months	8.0
Other	1.0

Source : Question P85

Length of Waiting for Permits to Start Firm's Operation
(Percentage rounded)



The tax system is not regarded as a stimulant to investment (84%). Only those entrepreneurs operating in construction services expressed a slightly different opinion on this point.

Table 23

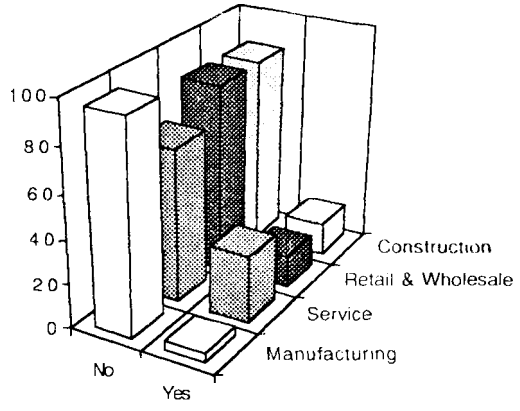
Investment Incentives Embedded in Tax System
(Percentage in Each Line of Activity)

Type of Activity Conducted	Does tax system stimulate investment?	
	No	Yes
Manufacturing	95.9	4.1
Service	69.8	30.2
Retail & Wholesale	85.6	14.4
Construction	85.1	14.9

Source: Questions P8, P87

Graph 23

Investment Incentives Embedded in Tax System



Source: Table 23

Although only a few firms are exporters, 34% of them consider the present limited form of Polish currency convertibility to be important. However, more than half of the respondents viewed it as either irrelevant or not too relevant.

Nonetheless, only 22% or respondents felt that increased convertibility would be undesirable, while 62% were in favor (P89).Of these, more than half wanted reforms to accomplish both external convertibility and capital account convertibility. Respondents were given the option to state that they did not understand this question. Although the question itself contained a great deal of carefully phrased information, 12% indicated that they did not understand.

When the same question was rephrased to ask about the desirability of currency convertibility from the point of view of the economy as a whole, the share of negative responses dropped

to 6% (from 22%), while 10% still indicated that they did not understand. These numbers point to the general understanding of the macroeconomic significance of maintaining and enlarging currency convertibility, even if it is not directly relevant to the operations of the entrepreneur's own firm.

Table 24

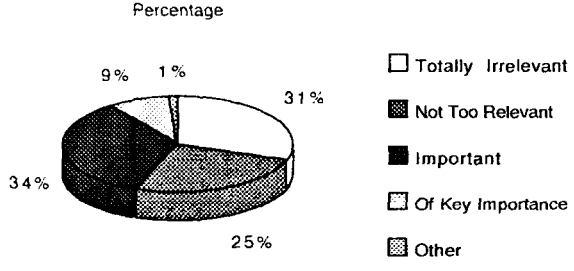
Relevance of Currency Convertibility

Is convertibility relevant for your firm?	Percentage
Totally Irrelevant	31
Not Too Relevant	25
Important	34
Of Key Importance	9
Other	1

Source: Question P88

Graph 24

Relevance of Currency Convertibility



Source: Table 24

When asked why currency convertibility is relevant for their own firms (open question P91), two-thirds of the respondents

gave reasons having to do with greater openness of the national economy. Nearly 15% saw currency convertibility as a useful device for facilitating payments. An apparent inconsistency is that 21% stated that convertibility is irrelevant (as compared with 31% in question P88).

Quite surprisingly, about 40% of firms opted for clean float. To our minds, this may point to a lack of knowledge among a large number of businessmen concerning the consequences of particular exchange rate regimes[22]. Though many entrepreneurs seem to be risk lovers (at least "on paper"), an equally large proportion are aware that exchange rate volatility may be damaging (35%, question P94).

It should also be remembered that foreign trade exposure of SMEs is very low, whence they may suffer only insubstantial damage from exchange rate volatility. This may explain the ease with which the entrepreneurs supported the clean float. Interestingly, the present crawling peg system was supported only by about 15% of the respondents.

Finally, it is reassuring despite high inflation to see that the majority of entrepreneurs had quite accurate short-term (three month) expectations regarding the exchange rate. Over 60% predicted the actual level without any gross inaccuracy. Interestingly enough, 32% of the respondents did not want to state their prediction as to the nominal exchange rate level in three month time, explaining that the economy is too unstable and/or that the behavior of government is too unpredictable.

22 Clean float could largely destabilize SMEs, especially in the absence of hedging instruments. It should be noted also that firms expressed an overwhelming lack of interest in such instruments. In question P95, two-thirds of the respondents were not interested in using currency futures, and only 14% wanted to use them to hedge exchange risk!

5.5 Conclusions . . . . . (Questions 97-102)

According to survey responses, a person starting a new small- or medium-size enterprise faces the following problems:

Table 25

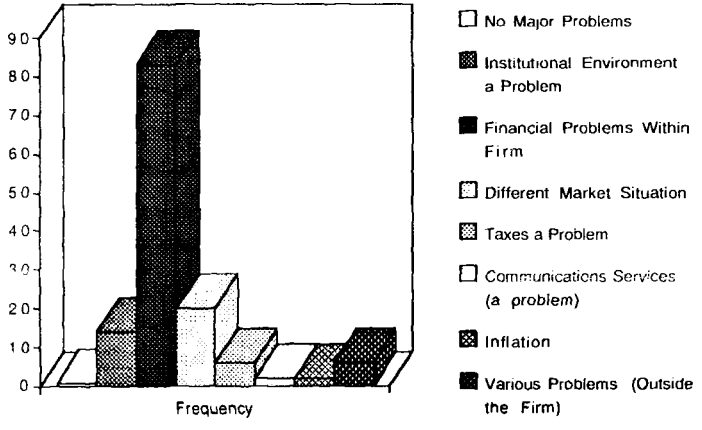
Major Problems Starting a New Firm

Problems Starting a New Firm	Frequency
No Major Problems	1
Institutional Environment a Problem	14
Financial Problems Within Firm	83
Different Market Situation	20
Taxes a Problem	6
Communications Services (a problem)	2
Inflation	2
Various Problems (Outside the Firm)	6

Source : Question P97

Graph 25

Major Problems Starting a New Firm



Source: Table 25

Surveyed firms stated that the attitude of the central government toward private business is much better than that of local authorities. Only 25% of respondents were of the opinion that society as a whole has a positive or at least a neutral attitude toward the private sector in general.

More than 60% of the respondents have never heard of any domestic or foreign program to promote or help private sector development. In order to create an environment conducive to the growth and development of small- and medium-size private enterprises they recommend the following actions:

Table 26

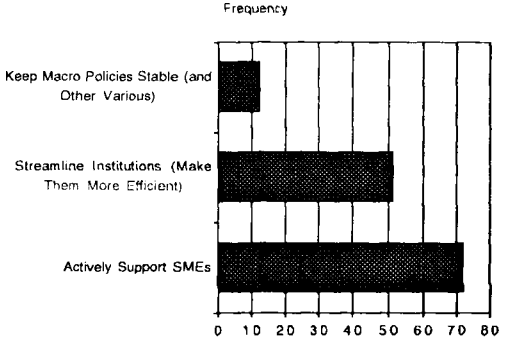
What Should the Government Do to Stimulate Private Business?

Action Suggested	Frequency
Actively Support SMEs	72
Streamline Institutions (Make Them More Efficient)	51
Keep Macro Policies Stable (and Other Various)	12

Source : Question P101

Graph 26

What Should the Government Do to Stimulate Private Business?



Source: Table 26

6. Private enterprises in Poland: Review of Other Surveys & Summary of Results[23]

This Section attempts to summarize the results of several surveys, etc., carried out in Poland by various research groups in the last three years. The following original studies are considered.

[1] A survey carried out by the GIME (Gdansk Institute for Market Economics) in November 1991. This survey consisted of a sample of 300 private firms from three selected regions (voivodeships): Gdansk, Lodz, Krakow. The survey includes firms which employ no fewer than five persons, and which are owned by physical or legal persons.

Cf: M.Grabowski, P.Kulawczuk (eds.), Odbudowa sektora malych przedsiebiorstw - analiza i rekomendacje [Reconstructing the small business sector - analysis and recommendations], Instytut Badan nad Gospodarka Rynkowa [Institute for Market Economics], Gdansk 1992.

[2] The sequel to the survey in [1], repeated in June 1992. This survey contains a sample of 272 firms, and is similar to [1].

Cf: M.Grabowski, P.Kulawczuk, W.Sak, Pionierzy kapitalizmu [Pioneers of capitalism], Instytut Badan nad Gospodarka Rynkowa [Institute for Market Economics], Gdansk 1992.

[3] A survey carried out by the Institute of Labor and Social Research (Warsaw) in March-June 1990. This survey contains a sample of 363 firms from four regions (voivodeships): Warszawa, Gdansk, Czestochowa, Ciechanow. It

23 The following analysis draws extensively on a larger, annotated background paper written in Polish by M. Jozefowska and G. Pruban; see Section 1 for details.

concentrates on the employment potential of small firms (crafts and services), and on other labor-related issues.

Cf: J.Tulski, A.Wozniakowski, Sektor malych i srednich firm prywatnych w Polsce i uwarunkowania jego rozwoju [SMEs in Poland - conditions of their development], IP-iSS, Warszawa 1993, processed.

[4] A survey carried out by the Statistics & Economics Research Unit of the Central Statistical Office of Poland in 1991. This survey contains a sample of 97 SMEs drawn from a population of 3115 manufacturing firms employing between 50 and 200 workers and operating in the regions (voivodeships) of Gorzow and Lodz.

Cf: L.Zienkowski (ed.), Male i srednie przedsiebiorstwa w latach 1990-1991 [SMEs in 1990-1991], ZBSE GUS & PAN [Statistics & Economics Research Unit of the Central Statistical Office & the Polish Academy of Sciences], Warszawa 1992.

[5] A survey carried out by the World Bank in May 1991. This survey contains a sample of 93 manufacturing private firms drawn from a population of 6646. Surveyed firms employed seven or more workers.

Cf: L. Webster, Private Sector manufacturing in Poland: a Survey of Firms, Industry Development Division, Industry & Energy Department, The World Bank, Washington DC 1992.

A summary of major findings follows. It is divided into four subsections: The Entrepreneur; Finance; The Market & its Institutional Settings; The Current Situation and Expectations.

The Entrepreneur

In general, a Polish private firm is set up as some form of partnership of three to four persons (especially in the case of the

manufacturing enterprises). Firms are predominantly of small and medium size. In situations where there is a single proprietor, he or she assumes managerial tasks as well. More than half of the original owners have a university or equivalent diploma (of which two thirds are in engineering or science). An additional one-third of owners have completed high school.

In the manufacturing sector, the proportion of owners who are university graduates (with specializations in engineering or other sciences) is above 30%.

