

# **Small and Medium-Sized Enterprises in the Czech Manufacturing Industry\***

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## Abstract

In the framework of the economic reform implemented in the CSFR since 1990, the re-establishment of the private sector has been a key element. The role of small and medium-sized enterprises—because of their ability to increase competitiveness of production and consequently the export performance, to adopt new technologies, to modernise the economic structure and to create new employment opportunities—has been extremely important.

This paper starts with a brief introduction into the history of industrial organisation in Czechoslovakia and then focuses on the development of the private sector in the country, which was at the beginning almost identical with the sector of SMEs. After these first steps, systemic governmental assistance to SMEs was developed and implemented. This system is explained, and the performance of SMEs and barriers in this field are characterised.

## Abstrakt

V rámci ekonomické reformy zaváděné v ČSFR od roku 1990 bylo znovuvytvoření soukromého sektoru klíčovým prvkem. Úloha malých a středních podniků je velmi významná vzhledem k jejich schopnostem zvyšovat konkurenční schopnost výrobků a služeb, a tím i exportní výkonnost, zavádět nové technologie, modernizovat ekonomickou strukturu a vytvářet nové pracovní příležitosti.

Tento příspěvek nejprve stručně uvádí historii průmyslové organizace v Československu a potom se zaměřuje na rozvoj soukromého sektoru v zemi, který byl zpočátku téměř identický se sektorem malých a středních podniků. Po těchto prvních krocích byla vypracována a zavedena systémová vládní podpora sektoru drobného a středního podnikání. Tento soubor opatření je vysvětlen a je charakterizována výkonnost malých a středních podniků, jakož i překážky vyskytující se v této oblasti.

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## **1. The History of Czechoslovak SMEs and Industrial Organisation (1918–89)**

At the beginning of the 20th century, the Czech Lands were the most industrially developed part of the Austro-Hungarian Monarchy, competing technologically and commercially with the most advanced countries in Europe. Formed during the break-up of the Austro-Hungarian Monarchy in 1918, Czechoslovakia by the 1930s ranked among the ten major European industrial countries, enjoying a strong tradition of craftsmen skilled in producing machinery and other manufactured goods and of businessmen adept in exporting these goods. Incomes were high, and the well-developed economy succeeded in forging close financial and industrial links with the rest of Europe.

During the inter-war years, the importance of the industrial sector for Czechoslovakia's economy steadily increased. As early as 1921, 33.8 percent of the working population was employed in industrial occupations. Estimates indicate that by 1938 the industrial sector accounted for 65 percent of the total value of Czechoslovak production, and that in 1937 it contributed 35 percent to the national income.

The rise in industrial production was accompanied by moves to introduce labour-saving devices in the production process, to reduce the costs of production and to improve profit margins which gave renewed impetus to the trend toward rationalisation and concentration in Czechoslovak industry. However, this process had differing effects on individual branches of industry (an effective oligopolistic structure in iron and steel production, as well as widespread dispersion in the food-processing, textile and clothing industries). In that period, Czechoslovakia had a substantial base of small and medium-sized firms. According to the 1930 census, a total of 378,577 firms employed between one and five people; these consisted of handcraft workshops or small specialty establishments, mainly in the food-processing, wood, clothing and leather industries. As Teichová (1988, p. 37) points out, this accounted for 89 percent of industrial firms yet used only 10.5 percent of all power produced, whereas the 41,438 establishments with six or more employees (11 percent of all industrial firms) consumed 89.5 percent of all power used by Czechoslovak industry.

Although self-employment and small firms continued to play a significant role, the overwhelming majority of Czechoslovak workers were employed in the medium-sized and large-scale enterprises. Despite the relatively widespread distribution of medium-sized enterprises, a tendency towards concentration took place. Table 1 reveals that enterprises with more than 500 employees represented only 1.1 percent of all undertakings but employed 29.4 percent of all industrial workers

while firms with more than 250 employees accounted for 42.1 percent of total industrial employment.