More than 40% of the current owners of private businesses have previously worked in the public ("socialized") sector enterprises in managerial positions. About 20% of current owners simultaneously own some other private business.

Most firms make use of the professional experience that their employees have acquired during previous employment in other private businesses.

There are a number of motives for which people decide to start up their own business. Respondents note their striving for self-fulfillment, ambition, the need to use the knowledge they possess, and independence (financial as well as professional). Financial independence adds to the fulfillment of material needs of oneself and one's family, while professional independence allows one to avoid performing nonsense tasks.

Finance

Personal savings, loans from the family, and the like constitute the major source of start-up capital for most firms. By contrast, the share of bank credit in financing the initial investment is negligible. This was mainly due to the high nominal interest rate and the amount of required collateral. The same factors are reported to cause low usage of short-term bank loans (to provide working capital).

In addition, banks are not very favorably inclined toward serving the needs of small businesses. Yet, part of the blame for this state of affairs is must be shared by the SMEs themselves. In their effort to evade taxes, they tend seriously to underreport their turnover and/or profits, or to operate on a cash-only basis. These practices damage their credibility with potential lenders such as commercial banks.

Another problem is a wide-spread tendency to present over-optimistic analyses of the expected profitability of proposed investments. All of these factors adversely affect the attitude of commercial banks' toward the private sector as a whole, which reduces credit access for all firms, including those who are indeed creditworthy.The entrepreneurs generally declare their willingness to apply for loans denominated in hard currency, but the overall magnitude of loans actually taken is low in proportion to open lines of hard currency credit committed to Poland by foreign creditors. The decisive factor poor quality of submitted credit applications. Potential borrowers are generally not able to submit a credit application meeting minimum formal requirements, as judged by Western standards.

In this context the issue of (financial) liquidity of enterprises becomes crucial. Entrepreneurs lack adequate knowledge as far as liquidity management of the firm's assets is concerned. Firms are known to be "balancing on a tightrope" as far as the term structure (maturities) of their assets and liabilities is concerned. This produces a tension which destabilizes the economy and inhibits growth, which in turn leads to so-called "insolvency chains"[24].

Other factors adversely affecting the financial side of firms' operations include low efficiency of the banking system, the

24 An insolvency chain arises when firms owe one another substantial sums of money, but no one pays or expects to be paid.

high cost of working capital, and the substantial budget deficit of the central government.

The other main part of the firm's financial condition is shaped by fiscal factors. Currently, the biggest financial burden comes from (compulsory) social security contributions. At the end of 1991, firms reported that the turnover tax and customs duties were the most fiscally oppressive of all taxes that they paid. A year later local taxes and fees were awarded this distinction. However, this changed perception might be attributed simply to increased evasion of income and turnover taxes. Tax evasion allows legally established firms to compete on an equal footing with firms from the gray economy.

In summary, with respect to financial constraints on private sector growth, the major obstacles are the lack of capital, problems with maintaining adequate liquidity, and the heavy tax burden.

The Market and its Institutional Setting

The strongest competition for private firms comes from other private firms and from semi-legal firms operating in the gray economy. In mid-1992, firms had different perceptions about the degree of competition coming from importers and from SOEs, but generally considered them to be less threatening than in the third quarter of 1991. About half of the firms declared that the market for their product had shrunk, while another quarter averred to the contrary. Both proportions grew from 1991 to 1992, indicating an increased polarization of firms' opinions on this point.

Heavy dependence on one or a handful of large customers (oligopolistic SOEs) is slowly withering. Still, this dependence remains high in absolute terms. Consequently, the economic condition of private SMEs is directly and strongly correlated

with the economic condition of SOEs. Given the often unfavorable state of affairs in the SOEs, the decreased dependence of SMEs on SOEs may give the former an added growth stimulus

SMEs themselves are major customers of other SMEs. evertheless, with the exception of trade and services, purchases (orders) from SOEs continue to be important. SMEs are supplied by other SMEs and SOEs in about the same proportion.

As concerns the spatial distribution of sales, most SMEs operate in and produce for their local markets. A shift toward national market has been noticeable since mid-1992, especially for manufacturing firms.

International markets continue to play a negligible role, although firms do declare their willingness to start or to increase their foreign operations. In mid-1992, more than 15% were looking for a foreign partner with whom to form a joint-venture (slightly increased from the third quarter of 1991).

More than half of the respondents feel that suppressed demand is the second most important obstacle to the growth of their firms, following only financial problems. Insufficient demand is reflected in low utilization levels of (productive) capacity. Nearly 40% of firms use only from 40% to 80% of their capacity.

In order to increase their market share, firms try advertising. In the previous year (1992), there was a substantial increase in the proportion of firms who had raised their advertising expenditures. The average level of those expenditures also rose substantially, but still remained low in absolute terms (most firms spent less than 50 million zloty per year on sales promotion). Most advertising is simply informative. Aggressive advertising campaigns geared to winning over customers are still a rarity. The low absolute level of advertising expenditure indicates that firms predominantly use the simplest techniques, for example:

press ads, billboards, backlit displays, small gifts to customers. It is hard to judge the effects of this advertising, and especially its efficiency.

Generally, firms do not perceive conditions in the labor market to be a barrier to growth. This observation should be contrasted with the wide-spread opinion that it is difficult to find a right man for the job. Informal ties inside the firm, as well as between insiders and outsiders (including relations SMEs - SOEs and SMEs - commercial banks) have become increasingly important to the firm's general condition, as well as to its relations with local and central government. Such ties strengthen the firm's competitiveness.

The Current Situation and Expectations

The data seem to show that in mid-1992 the economic situation of SMEs stabilized. This conclusion may be inferred from the increasing proportion of respondents who noted a decrease in the temporal variability of such basic microeconomic indicators as profit, sales, cost, employment, prices, and investment. More detailed scrutiny shows a slight increase in a number of firms who declared a decrease in profit, sales, and planned inventories. Simultaneously, there was an increase in the number of firms who wanted to increase employment and investment. These observations point to an increasing diversification of the economic condition of SMEs.

Among sources of capital to firms, retained earnings are still by far dominant. There has been even a slight increase in the number of firms for whom retained earnings are the most important capital source. The second most important source of capital was loans from commercial banks. Some changes are noteworthy with respect to other sources, most significantly there been an increase in capital contributions from new co-

operative partners (domestic or foreign). This indicates more active search for new capital on the part of SMEs, and may signal that they are achieving greater economic maturity.

Concerning privatization programs, entrepreneurs continue to declare their interest in buying (exclusively or in partnership) a SOE as a going concern, or in buying its fixed assets (plant, machinery, equipment). However, SMEs are less inclined to lease space or machinery from SOEs than they had been previously.

On average, entrepreneurs expect that their firms will grow, although rather slowly. Pessimists are very few among them. There is a tendency to plow profit back into the business, at least as a source of working capital. Possibly, such behavior is forced on entrepreneurs by increased competition. Interestingly, entrepreneurs strongly prefer to reinvest in their own businesses than to purchase financial instruments (a very low percentage of them hold long-term deposits or buy CDs with long maturities).

Thus, it may be concluded that cautious optimism is prevalent among entrepreneurs. Nevertheless, they tend to have realistic expectations. For example, it is widely accepted that new customers and outlets must be actively sought, and that without these the firm may fail.

Entrepreneurs expressed the opinion that there is a need for active support from government and the local authorities. This view is accompanied by demands to contain competition from the semi-legal gray economy, whose activity undermines the profitability of legitimate businesses, and forces the latter to compete by evading taxes and engaging in other redistributional activities.

7. *Legal Aspects of Starting and Operating SMEs in Poland*

It is impossible to analyze economic activity without paying due attention to its legal aspects. Such an analysis serves a dual role in the present study.

The first role is educational. It was necessary for the researchers involved in the project -including the present authors- to acquaint themselves with the rudiments of the legal setting concerning private SMEs in Poland. In this respect, legal analysis has been a building block in our overall analysis.[25] It is hoped that this educational role may be relevant for majority of readers, as well.

The second role is directly related to the goal of the project, i.e. presentation of recommendations for policy makers and legislators. In this role the legal analysis directly contributes to the set of final recommendations presented in Section 8.

All in all, legal analysis is to present a still picture of the legal framework governing SMEs (positive analysis) and then to postulate particular changes in the legal setting (normative analysis).

7.1 The Existing Legal Framework

7.1.1 Setting Up an Enterprise

In this sub-section we address the following questions:

(i) What legal forms are possible for private enterprises?

(ii) What is the legal procedure for establishing a new firm?

(iii) What are current restrictions and limitations on establishing and operating a firm (for example: permits, concessions, quotas, etc.) ?

25 A number of background papers and technical notes have been prepared on this subject (in Polish). For details see Section 1.

(iv) What, if anything, is particular to SMEs in the context of the preceding questions, and what are recent trends in the law?[26]

7.1.1.1 Legal Forms of Small Enterprises

In Polish law there is no regulation directly and explicitly delineating enterprises according to their size (for example: very small, small, medium, large, very large). The law only specifies the notion of the non-agricultural economic activity.[27] Article 2, Paragraph 2 of the Law on Economic Activity (LEA) states that natural and legal persons, as well as some organizational units not possessing the status of a legal person, may constitute an economic unit.

- Legal persons

An organizational entity (unit) achieves the status of legal person when it has been entered into the proper register maintained by a Court of Law. There are separate registers for different types of legal persons.

The following kinds of legal persons, which are both types of capital partnerships, are most important for the purposes of SMEs:

(a) Limited Liability Company.[28]

(b) Joint Stock Company (Corporation).[29]

Both of these organizational forms are regulated by the Polish Commercial Code,[30] and the Commercial Register applies to both.

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26 This question will not be answered separately, but will be treated together with questions (i) - (iii).

27 Law on Economic Activity (LEA) of December 23, 1988, Article 2, para 1. The LEA should be considered as a sort of "economic constitution". Its passage marked a breakthrough in viewing generally unlimited economic activity as a basic right of citizens, in contrast with the law and practice of the communist era.

28 In Polish: "spolka z ograniczona odpowiedzialnoscia", abbreviated to "sp. z o.o.".

29 In Polish: "spolka akcyjna", abbreviated to "sp. akc."

30 Hereinafter abbreviated Com.C..

(a) Limited Liability Company. Limited liability companies are regulated by Articles 158-306 of Com.C. It may be established for economic purposes only. Its minimum initial capital should be 40 million PLZ[31] (currently, this is a little more than $2000). This is a capital partnership and Article 159, Paragraph 3 states that partners are not liable for obligations of the partnership itself.

In essence the last feature limits the liability of investors to sums up to their contribution to (or share in) the venture, and has always constituted one of the fundamental characteristics of the modern capitalist system. Limited liability is crucial for stimulating the investment process in the Polish economy.

The Law on Changes in the Existing Tax Laws, enacted March 6, 1993, partially abolished the above fundamental rule and created a liability to partners in limited liability companies for the firm's tax obligations owed to the State. Each partner is liable proportionally to his or her stake in the firm's profit. In case of private debt, the original provisions for limited liability still apply.

Apart from abrogation of limited liability for tax obligations, existing regulations for limited liability companies are favorably regarded within the legal profession and among entrepreneurs. These provisions are well-suited to the needs and possibilities of SMEs.[32] For one thing, every partner has the right to control daily operations of the firm. Another feature, especially important for SMEs, is the ability to form a one-person limited liability company.[33]

31 Polish zloty.

32 In fact, the limited liability company is one of three most frequently used forms of enterprise, the other two being the single proprietorship (ie\5.\1, a natural person's firm) and the civil law partnership. Our survey consisted of 19% limited liability companies and 34% civil law partnerships, as well as 40% of other organizational forms, mostly single proprietorships. See Question P7.

33 This feature was introduced January 1, 1989. See Amended Article 158 of the Com.C.

(b) Joint Stock Company. This form of business organization is suited to large ventures, but theoretically may be used as well by medium-size firms.[34] Currently the minimum initial capital requirement is one billion PLZ (slightly more than $50,000) according to Article 311, Paragraph 1, Com.C.

This form also has certain relatively complicated organizational features which make it more costly to operate, and therefore not very attractive for small businesses.

- Entities Not Possessing the Status of Legal Persons

(c) Civil Law Partnership.[35]
(d) (General) Partnership.[36]
(e) Limited Partnership.[37]

The last two types are sometimes called Commercial Partnerships, since they are governed by the Commercial Code, while the first type is governed by the Civil Code.[38] All of them may be used, and perhaps should be used, as forms of legal organization for small businesses.

(c) Civil Law Partnership. In a civil law partnership the number of partners is not limited. The personal composition of partners is fixed, once the Partnership is established. Partners have unlimited liability.

(d) General Partnership. A general partnership is the simplest form of partnership permitted under the Civil Code (Arti-

34 Joint stock companies accounted for 4% of the firms in our survey. See question P7.

35 In Polish: "spolka cywilna" or "spolka prawa cywilnego", abbreviated to "sp.cyw.".

36 In Polish: "spolka jawna".

37 In Polish: "spolka komandytowa".

38 Formally, this distinction is no longer valid, since the Commercial Law is a part of Civil Law. Thus, all the three partnerships are Civil Law partnerships.

cles 75–157). It is similar to a civil law partnership. However, there are some formal differences: for example, a general partnership is subject to registration in the Commercial Register,[39] and it can operate as a separate legal entity although it has no status as a legal person.

General partnerships are rare in Poland. This may be attributed mostly to tradition, and to ignorance about this form of organization among persons who are setting up small firms.

(e) Limited Partnership. A limited partnership is an especially elastic and versatile form of business organization. It was reinstated into the Polish Commercial Code in 1991 (after being absent for 27 years).[40] The character of this form is intermediate between a personal partnership (civil and general), and a capital partnership (limited liability company and joint stock company).

Limited partnerships seem especially well-suited for SMEs, since by allowing for limited, non-active partners, this form of organization permits a firm to raise capital without public subscription (ie., without needing to incorporate itself as a joint stock company). Unfortunately, during the two years since the reinstitution of limited partnerships, very few businesses have adopted this structure.[41]

Unfortunately, the infamous Law of March 6, 1993 (cited above) in Article 6, para 2, has abrogated the limited liability of limited partners with respect to tax obligations (Article 6, paragraph 2).

39 Partners should sign a written contract establishing the partnership. Unless and until registered, this partnership remains a civil law partnership.

40 By the Law of August 31, 1991, which changed the formerly active Decree of the President of the Polish Republic.

41 It happens that this form of an enterprise is often not known among local officials who register firms!

A separate category of firms are those with foreign participation. We do not discuss this category here, except to note that it was pioneered by the so-called "Polonia firms", firms established by foreigners of Polish descent. These firms started their legal life in 1982 and generally died in 1989. [42] Currently, firms owned or co-owned by foreigners can be established solely as limited liability companies or joint stock companies. The initial capitalization threshold, which used to be $50,000, is now subject to the general regulations of the Civil Code.[43] In addition, these firms receive some tax breaks (according to the discretion of the Minister of Finance).

7.1.1.2 & 7.1.1.3 Legal Procedures and Limitations

For entities without the status of a legal person (limited liability companies and joint stock companies) Court registration of the sort described above is sufficient.

For entities with the status of a legal person (natural persons and personal partnerships: civil law partnerships, general partnerships, limited partnerships) registration in Court is not possible. These entities are obliged to be recorded in the Records of Entities Undertaking Economic Activity maintained by the local administration. The recording fee is low (currently 300,000 PLZ, less than $20). We conclude that these conditions are very favorable for SMEs.

This apparent total freedom of economic activity is limited in many areas by required concessions or permits.[44] Concessions

42 Still some (grandfathered) "Polonia firms" survive.

43 For joint stock companies this makes practically no difference (at least financially). For limited liability companies the difference is substantial and extremely favorable, since for them the capitalization threshold is about $2000.

44 As per the Amendment to the LEA of October 16, 1991.

are required for fifteen types of activities ranging from mining to private investigator agencies and pharmacies.[45]
Composition of the list of commodities and services that require a license in import and export is especially volatile. This volatility should be viewed as especially detrimental (and possibly prohibitive) barrier for small business. Concessions are granted by the proper organs of the central Government (usually Ministries). A concession may be granted under condition that the recipient will deposit a substantial amount of collateral. Such collateral requirements discriminate against small business.

Permits are regulated by laws other than the LEA.[46]

Especially relevant for SME's are permits required and issued by local authorities. These pertain to organizing trade in market places, wholesale and retail activities, food catering, establishing currency exchanges, and organizing sporting events. Coverage is extensive and adds to the costs of operation of enterprises. Entrepreneurs tend not to criticize the regulations as such, but rather the "carriage of law" (or perhaps its miscarriage) by local government.
Firms are also subject to a large number of other regulations. These range from sanitary and fire protection statutes to the licensing of professions. In addition, each firm is supposed to get a national statistical number and tax registration ID. SME's receive no special treatment in regard to these regulations.

45 Fortunately, from time to time an activity is deleted from the list: for example, a concession is no longer required to trade in paints containing precious metals!

46 Permits have various names in Polish: zezwolenia, pozwolenia, upoważnienia.

7.1.2 Operating an Enterprise[47]

7.1.2.1 Financial Law[48]

Any specificity of SMEs that may apply here will be due to the legal form they assume. Therefore, in this sub-section, by SMEs we understand only those which assume either a form of a sole proprietorship or a personal partnership (civil law partnership, general partnership, or limited partnership) – hence, do not enjoy the status of a legal person.

SMEs are subject to taxation and accounting rules as set forth following legal enactments.[49]

(1) Tax on Goods and Services (VAT), and Excise Tax: Law of January 8, 1993.

(2) Personal Income Tax: Law of July 26, 1991.

(3) Accounting Practices:

- Maintenance of a tax book of revenues and outlays: Ordinance of the Minister of Finance, 1992;
- Maintenance of full financial records:[50] Ordinance of the Minister of Finance, January 15, 1991;
- Maintenance of a so-called "tax card" (a simple form of lump-sum tax): Ordinance of the Minister of Finance, December 20, 1991.

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47 For completeness, one should add a discussion about closing down an enterprise, which is omitted in the present analysis.

48 In this sub-section we analyze Tax Law and Accounting & Book keeping Regulations. Foreign Exchange Law and related legal topics are not considered here, mostly because there are few export/import firms in our survey (see questions P77-P80). For example, answers to question P77 show that our sample contains only six exporters.

49 We discuss only major regulations. These delegate many problems, particularly implementation, to lower level legal acts.

50 This is optional for SMEs, not obligatory.

7.1.2.1.1 VAT and Excise Taxes

The said Law of January 8, 1993 grants an exception from both VAT and excise tax to firms whose yearly turnover is less than 600 million PLZ (about $30,000). This exemption is obligatory. It is intended to relieve small businesses from the duty to maintain cumbersome VAT and excise records.
Unfortunately, the advantage of this exemption is deceptive. Under the version of VAT adopted in Poland, a firm may deduct from the VAT it pays (which is calculated on the basis of firm's gross sales), the VAT levied on inputs bought from the outside (i.e. already paid by suppliers). A firm exempt from VAT cannot, of course, subtract VAT paid on inputs bought, thus VAT on inputs becomes a cost and pushes the product price up. It may cause certain stratification in the market, with VAT payees selling to other VAT payees, and VAT-exempt firms to other VAT-exempt firms. This could marginalize small enterprises, which are ex definitio VAT-exempt. Therefore, it would be more cautious, if firms could have an option rather than obligation of being VAT- & excise-exempt. In its present form the exemption is often perceived as a means of easing the work of tax administration rather than benefiting small businesses.

7.1.2.1.2 Personal Income Tax

The major problem for SMEs is the lack of any investment tax credit. Given the currently high nominal cost of credit, the absence of such a tax credit seems to be a decisive element of many decisions not to invest and not to modernize.
Leasing of fixed capital is becoming increasingly popular among SMEs. It is known from the experience of other countries that leasing may offer special advantages, and may in fact

be the only method available to SMEs for acquiring fixed capital.

It is clear that leasing fees are directly linked to the use of the leased object and thus should be treated as costs to the lessor. Unfortunately, under the Amended Law on Personal Income Tax[51] leaseholds are treated as a form of contract for sale. For this reason, leasing fees are often not counted as costs, and thus must be be paid from the lessor's after-tax income.

If leasing continues to be considered a form of contracting for sale, this method of acquiring capital equipment will die out. Such a development would deprive SMEs of a very promising source of capital equipment, which may be in some cases the only available source.

Amortization schemes and rules for revaluation of assets are governed by the Ordinance of the Minister of Finance, March 27, 1992. Two methods of amortization are possible, linear and progressive (accelerated). Under both methods, amortization rates depend on the period of time over which a particular piece of fixed capital is used, irrespectively of the intensity of use (ie., the number of shifts worked).

It would stimulate the usage of of scarce capital resources if the rules allowed for linking the amortization rates with intensity of use, for example, by tying these rates to the value of output in either real or nominal terms.

7.1.2.1.3 Accounting Practices[52]

Maintenance of limited financial records in the form of a tax book of revenues and outlays appears to be a method well-suit-

51 In particular, Article 23, paragraph 1, items 2 and 3.

52 We have chosen to discuss amortization rules and recording of leases in the preceding section on Income Tax because these rules affect costs, and thus affect taxable income.

of medium size firms. It is generally considered acceptable by both the Tax Administration and the payees.
This form of accounting may be too complicated, however, for small firms. We suggest that these firms be permitted to use the simpler accounting practice, the lump-sum "tax card", which is now reserved for very small firms. Apart from the lessening the administrative burden for small firms, this reform would also reduce the need for frequent audits on the part of tax administration, thus benefiting both sides.

7.1.2.2 Labor (Employment) Law

According to the article 5 of the LEA, any economic entity, irrespective of its legal form, may employ labor without any limitation and without any obligatory intermediation of third parties (as was the case before the enactment of the LEA).[53]
For SMEs, the only difference in treatment is indirect and concerns the applicable tax laws (see sub-section 7.1.2.1 above). Thus, there is a connection between the number of employees and the firms' tax treatment. Firms employing more then five workers (and even less in selected lines of business) are not eligible for the simplest taxation scheme, the lump-sum" tax card".[54] Otherwise SMEs are on the same footing as other firms.
Persons undertaking economic activity, as well as their employees, are liable for obligatory social security contributions. For employees the rate is 45% (plus 3% for the Employment Fund).[55]

53 The only exception pertains to non-resident aliens, whose employment requires a permit from regional (voivodeship) authorities.
54 Ordinance of the Minister of Finance, December 20, 1991.
55 Self-employed persons and co-employed family members pay at the rate of

Generally, the Labor Code[56] protects basic rights of the employees, and as such makes industrial relations more "civilized". It seems that most SMEs should have no problem with the regulations, except for the extremely high financial burden of Social Security contributions, which are a form of taxation. Since Social Security contributions apply only to contracts for labor, SMEs try to bypass them by entering into other kinds of contracts based on Civil Law rather than Labor Law. This is generally not illegal, but as a result the degree of employee protection decreases substantially.

Two kinds of contracts substitute for labor contracts:

(i) Contract of Agency[57]. In a contract of agency, one party (the agent) agrees to perform certain "delegated" tasks for the other party (the principal). Tasks may be subcontracted. This type of contract applies to both natural and legal persons. The agent is committed to perform the delegated tasks, rather than to obtain a specified result.

(ii) Contract for Producing a Result[58]. In a contract for producing a result, the agent is committed to achieve a specified result or product for the agreed fee. The risk of achieving or failing to achieve the result is borne by the agent. The production of the end result may be subcontracted.

Persons entering into these two types of contracts do not receive the right to social protection benefits, like paid leaves of absence, maternity leaves and benefits, protection from abrupt termination, and unemployment benefits. This is because these contracts are not governed by the Labor Code.

Recognizing the financial problems faced by SMEs in connection with high social security premiums, it is hard to justify the

56 Law of June 26, 1974, with later changes and amendments.

57 In Polish: Umowa zlecenia. Articles 734–751 of the Civil Code.

58 In Polish: Umowa o dzieło. Articles 627–646 of the Civil Code.

unequal treatment of SMEs and larger firms. Comprehensive reform of social protection programs are needed (as well as reform to the social security system itself). The necessity for such reform is recognized in both the legal and economics profession. Further discussion on this topic lies beyond the scope of the present study.

Another relatively minor proposal which is sometimes suggested in connection with labor law is that the "minimum obligatory termination period" should be shortened for very small businesses (it is currently three months).

7.2 Evaluation and Postulates

Given the legal framework in which SMEs currently function, what changes in laws and regulations may be suggested? The answer will depend on the goal which these changes are intended to achieve.

A minimum goal would be that the creation, operation, and growth of SMEs should not be obstructed. A maximum goal would be that the laws should promote creation, operation, and growth of SMEs.

With respect to the existing law, this first minimum goal has been realized in the LEA and subsequent legislation, which has generally adhered to the LEA's philosophy. Except for some minor problems, there is no feeling that SMEs are victims of discrimination (in comparison with large private firms and SOEs).

If we look at the implementation of the law, then the major problem seems to be inefficiency and the continued low level of knowledge and competence of government at various levels. Nonetheless, it does not seem that the SMEs' situation is worse in this respect than that of other firms.

Having concluded that our minimum goal has been by and large achieved, let us look at the maximum goal. We are aware

of the fact that adopting this goal in its entirety, or adopting any of its three components, would mean giving preferential treatment to SMEs. Can such a stance be warranted? A positive answer can be found in Section 2 of the present study (A Rationale for Small Business). With this in mind we are able to go beyond a (short) evaluation of the legal framework that we described in Section 7.1 above and present a number of specific postulates that would promote SMEs. Later, in Section 8, these specific legal proposals will be amalgamated into the whole set of our policy recommendations.

The Polish law rarely makes any explicit distinction among enterprises on the basis of their size. Thus, SMEs do not get any separate or special treatment. However, one may find important examples showing that it was an implicit intention of the legislature to facilitate or even promote the smallest firms. The most important example of implicit preferential treatment concerns setting up an enterprise simply by writing it into the "records of economic activity". This is a simple and cheap procedure, posing negligible formal constraints. Another example is use by small businesses of the lump-sum form of taxation, the "tax card".

With the exception of "tax card", the same legal options are available to large firms as to small firms.

Rather, one might claim that SMEs are themselves effectively barred from using the form of limited liability companies and joint stock companies for their operation (due to the initial required capitalization levels of forty million PLZ and one billion PLZ) However, this seems to be an invalid criticism, since those forms are naturally designed for larger ventures and from this perspective the initial required capitalization may even be too low.

Altogether, as far as starting up a firm is concerned the situation seems satisfactory. There is no need (nor possibility, it

seems) to put any artificially designed demarcation line dividing firms into small and medium, on one hand, and large, on the other.

It could possibly help to put regulations concerning all the necessary permits for specific lines of economic activity into one comprehensive text, which would then be widely disseminated.[59] This could help to stabilize particular small businesses, in view of the low competence of local authorities and relatively high costs of legal consulting. However, this is a lower priority.

What is bothersome to SMEs is that some tax regulations, or more broadly financial regulations, are so vaguely worded that they allow different possible interpretations. Most damaging is the high frequency of changes in laws and regulations. These changes are perceived to reflect the fiscal needs of the budget rather than desire to promote the growth of private firms.

Apart from the comments above, we also note some specific issues that in our opinion call for rectification.

1. The opportunity to use the lump sum form of taxation (the tax-card) should be extended to include not only very small, but also small firms.
2. Estimated tax payments are now due every month. This period could be extended to, say, a quarter. This would function as a cheap (zero nominal interest rate) and simple form of short term credit for the firm's current operations. To protect the fiscal interest of the state, this extended three-month "preliminary tax collection period" could be made conditional upon timely payment of taxes due and could be revoked in case of misbehavior by the firm.
3. Tax brackets should not be frozen in the event of 30 percent inflation (as provided for in 1993).

[59] As is done in the LEA with respect to concessions.

4. The right to adjust the book value of the firm's fixed capital for inflation should not be suspended (as it was in 1992). Thus, the firm's amortization cost should be counted after adjusting for inflation.
5. The right to treat the leasing fees as costs should be restored.
6. Accelerated amortization should be allowed on a larger scale. Also, consideration should be given to linking amortization rates to the intensity of capital use (number of shifts worked).
7. The practice of levying income tax on exchange rate differentials (arising over time due to domestic currency devaluation) is very dubious when applied to loans denominated in hard currency. This practice renders hard currency denominated (low inflation) loans irrational and superfluous in comparison with loans denominated in domestic currency (high inflation).
8. The present system is faulty of offsetting current business losses with future income for tax reasons. Again, this system does not allow corrections for inflation, and makes it obligatory to spread the offset evenly for the next three years. We suggest changes to allow for inflation.
9. Limited liability companies face one fundamental problem connected with financing their growth from retained earnings (plough back). If partners in a limited liability company want to reinvest their profits in the firm, this part of profit will be taxed twice: first, as the limited liability company profit; and again as an imputed dividend of the partners (even though it does not end up as income to the partners, but rather is used to increase the firm's capital!).
   If a limited liability company wants to use its retained earnings internally without increasing the firm's capital, these funds will be taxed three times: first, at the stage of the firm; second, at the stage of the partner; and third, again at the stage of the firm, as income contributed by a partner.

There is no legal way to avoid this triple taxation. This means that the effective tax rate on retained earnings that do not increase the firm's capital could be as high as 70%. Thus, the price of internally generated funds can be prohibitively high for a limited liability company.

We support the adoption of reforms which would tax profits in limited liability companies at most two times, provided that the firm's capital is not increased, and one time if it is increased.

10. There should be rectification of erroneous regulations and practices pertaining to the application of VAT to imported and exported services. Namely, taxes on imported services cannot now be deducted from their value in the computation of VAT. Also, export services are frequently taxed at the basic VAT rate, rather than at the zero rate.
11. Joint tax returns should be permitted for married couples in situations where one of them is a (very) small business owner.
12. Because of the current stance (or "policy") of the tax administration, it is virtually impossible for firms to hold reserve funds to offset losses from non-collectibles. We suggest that the tax administration adopt a relaxed attitude toward such funds.

We also offer the following comments and suggestions relating to labor law.

The Polish Labor Law is more protective of the employee than the employer. This imposes high costs on businesses, which in the case of SMEs may profoundly hamper capital accumulation and growth.

Therefore, although we do not propose[60] any general changes to that imbalance of protection, we call the reader's attention

[60] Because of social and political ramifications.

to the plight of the smallest firms. Perhaps, instead of obligatory full Social Security protection,[61] voluntary subscription to full Social Security protection could be permitted for small or very small firms.

Finally, the minimum job termination periods could be shortened for very small firms.

We conclude this section with some final remarks.

The worst thing for all taxpayers, including SMEs, are frequent and chaotic changes in financial laws and regulations. These often cause the tax system to lose consistency. By virtue of their small size, SMEs are especially vulnerable to these detrimental influences. Therefore, although we ourselves propose some changes, the tenor of our advice is that in law-making one should move very cautiously, and first consult the SMEs via their organizations.

Another general comment concerns the vague wording of many laws. This criticism has been voiced by the present Polish Ombudsman.[62] This only reinforces our comment about moving cautiously and without haste. The damage done by poor law-making is usually very costly to repair.

The final comment concerns proper priorities in law-making. Institutions involved with market economy institutions have certain fundamental aspects which must not be changed, suspended, or abrogated under any circumstances, since this would disrupt the whole system and lead to its eventual collapse. Preserving these fundamentals is superior to any conceivable short-run goals.

We will provide one example with relevance to SMEs. The principle of limited liability is one of the basic pillars of market societies, and its contribution to the growth of those societies

61 Which, due to very high premiums, leads firms to substitute labor contracts for civil law contracts.

62 And formerly by the Polish Ombudswoman.

in the past one hundred years cannot be overstated. This role is obviously superior to any problems relating to financing temporary budget deficits, etc., however threatening they may seem.

Even so, the general principle of limited liability has been recently abrogated in Poland.[63] Partners in a limited liability company are liable with their personal property for monies due to the State (taxes and quasi-taxes). This provision, of course, is not specific to SMEs. But they are the most vulnerable to measures of this sort.

Public reaction to this measure has been so overwhelmingly negative that one would expect its fast retraction. But, as we have stated, the damage has already been done. First and foremost, this damages the general expectations of economic agents. This damage will take a long time to repair. Second, because of a sequence of political decisions, the Polish parliament has been dissolved and the legislative process halted for several months — until a new parliament is convened after the September 1993 elections.

This shows what sort of problems may arise once a bad, politically motivated, and hastily prepared piece of legislation is enacted. For this reason, we stress our recommendation for caution together with other recommendations for legal reforms.

This caution is relatively easy to exercise, as the legislature is dormant now. It will be, though, more difficult to exercise with a new parliament.

63 As described above. See the Law of March 6, 1993.

8. *Final Recommendations*

We begin by stating the general philosophy that stands behind our recommendations, since is should be remembered that our recommendations are necessarily subjective and normative.
The recommendations are based on:
(i) Results we obtained in our survey [presented in Section 5].
(ii) Comparisons with results obtained by other recent surveys [cited in Section 6];
(iii) Analysis and recommendations presented by legal experts [summarized in Section 7];
(iv) Knowledge of theory from economics and related fields.
The recommendations also reflect our beliefs as to the best economic order. Generally, we tend to believe in economic freedom and in equality of opportunity for all economic agents. This means that only limited state intervention should be allowed and that too much policy activism is not recommended. If there is to be an active economic policy, we tend to give more credit to supply-side policies than to demand-side management. In Poland's present situation, we would phrase the latter judgment more definitively by saying that Keynesian demand-side management can only be detrimental. However, there is a range of supply-side policies which we would endorse.
We support market-oriented institutional changes. Institutions may be a burden or a relief. Either way, they are inescapable.[64] One should try to contain them, control them, use them, and as far as possible, not let them petrify the status-quo.
As we have shown, SMEs have a special role to play in promoting prosperity (meaning that in their absence prosperity

64 Except for escapes into certain textbooks of economic theory.

decreases). At the same time, they have the "natural disadvantage" of higher transaction costs. Therefore, our initial ideological stance, that all economic agents should be allowed equal opportunity must mean in the context of SMEs, that certain promotional activities benefiting SMEs is acceptable and indeed necessary, since it helps to equalize their chances.

In this vein, we propose several institutional and policy measures promoting the start-up, operation, and growth of SMEs. It should be stressed, however, that the general idea here remains that one should avoid or at least minimize redistributional effects of any institutional changes and economic policies promoting SMEs. In other words, we do not suggest the promotion of SMEs at the direct expense of other firms and households. Recognizing these principles, we try to avoid presenting a long "shopping list" of the moves that would certainly increase the microeconomic efficiency of SMEs at the cost of decreasing macroeconomic efficiency. The goal of promoting SMEs is not to increase the well-being of their owners and employees at the expense of others, but to contribute to general prosperity.[65]

Thus, there are at least two good reasons for not concurring with the frequently heard proposal to decrease the interest rate on loans to SMEs:

[1] The proposal is meaningless without specifying exact mechanisms of how to accomplish it, and without identifying sources of finance.

[2] The efficacy of this proposal is theoretically doubtful, since there is a long and winding road from a specific decrease in interest rates to a general increase in prosperity.

65 The promotion of SMEs is not aimed at strengthening Olsonian "redistributional coalitions"! See Mancur Olson, The Rise and Decline of Nations, Yale University Press, New Haven 1982.

In this section, we present a look at the life-cycle of a stylized Small-or-Medium-Size-Enterprise (a SME). We will present our suggestions as comments and annotations to problems encountered by this stylized SME throughout its life. Actually, we are only interested in the period from the firm's inception to its achievement of a certain maturity and size that would allow us to regard it as being no longer an infant.[66]

When a person makes a preliminary decision about starting-up a business, the first question is what are the available legal forms and which one would be suitable under the circumstances? An auxiliary issue concerns the relevant procedures for setting-up a firm.

Both the analysis of the applicable laws and the questionnaires have convinced us that the available forms are more numerous and diversified than necessary. Procedures for setting a firm are also straightforward and cheap. Firms do not report any serious problems with registering a firm, although two or three years ago this still was one of the major nuisances for people starting economic activity.

A real problem is the inadequate knowledge of enterprise forms and start-up procedures on the part of prospective entrepreneurs, and clerks and civil servants working at local levels of government.

We therefore recommend the following:

1. No changes should be introduced as far as available legal forms of enterprises are concerned. The same pertains to start-up and registration procedures.
2. "Legal experiments" changing the traditional, fundamental characteristics of particular enterprise forms should be avoided, even if they seem to serve a particularly important short-term goal. Stability of legal framework is crucial.

66 This allows us to avoid problems of bequests, infinite life horizons, etc.

In particular, we suggest recission as quickly as possible of the deplorable amendment to the Law (on the changes in the existing tax laws) of March 6, 1993 that introduced unlimited liability of partners in limited liability companies with respect to tax obligations.

3. Local authorities should train their personnel to convey full and accurate information about the available legal forms of enterprises (and related issues) to the public.
   In particular, the form of a limited partnership [spolka komandytowa] should not be neglected, and should perhaps even be promoted as especially suitable for SMEs.
   Without going into detail, we observe a tendency to increase the scope of licensing, requiring permits, etc., for a growing number of activities. We strongly oppose this tendency. It is not only detrimental to consumers,[67] *but it is also especially threatening to small businesses which are more vulnerable to increases in fixed costs than large firms.*
4. It is, therefore, recommended that the government's itch to regulate and license economic activities an ever growing degree be reversed.
5. A minor proposal in this context is to combine all the rules and regulations on permissions and the like in one document.
6. Governmental consulting agencies for small business should be established and operated locally either free of charge or for a nominal fee, as an element of government supply-side economic policies. Obviously, the consulting agencies' work should not be limited to advising on start-up issues only. A fuller range of financial and economic counselling should be offered.

67 By increasing costs and lowering the allocative efficiency of the economic process.

7. We do not deny the possibility that private consulting firms would do a better job than the governmental agencies proposed above. Their operation should not only be encouraged, but also stimulated (especially since they may be small businesses themselves). However, there is an entry barrier and an asymmetric information problem here. To alleviate this, a scheme may be devised[68] under which the first day of consultancy to a small business (prospective or established) is offered free of charge (the fee is paid by the government). If the client finds it useful and worth the money, it may be continued on a non-subsidized basis.
8. There is a number of established or prospective volunteer organizations, mostly from abroad, which have the aim of supporting small business exactly in the ways described above. The Polish government is urged to advertise their existence and the availability of their good services.

Once the informational and legal hurdles are passed, the would-be entrepreneur faces financial problems relating to start-up capital. In Poland as elsewhere, the major source of finance are the entrepreneur's own funds (accumulated savings), as well as money borrowed from (or donated by) family and friends.

Obviously, drawing on one's own funds is rather a necessity than a virtue. This source of investment funds is very limited. What is needed is financial intermediation between savers and investors according to an economy-wide plan.[69] *But intermediation has its transaction costs. In the case of SMEs these may be high.*[70] *So loans for investment purposes may be not only hard to get, but also expensive. We propose the following measures.*

68 This scheme has actually been tried in developed market economies (DMEs).

69 Since we are dealing here with a small enterprises, raising capital at the stock markets is ruled out. What remains, in practice, are bank loans and, perhaps, mutual savings/credit associations.

70 Either objectively high, or high in SMEs' perception.

All the proposals concerning consulting must be repeated in the context of getting institutional funds for start-up. Even if credit is potentially available, prospective investors are not (technically) able to prepare and present a properly constructed investment plan and credit application. Thus, training and consulting is necessary about how to work with banks and how to secure a loan.

10. Availability of foreign (usually public and preferential) credit for SMEs should be advertised by government agencies.
11. The tax treatment of firms taking foreign credit denominated in hard currency should be more favorable than it is now.

    In particular, taxation of exchange rate differentials on loans denominated in hard currency should be reduced or eliminated.
12. One of the problems in applying for a bank loan, especially for new (or young) businesses, is the amount of required collateral. This may be prohibitive for a prospective small businessman. We propose the more aggressive provision of credit guarantees.

    Statistically, credit guarantees would carry a cost for government, since there will be defaults on loans. Hence, credit guarantees would amount to a subsidy for growth of small business.[71]

    Such a policy can be selective by branches, professions, or regions, in order to suit the Government's macro-policy goals. A record should be scrupulously maintained to prevent failing enterprises from using the public subsidy again and again.

    It must be added that the issue of credit guarantees is, of course, not limited to start-up investment capital. Basically

71 We assume that would be more successful loans than failures and cheats.

the same considerations apply as well to loans for subsequent investment and short-term working capital.

13. Having settled the issue of credit unavailability, let us turn to the cost of credit. Given continued high inflation rates, nominal costs of loans are high, even prohibitively high.[72] We do not, however, propose direct and explicit interest rate subsidies, because:
- We do not consider them to be sound theoretically;
- They are not particularly viable, given the condition of the State budget;
- They are not particularly viable, given the relative weaknesses of the SMEs' lobby.

14. As an exception to the above rule we propose the use of financial resources already earmarked for regions officially designated as being "hit by particular economic hardships"[73] to subsidize bank loans to entrepreneurs who promise to increase employment by a specified amount.

Assuming that our stylized entrepreneur has somehow secured investment funds, the next hurdle concerns property rights. Generally, many economic processes still cannot be effectuated in Poland, or at least cannot be effectuated quickly and without high transaction costs because of unresolved property rights issues.[74] *For our purposes, the discussion of property rights touches on at least three problems:*

The long awaited Reprivatization Law, that would enable interested parties to sort out outstanding property rights conflicts and deadlocks. The latter are originally the aftermath of the World War

72 In many instances, the nominal interest rate is no less relevant than the real interest rate. High nominal interest rates may cause liquidity problems and even lead to firm's insolvency, despite low real cost of the loan or the firm's good long-term prospects.

73 Mostly regions with very high rates of structural unemployment.

74 These costs are usually prohibitive for small business.

II, of postwar, communist-led (and often illegal even in the light of the then existing law) confiscations, and of nearly half a century of neglecting property issues.[75]

The increasing use of mortgage credit. In the earlier discussion of collateral, we did not mention mortgage credit as one of the possible solutions. Obviously this requires sorting out some property rights issues first.

Land and premises leasing. Lack of diversified legal standards that are well embedded in everyday business practice severely limits the use of lease. This, in turn, exercises negative influences similar to these stemming from the lack of uncontested property deeds, as mentioned above. In addition, local authorities (who in many instances are the owners of premises and less often of land) are not inclined to lease for extended time periods. Short leases inhibit investment by lessors.[76]

Concerning these issues, we offer the following recommendations:

15. The Reprivatization Law should be enacted as soon as possible, clearing the way for ultimate settlement of real property disputes.
16. It is hard to envisage radical and effective ways to encourage local authorities to lease property for longer periods. Nevertheless, the following three things should be done:

- Create a political climate encouraging local authorities to lease for longer periods;
- Speed up reform of local finance, and at the same time educate local authorities that a stable economic environment (including longer lease contracts) is conducive to investment, and hence to local economic prosperity and increased tax revenue;

75 Neglected by everyday practice, and to a lesser extent by law.

76 We base our observations on the recent "Privatization Survey in Eastern Europe," by Rapaczynski and Frydman, mimeo, Warsaw 1993, which cites indecision of local authorities in granting leases.

- It is possible, though we have not explored this issue deeply, that a more sophisticated legal framework for leasing may be helpful. A review of legal structures pertaining to leasing could be desirable.

The next issue that the entrepreneur faces concerns his skills, as well as skills of his managers and workers skills. Based on the results of our survey, we propose the following:

17. Managerial training for small entrepreneurs should be organized by central and local authorities, with emphasis on law, banking, and marketing. Training courses should be short, hands-on, and not oriented toward theory. It seems that universities and other non-profit organizations should be encouraged by Government grants of appropriate financial and logistic support in order to open Small Business Centers.

Our entrepreneur has successfully started business operations. From survey responses, and from our analysis of legal institutions, we observe a number of obstacles to the firm's day-to-day operation and its long-term growth. Numerous legal impediments have been described in detail in Section 7. Therefore, we repeat them here only briefly.

18. Old, administratively sanctioned, petrified channels of cooperation and product distribution that existed for forty years have ceased to exist. Fast and reliable information about customers, potential markets, and channels of distribution, on both a regional and national level, is a crucial element of SMEs success.

The free flow and efficient exchange of commercial and industrial information should be encouraged by Government. Free (costless) access to standardized commercial information system should be therefore granted to SMEs. Of course, this requires the creation of such information networks based on EDI.[77]

A minor point in the context of disrupting the existing channels of cooperation is the one we mentioned in Section 7 about VAT exemptions. There, we argued for optional, rather than obligatory, VAT exemptions for small businesses.

19. An efficient system of payments is a prerequisite for economic success. Despite often heard popular critique of the allegedly very slow speed of "technical" change in Polish banking, the authors recognize that these changes take time. We are moderately satisfied with the pace of change. Thus, we modestly propose that modernization of the payments system continue to be one of the top priorities in a policy of transforming the whole financial sphere.

One of our initial postulates pertained to facilitating acquisition of venture capital. Certainly, this issue does not cease to be a problem once the firm has started. After a period of successful operation, the firm looks for ways and means to invest and grow. The availability and cost of finance again becomes crucial. In addition to our proposals relating to start-up capital, we now add the following measures to increase economic growth by tapping both external (banks) and internal (amortization and retained earnings) sources of finance.

20. With respect to amortization rates, we propose:

- Allowance for widespread use of accelerated amortization rules (the existing regulations should be reviewed with this in mind).
- Possible linkage of amortization rates to the intensity of fixed capital use (number of shifts worked).
- Introduction (definitely!) of an investment tax credit. This proposal is unequivocal from legal expertise, responses to

77 EDIFACT, ANSI, or other compatible transmission protocols. The work done in this area so far by PolPro Co. in Warsaw falls short of the existing needs.

our and other surveys, economic theory, and the practice of other countries.

- Treatment (definitely!) of leasing fees as costs.[78]

There is no need here to re-emphasize the negative relationship between level of taxation and economic effort. However, in compliance with our philosophy, we do not propose tax breaks for small business only, since these would have strong redistributional effects. We offer instead the following general proposals, or rather remarks.

21. The Minister of Finance should hang an enlarged graph of a Laffer Curve on the wall opposite his desk.
22. It should be remembered that, because of their small size, SMEs are more easily damaged by excessive tax burdens than large firms, which better absorb external shocks. This should be remembered when setting any tax burdens.
23. Excessive taxation causes "excessive" tax avoidance. Even legal tax avoidance occasions transaction costs, and is generally easier for larger firms. Thus, due to excessive taxation, smaller firms tend to plunge into (illegal) tax evasion and the gray market. One such example involves replacing costly labor contracts (nearly 50% social security tax) with civil law contracts (no social security tax, no employee protection). Therefore a decrease in social security burdens must be proposed. We fully appreciate that this can be done only as an element of a comprehensive reform of social protection programs.
24. Taxation rules and their implementation cannot be aggressive. By this we mean that creating loopholes in enacted legislation, and then trying to close them by issuing dubious "executive orders", or acting without specific legal authority, creates much more damage than letting legal tax avoidance continue. Above all, it destroys the confidence of economic agents.

78 This is what they are.

25. For the same reasons, tax policy cannot serve short-term, volatile fiscal goals.

So far, we have considered a SME operating exclusively in the Polish domestic market. Survey responses show that SMEs involvement in foreign trade is indeed marginal. Their foreign financial operations are virtually nil (a consequence of the fact that Polish currency is convertible only for current account transactions, and on a limited scale). Nevertheless, several points should be made, especially respecting foreign credit lines potentially available to SMEs and used only sparingly to date.

26. Government agencies should extend the information and training activities proposed above[79] to export promotion activities. In particular, there should be much more information about the availability to SMEs of foreign credit denominated in hard currency. Consulting assistance offered to exporters should especially stress advice on formulating investment project plans that will be formally acceptable by agencies representing foreign lenders.
27. The tax treatment of the exchange rate differentials on loans denominated in hard currency should be changed. Understanding that this would tantamount to exempting from tax those capital gains stemming from the exchange rate changes (recently, however, the zloty has been devalued), we note that such gains are more than offset by the Polish rate of inflation. Thus these capital gains are only nominal. The current capital gains tax on exchange rate differentials has the consequence of discouraging the use of foreign loans denominated in hard currency.

★ ★ ★

[79] In points 6, 8, 9, 10, 17, and 18.

In addition to the proposal we have already offered, a very important general recommendation should be added about the need to create a climate for entrepreneurship. The crucial question is whether the government (very broadly understood) is promoting a society led by consumers or producers. After half a century of artificially promoting state-owned enterprises, we tend to neglect the idea that the producer can be the most important.

Yet, it is to be remembered that with all possible consumer sovereignty, long-run prosperity is led by producers. Developed and prosperous societies are those which maintain high and efficient production effort (and hence consumption). High consumption without high production effort, if it occurs, is a short-lived phenomenon.

Prosperous societies are those in which people think of themselves as producers. This requires a change in an entire society's wage earner mentality. An entire society cannot consist of wage earners. There must be entrepreneurs.

In order for such a change of mentality to begin, there must be a clear political and ideological message which says, "Yes, we are building a society of producers in which the merits of entrepreneurship are not inferior to the values represented by consumers, employees, and above all, the Government."

The responses to our survey allow us to be a bit optimistic in believing that such a beneficial change in attitude toward small business may now be occurring in Poland.

9. Appendix I: Text of the Questionnaire

September 1, 1992
ICEG - International Center for Economic Growth, San Francisco
ASRC - Adam Smith Research Centre, Warsaw
UW - University of Warsaw, Warsaw
PBS - Social Surveys Lab, Sopot

Interviewer:_____

Date of the interview:_____

Name of the firm:_____
_____

Address of the firm:_____
_____
_____

SURVEY
on Polish private small & medium enterprises

I. basic information

1. Position held by the respondent: (K1)
   owner or co-owner 1
   director 2
   other (specify)_____ 3

2. Sex of the respondent: (K2)
   male 1
   female 2

3. Age of the respondent:_____ years (K3)

4. Month/year of the Firm's registration:_____ (K4)

5. Month/year of the actual beginning of activity by the Firm:_____ (K5)

6. Who is the owner of the Firm (shares of ownership in per cent):

The State	_____%	(K6)
The Respondent	_____%	(K7)
Other private co-owner	_____%	(K8)
Private foreign investors	_____%	(K9)
Firm's employees	_____%	(K10)
Other (specify)	_____%	(K11)
TOTAL:	100 %	

7. Legal form of the Firm: (K13)

Limited Liability Company	1
Joint Stock Company	2
Civil Law Partnership	3
(General) Partnership	4
Other (specify) _____	5

8. Which of the following describes your Firm the best: (K14)
(only one answer to be chosen)

Manufacturer	1
Service Firm (other than construction)	2
Retailer	3
Wholesaler	4
Construction Firm	5
Other (specify)_____	6

9. Principal Product (or Service) (K15)

_____

_____

II. the entrepreneur

a. the profile

10. Education of the Respondent: (K16)

primary school not completed	1
primary school completed	2
vocational school completed	3
secondary school (general or technical high school) completed	4
post-high-school training completed	5
college or university not completed	6
college or university completed	7
post-graduate education	8
other (specify)_____	9

11. What kind of short-term training (courses) would be the most useful for you now? (choose only one) (K17)

none	1
accounting/book-keeping	2
marketing	3
training in using banking and financial services	4
learning modern production techniques	5
law	6
export/import	7
other (specify)_____	8

b. the beginnings of activity

12. Beginnings of the Firm. Why was it founded; When; By whom; What were the main products manufactured at the beginning? Basic differences in the Firm's profile in the beginning and today (respondent should tell his/her own story):_____ (K18)

_____

_____

III. firm's profile

a. labor and its cost

(i) Structure of Labor

(in questions 13-24 give absolute numbers)

13. _____ Owners and members of their families employed full-time (K19)

14. _____ Hired workers (other than owners) employed full-time (K20)

15. _____ Apprentices employed full-time (K21)

16. _____ Total number of full-time employees (K22)

17. _____ Total number of part-time employees (K23)

Labor force by sex

18 _____ Males employed full-time (K24)

19. _____ Females employed full-time (K25)

Labor force by duties performed and qualifications

20. _____ Machine operators (except for office machines) (K27)

21. _____ Auxiliary workers: in packing, transport, etc (K28)

22. _____ Administrators (K29)

23. _____ Technicians, Engineers (K30)

24. _____ Other workers (specify)_____ (K31)

25. Do the newly employed workers generally posses proper skills and qualifications? (K32)

No. (Why?)_____ 1

_____

_____

Yes. (Why?)_____ 2

_____

_____

Other (comments):_____ 3

_____

_____

26. Are there any problems in finding workers with skills required? (K33)

No 1

Yes (what kind of problems:)_____ 2

_____

Other (comments)_____ 3

_____

27. Does the Firm organize any training for its workers? (K34)

No. (Why?)_____ 1

_____

_____

Yes (Please specify in what forms, why, how often):_____ 2

_____

_____

Other (comments)_____ 3

_____

28. Where have the workers acquired skills they use in the Firm? (K35)
Indicate three best fitting answers and rank them in a descending order by placing numbers 1, 2, and 3 next to them.

In school(s) 1
In extra-mural courses 2
On the job, during their former employment in other Firms 3
On the job, during their present employment 4
Other (comments): 5

29. Are the employees represented by the Unions? (K36)

No 1
Yes (what Union?): _____ 2

_____

Other (comments):_____ 3

_____

If not, are the workers likely to form a Union in the Firm within the next 12 months? _____ (K37)

_____

30. Has it ever in the Firm's history been necessary to reduce employment? (K38)
(it concerns employment reduction related to the general state of the economy rather than cases of incidental terminations or quits)

No, it has never been necessary 1
Yes, it has been necessary 2
Other (comments):_____ 3

If yes, explain when, in what number and in what form it has taken place (e.g, group layoffs, temporary layoffs, working short hours, etc) (K39)

(ii) Cost of Labor

31. What is the total cost of labor (including wages, salaries, bonuses, benefits, taxes, social security taxes and contributions, etc.). Give the total value for the entire Firm per month (specify the date_____): (K40)

_____zlotys/month

32. How much of the above total is actually paid out to workers/employees. Give the gross value, i.e. thatbefore deducting the preliminary personal income tax due: _____ zlotys/month (K41)

33. Who determines the wage rates of the hired employees/workers (except salaries of the directors)? (K42)

1 The owner or the top management without any outside interference 1
2. Wage rates are the result of bargaining between owner/management and Trade Unions 2
3 Other (specify): _____ 3

34. Who determines the top management compensation? (K43)
1. Board of Directors 1
2. The owner(s), after consulting the directors 2
3. The owner(s), solely and without consulting the directors 3
4. Other (specify): _____ 4

35. Who determines whether a director should be terminated:_____ (K44)

36. How many directors have been terminated during the past 12 months: _____ (K45)

37 How much severance pay did the terminated directors receive: (give the amount in zlotys or describe, e.g. this and this many shares; fill in "zero"; or fill in "n.a."):_____ (K46)

38. Are the directors required to post bonds or security deposits that they lose in case of poor firm's performance: (K47)
1. No 1
2. Yes (explain):_____ 2

39. Have relative wages within the firm ever been adjusted to attract workers of particular profession/skills: (K48)
1. No, never 1
2. Yes, once 2
3. Yes, two-three times 3
4. Yes, many times 4
5. Other (specify)_____ 5

40. Estimate, what proportion of regular (non-bonus) pay to workers was contingent on: (K49)
- amount of time worked by that worker:_____% (K50)
- individual performance of that worker:_____% (K51)
- group (team/department) performance:_____% (K52)
- performance of the entire firm:_____% (K53)
- other (specify):_____% (K54)

TOTAL: 100 %

41. Do you believe that effort and work discipline can be increased while shirking and absenteeism decreased by paying wages that are higher than standard? (K55)
1. No 1
2. Yes 2
3. Other (specify):_____ 3

If yes, do you follow such a policy (K56b)
1. Yes 1
2. No 2

b. FIXED CAPITAL

(i) Land and Structures

42. How did the firm acquire currently occupied premises? (K57)
(can choose more than one answer)
1. Bought them. When:_____ 1
From whom:_____
_____
2. Inherited them 2
3. They have been a property of the firm's owner or of the member of his/her family 3
4. Have been leased for at least several years (since when:_____ 4
_____)
5. Have been leased for yearly periods (altogether since when: 5
_____)
6. Are leased monthly (altogether since when: _____ 6
_____)
7. Other (comments):_____ 7

43. How did the firm acquire currently occupied land? (K58)
(can choose more than one answer)
1. Bought them. When:_____ 1
_____
From whom:_____
_____
2. Inherited them 2
3. They have been a property of the firm's owner or of the member of his/her family 3
4. Have been leased for at least several years (since when:_____ 4
_____)
5. Have been leased for yearly periods (altogether since when: 5
_____)
6. Are leased monthly (altogether since when: _____ 6
_____)
7. Other (comments):_____ 7

44. Are the currently occupied premises and land adequate for the firm? (K59)
1. Too small 1
2. Just right 2
3. Too big 3
4. Other (comments)_____ 4

If "too small" then:

45. Is it possible for the firm to purchase or lease more land and larger premises? (K59 BIS)
1. No. Why:_____ 1
_____

2. Yes 2
3. Other (comments)_____ 3

(ii) Plant and Equipment

46. What is your estimate of the average age of firm's core equipment: (K61)
1. Less than one year 1
2. 1-3 years 2
3. 3-5 years 3
4. 5-10 years 4
5. 10-20 years 5
6. More than 20 years 6
7. Other (comments):_____ 7

47. Has the firm bought any additional (brand new or used) equipment since the beginning of its activity ? (K62)
1. No 1
2. Yes 2
3. Other (comments):_____ 3

48. What is the main source of equipment bought by your firm? (only one answer to be chosen) (K63)
1. Domestic manufacturers 1
2. Foreign manufacturers, mainly from the former Comecon countries 2
3. Foreign manufacturers, mainly from the countries other than Comecon 3
4. Other (comments)_____ 4

49. Does the firm encounter any problems with buying imported equipment? (K64)
1. No 1
2. Yes. (What kind of?)_____ 2
_____
_____
3. Other (comments):_____ 3

50. What kind of problems regarding the use of domestically produced equipment does the firm encounter? (K65)
1. No problem at all 1
2. Low quality 2
3. It is more expensive than the imported one 3
4. The required equipment is not manufactured domestically 4
4. Other (comments):_____ 5

51. Which fixed capital depreciation method do the firm's accountants use? (K66)
1. write-offs against current costs 1
2. the straight line method/the fixed installment system 2
3. other (describe):_____ 3

c. finance and cost of capital

52. Specify the sources of funds used to meet current financial needs of the firm just after it started and now. Fill in the table below, inserting (x) where appropriate.

Sources of funds	during first six months (K67)	between the 6th month & 1st year (K68)	between 1st and 3rd year (K69)	after 3 years (K70)	
1.own savings					1
2.lent by family					2
3.lent by friends					3
4.provided by a gov't program					4
5.lent by a bank					5
6.reinvested profits					6
7.credit by suppliers					7
8.other (specify)					8

53. What is the most serious problem faced by your firm in the area of finance:_____ (K71)

54 Has your firm ever tried to take a loan from a commercial bank or another financial institution? (K72)

1. No 1
2. Yes, but never successfully. Why:_____ 2
3. Yes, the firm has taken a loan/loans (even if there were credit denials in the meantime).Specify how many loans have been taken:_____ 3
4. Other (specify):_____ 4

If the firm has obtained one or more loans, what were the terms (specify terms for three most important loans):

	first loan: (K73)	second: (K74)	third: (K75)
interest rate:			
maturity period:			
name of the bank:			

55. Assuming the current levels of interest rates on loans denominated in zlotys (domestic currency), could your firm envisage taking a long term loan? (K76)
1. No. Why:_____ 1
_____
2. Yes. 2
3. Other (specify):_____ 3

56. How difficult would it be for your firm to obtain a long term loan now (assuming a market-level, non-subsidized interest rate): (K77)
1. Very easy 1
2. In norm 2
3. Rather difficult 3
4. Very difficult 4
5. Other (specify):_____ 5

57. Main problems with obtaining a loan: (K78)
(can select more than one answer)
1. A lot of paper work 1
2. The firm has too small own capital to obtain an outside loan 2
3. The loan that can be obtained is too small anyway 3
4. Creditors prefer their traditional customers, especially those with large current accounts/deposits at creditor's institution 4
5. Creditors discriminate against your particular firm 5
6. Creditors require excessive guarantees/collateral. Specify: 6
_____
_____
7. Other (specify):_____ 7

d. raw materials, semi-products, and energy consumption

58. What is the proportion of imported raw materials and semi-products in the total of raw materials and semi-products now as opposed to the beginnings of the firm's operation: (K79)
1. Roughly the same 1
2. Higher 2
3. Lower 3

If there has been a change, how do you explain the reasons: (K80)
_____
_____
_____
_____

e. technology and productive capacity

(i) Production

59. How many hours per week does the firm operate? _____hours (K81)

60. How many hours per week could the firm operate, if it were using its productive capacity to the fullest?_____hours (K82)

61. Was there any change in the final consumer price of your principal product (commodity or service) during the past 12 months? (K83)

1. No, there was no change 1
2. Yes, there was an increase by_____% 2
3. Yes, there was a decrease by_____% 3
4. If there was a change, state the reasons why:_____ 4

_____

_____

5. Other (comments):_____ 5

62. Does the firm currently sell all it produces? (K84)
(In the case of a service firm compare the demand for services provided with the maximum potential level of providing them)
1. No, the firm wants to sell more (too low demand) 1
2. Yes (demand equals supply) 2
3. Yes, though it could sell much more (too low supply) 3
4. Other (specify):_____ 4

63. If the firm cannot sell all it produces, does it lower the prices of its products? (K85)
(In the case of a service firm it pertains to the situation in which the demand for services provided is lower than the maximum potential level of providing them)
1. No 1
2. Yes 2
3. Not applicable 3

If not, state why

_____

_____

If yes, was this strategy successful.

_____

_____

_____

64. If the firm could sell more than it produces, then why it does not increase production? (if not applicable, indicate below) (K86)

_____

_____

_____

_____

(ii) Changes in Production

65. How has the level of firm's output changed during the past 12 months? (K87)
Indicate no more than two most important causes of this change:
1. No change has been recorded 1
2. It has grown - due to the changes in exchange rate 2
3. It has grown - due to the changes in prices of raw materials 3
4. It has grown - due to the increase in demand 4
5. It has grown - due to the changes in legal regulations 5
6. It has grown - because imported competitive goods are now more expensive 6
7. It has grown - because supply from state owned enterprises has fallen 7

8. It has grown - due to other reasons (specify): 8

_____

_____

9. It has fallen - because aggregate demand was falling 9
10. It has fallen - due to increased competition from imports 10
11. It has fallen - due to increased competition from domestic producers 11
12. It has fallen - due to high cost of imported raw materials and semi products 12
13. It has fallen - due to high cost of domestic raw materials and semi products 13
14. It has fallen - because of labor shortage 14
15. It has fallen - due to other reasons (specify): 15

_____

66. When compared with the beginning of firm's operation, has the profile of production changed? (i.e. has the mix of final products/services rendered/goods sold changed markedly) (K88)
1. Yes 1
2. No 2
3. New products (describe them; why did the firm began producing them; for what market?): _____ 3

_____

_____

_____

Output of the following products has increased: _____

_____

_____

Output of the following products has decreased: _____

_____

_____

The following products have been discontinued: _____

_____

_____

_____

67. What changes are foreseen for the future? (K89)
(choose only one answer):
1. Maintaining the same level of output and the same product mix 1
2. Maintaining the same level of output but introducing new products 2
3. Substantial increase in output and in productive capacity (increasing the size of the firm) 3
4. Increase in output but within the same productive capacity (the firm will not grow but it will use higher proportion of its productive potential) 4
5. Decreasing output 5
6. Other (specify): _____ 6

_____

_____

68. If you plan maintaining or decreasing the level of output, state why (choose only one answer): (K90)
    1. Because it will ensure optimum economic (financial) performance 1
    2. Because there is no demand for increased production 2
    3. Because the current high demand is a temporary phenomenon 3
    4. Due to lack of investment funds 4
    5. Due to fear of too high a risk associated with investing 5
    6. Other (specify):_____ 6

69. Do you intend to start another, new firm within the next 12 months (in the case of a director who is not the co/owner it means whether she or he intends to quit the present firm and start his own enterprise)? (K91)
    1. No 1
    2. Yes, I contemplate it, but I am still undecided 2
    3. Yes, I am sure I will do it 3
    4. Other (specify):_____ 4

    If you gave answer #2 (yes, but still undecided), specify what could transform your decision into a definite yes:

70. If you have answered yes to question 69 above, what particular legal form will your new firm assume? (K92)
    1. Limited liability company 1
    2. Civil law partnership 2
    3. (General) partnership 3
    4. Joint stock company 4
    5. Other (specify):_____ 5

f. sales and marketing

(i) Profits

71. Has the firm recently been generating positive profits? (consider last two-three months) (K93)
    1. No, has been incurring losses 1
    2. No, has been breaking even (just covers costs) 2
    3. Yes 3

72. Is the enterprise more or less profitable now than at the beginning of its operation? (K94)
    1. Roughly the same 1
    2. More profitable 2
    3. Lass profitable 3
    4. Other (specify)_____ 4

(ii) Sales and the Market Structure

73. What channels of distribution are used by the firm? (K95)
(More than one answer can be chosen)
1. It sells in its own stores/factory outlets 1
2. It sells to state owned enterprises (other than retailers or exporters) 2
3. It sells to other privately owned firms (other than retailers or exporters) 3
4. It sells to state owned retailers 4
5. It sells to privately owned retailers 5
6. It sells to the government or its agencies 6
7. It sells to private exporters 7
8. It sells to state owned exporters 8
9. Other (specify):_____ 9

Indicate the major channel: (quote number from above list)____ (K96)

74. What are the major markets for the firm's produce? (K97)
(choose no more than two answers)
1. Locality (where it is manufactured) 1
2. In nearby towns 2
3. On the national market 3
4. In Western Europe 4
5. In countries of East and Central Europe 5
6. Elsewhere (specify): _____ 6

Indicate the major market: (quote number from above list)____ (K98)

75. Indicate typical recipients of services and goods supplied by the firm (choose no more than two answers): (K99)
1. Farmers 1
2. Town people in low income brackets 2
3. Town people in middle income brackets 3
4. Town people in high income brackets 4
5. Other (specify):_____ 5

76. Does the firm possess regular channels for distributing its produce (or service)? (K100)
1. No 1
2. Yes 2
3. Other (specify):_____ 3

If not, then how does it distribute its produce/service:
_____
_____

If yes, describe those regular channels:
_____
_____

(iii) Export

77. Is any part (or the whole) of firm's produce exported? (K101)
1. No 1
2. Yes, directly by manufacturer 2
3. Yes, via intermediaries 3
4. Other (specify):_____ 4

78. If yes, then what proportion of firm's produce is exported: (K102)
_____% (If there is no export, mark it as 0%)

79. If the firm exports, what are the major problem areas it encounters in connection with its export operations (choose no more than two answers)? (K103)
1. Taxation 1
2. Legal regulations 2
3. Tariffs 3
4. Banking 4
5. Excessive paper work and red tape 5
6. Other (specify):_____ 6

80. If the firm does not export, do you consider it advantageous (K104)
1. No, it is disadvantageous 1
2. Yes, it is advantageous 2

If disadvantageous, state briefly why:_____

(iv) Competition

81. Indicate the main competitor of your firm (choose one): (K105)
1. No competitors 1
2. Another small private firm 2
3. A large private firm 3
4. A state owned enterprise 4
5. A concern 5
6. A foreign owned company 6
7. A joint venture (Polish-foreign) 7
8. Imports 8
9. Other (specify):_____ 9

82. When compared with the beginning of firm's operation, has the number of direct competitors increased? (K106)
1. No 1
2. Yes 2
3. Other (specify):_____ 3

83. How many other enterprises do produce or sell the same array of products/services as your firm? (If you are a multi-product firm include enterprises whose array of products/services is the same as yours)? (K107)

1. None 1
2. 1-10 2
3. 11-50 3
4. 51-100 4
5. Over 100 5
6. Other (specify):_____ 6

IV. government policy

a. facts about firm's registration process

84. Have you had any problems with obtaining permission to start or expand firm's operation? (K108)
(in what year/s:_____) (K109)
1. Yes 1
2. No 2
8. Other (specify):_____ 3

If yes, then what problems and with what kind of permission:

_____
_____
_____
_____

85. How long did it take to obtain all the licenses, certificates, permits, etc necessary to start firm's operation? (K110)
1. Several days 1
2. Lass than a month 2
3. 1-3 months 3
4. 3-6 months 4
5. More than 6 months 5
6. Other (specify):_____ 6

b. taxation

86. What taxes (other than those levied on the payroll) is the firm subject to (even if your firm is now exempt from some particular tax and is not actually paying it): (K111)

_____
_____
_____
_____

87. Do you think that the present tax system includes some special devices that stimulate investment in new machinery, plant, or structures (e.g. a possibility of using accelerated depreciation method that would reduce the tax base, etc): (K112)
1. No 1
2. Yes. Explain:_____ 2

_____
_____
_____

c. domestic currency convertibility and exchange rate

88. Do you think that the partial (internal) convertibility of Polish (K113)
currency (introduced in January 1990) is for your firm:
1. totally irrelevant 1
2. not too relevant 2
3. important 3
4. of key importance; it is hard to imagine firm's operation without it 4
5. other (specify):_____ 5

89. Polish currency (the zloty) is convertible, but: (K114)
only internally, i.e. for domestic residents - physical persons living and firms registered in Poland; and
only for so called current transactions, i.e. for purchases of goods and services, rather than for capital investments.

In this connection, do you think that from the point of view of your firm it is necessary to enlarge the scope of convertibility:
1. No, it is not necessary to enlarge it 1
2. Yes, enlarge it to external convertibility - the zloty should be convertible for everybody, not only for domestic residents 2
3. Yes, enlarge it to convertibility on capital account the zloty should be convertible in capital investment transactions (e.g. buying foreign shares of stock, placing deposits in Swiss banks, Germans could buy Polish government bonds, etc.) 3
4. Yes, enlarge it to both external and capital account convertibility 4
5. Other (specify):_____ 5
6. I do not understand the question 6

90. Answer the above question once again, but judging from the point of view of the interest of the whole national economy (K115)
1. No, it is not necessary to enlarge it 1
2. Yes, enlarge it to external convertibility - the zloty should be convertible for everybody, not only for domestic residents 2
3. Yes, enlarge it to convertibility on capital account - the zloty should be convertible in capital investment transactions (e.g. buying foreign shares of stock, placing deposits in Swiss banks, Germans could buy Polish government bonds, etc) 3
4. Yes, enlarge it to both external and capital account convertibility 4
5. Other (specify):_____ 5
6. I do not understand the question 6

91. Why, in the first place, is convertibility important for your firm. Give three reasons, starting with the most important):
1._____ (K116)
2._____ (K117)
3._____ (K118)

92 Which of the following arrangements would be thee most advantageous for your firm - the exchange rate that is. (K119)

1. fixed, set by the state 1
2. fixed, set by the state but adjusted at times (by devaluing) 2
3. automatically devalued by a fixed, predetermined magnitude (i.e. the crawling peg - as we have it now) 3
4. floating - determined exclusively by foreign exchange market (the state could influence it only by buying and selling foreign exchange, on par with other market participants) 4
5. other (specify):_____ 5
6. I do not understand the question 6

93. If the zloty were convertible for capital account transactions, would your firm invest in any form abroad (in foreign securities, depositing on foreign bank accounts, buying foreign real estate, etc) (K120)
1. No, for sure not 1
2. No, rather not 2
3. Yes, rather yes 3
4. Yes, for sure yes 4
5. I do not know 5
6. Other (specify): _____ 6
7. I do not understand the question 7

94. What is exceptionally inconvenient/threatening for your firm: (K121)
1. Exchange rate swings/instability 1
2. "Inadequate" level of exchange rate 2
3. Both of the above with equal strength 3
4. None of the above 4
5. I do not know 5

95. If there were a foreign exchange futures market established in Poland, would your firm be interested in buying/selling foreign exchange futures contracts? (K122)
1. No 1
2. Yes, to hedge against exchange rate risk 2
3. Yes - to speculate on exchange rate fluctuations 3
4. Other (specify):_____ 4
_____
5. I do not understand the questions 5

96. Do you in your current management of your firm assume now that despite domestic inflation the exchange rate of the Polish zloty against major Western currencies will not be growing strongly (i.e. the number of zlotys per dollar will not be growing strongly): (K123)
1. Yes, the exchange rate will not have reached 15,000 zlotys/$ before the end of 1992 1
2. The exchange rate will have reached the level of 15,000 to 20,000 zlotys/$ before the end of 1992 2
3. The exchange rate will have exceeded 20,000 zlotys/$ before the end of 1992 3
4. I have no opinion, since Polish economy is very much unstable 4
5. I have no opinion, since it is hard to predict what the government will do next 5
6. I have no opinion, since Polish economy is very much unstable and it is hard to predict what the government will do next 6

7. Other (specify):_____ 7

_____

8. I do not understand the question 8

v. conclusions

97. What are the major problems a person starting a new business/firm faces now in Poland?_____ (K124)

_____

98. How do you rate the attitude toward private business in general on the part of:

	the govern -ment	local adminis -tration	state owned firms
	(K125)	(K126)	(K127)
(enter a cross where appropriate)			
1. Is very negative			1
2. Is negative			2
3. Is neutral			3
4. Is positive			4
5. Is very positive			5

99. How do you rate the attitude of the people (i.e. of the society) toward private business in general? (K128)

1. Is very negative 1
2. Is negative 2
3. Is neutral 3
4. Is positive 4
5. Is very positive 5

100. How do you rate the attitude of the people (i.e. of the society) toward your firm in particular? (K129)

1. Is very negative 1
2. Is negative 2
3. Is neutral 3
4. Is positive 4
5. Is very positive 5

101. Judging from your/your firm's perspective, what should the government do in order to stimulate more private businesses to be established? _____ (K130)

_____

_____

_____

_____

_____

102. Have you heard about any program of assistance for private firms (credit assistance or training assistance, for example)? (K131)

1. No 1
2. Yes 2
3. Other (specify):_____ 3

If yes, then what program was it? What is your opinion about it? (K132)
Have you participated in it?_____

_____
_____
_____
_____

* * *