Table 1  
Czechoslovak Industrial Enterprise Size Distribution  
(According to Number Employed, 1930)

Enterprise employment size categories	Number and shares of enterprises		Number and shares of workers employed	
	No.	%	No.	%
6–20	28,612	69.0	262,326	15.6
21–50	7,020	17.0	223,538	13.3
51–100	2,905	7.0	202,617	12.2
101–250	1,833	4.4	281,144	16.8
251–500	622	1.5	213,667	12.7
501 and over	446	1.1	492,160	29.4
TOTAL	41,438	100.0	1,675,272	100.0

*Source: Teichová (1988)*

According to Benáček (1994), the following factors characterised Czech society and formed the economic development before 1938:

- a reliance on democracy;
- a combination of market competition with foreign trade controls, cartels and bureaucratic interventions;
- restrictive monetary policy and convertibility;
- the enforcement of private property rights;
- a liberal attitude towards religion and other nationalities;
- competition between Czechs and the local German and Jewish minorities;
- intensive free trading, mainly with the Western and Southern neighbouring countries and
- a division of labour and specialisation in labour and human capital intensive industries.

The Nazi occupation of Czechoslovakia in 1939–45 severely suppressed practically all of the above mentioned factors. The short period of the left-wing capitalism in 1945–48 was characterised by an extensive nationalisation and confiscation of property and by increased central control. However, some features of small-scale entrepreneurship (the principle of serving the customer, esteem for the innovator and the hard worker, self-reliance, etc.) were retained during

1939–48 and survived in a hidden form until the late 1960s, even though by 1964 practically all private property was liquidated. As Benáček (1994) points out, these were the first roots of the present Czechoslovak entrepreneurship, having originated in Czech(oslovak) capitalism.

Nationalizing the economy effectively, which was the case of the Czechoslovak communist regime, after the coup in 1948, brought industries under the control of one body of ownership—the state. Small enterprises were either liquidated or integrated into larger enterprises. During the 1950s, the private sector was almost completely liquidated, while several thousands enterprises were merged into approximately 1,400 centrally controlled firms, 60 percent of which were accounted for by the manufacturing sector (Zemplinerová, 1989), thus stabilizing the development of the size structure of firms. As Table 2 illustrates, by 1960, 93.4 percent of Net Material Product (NMP) was under state domination (for all practical purposes, cooperatives behaved and were regulated like state firms). The non-farming private sector share of NMP had dropped from 33.4 percent to 1.6 percent in only the first twelve years after 1945. As the mid-1980s approached, Czechoslovakia found itself with 96.7 percent of its NMP dominated by the state sector and only 0.7 percent of contributed by the non-farming private sector.

Table 2  
The Percentage Share of NMP Produced  
by Individual Sectors, 1948–83 (Current Prices)

	1948	1960	1970	1980	1983
Total Net Material Product	100.0	100.0	100.0	100.0	100.0
Individual farms	1.1*	5.0	3.5	2.1	2.6
Private sector	33.4	1.6	0.9	0.5	0.7
Socialist sector	65.5	93.4	95.6	97.4	96.7
state-owned enterprises	62.9	81.8	85.1	87.5	86.4
cooperatives	2.6	11.6	10.5	9.9	10.3

\*one man or one family.

Source: G. McDermott, M. Mejstrik (1993)

The growth of organisational units gradually accelerated over time. After the Velvet Revolution in 1989, economic reformers faced a market dominated by large state monopolies (Zemplinerová, 1989), which were created and maintained by administrative action rather than by economic determination, and almost completely lacking a private sector, even when compared to Hungary or Poland. Small craftsmen who remained in the private sector were tightly regulated, highly

taxed, and always subject to capricious local officials.

## 2. The State Policy Towards SMEs After the “Velvet Revolution”

### 2.1. The Early Stage of Czech(oslovak) Reforms

In the framework of the economic reform implemented in the CSFR since 1990, the re-establishment of the private sector is a key element. The role of small and medium-sized enterprises—because of their ability to increase competitiveness of production and consequently export performance, to adopt new technologies, to modernise economic structure and to create new employment opportunities—is extremely important. At the same time, it stands to reason that the role of SMEs in solving huge economic problems of the country cannot be over-evaluated.

The Entrepreneurial Law of April 1990 legalised the establishment of private companies and permitted them to employ unlimited numbers of workers and produce a full range of goods. Step by step, a number of new laws and regulations affecting private enterprise took effect.

In terms of its contribution to GDP and employment, the growth of the private sector has been impressive. According to the Federal Statistical Office, GDP declined by 16 percent in 1991, but the private sector’s contribution to GDP rose by 28 percent. In fact, the private sector share in GDP doubled from 4.1 percent to 8.1 percent between 1989 and 1991. Similarly, private sector employment grew from 1.2 percent in 1989 to 16.4 percent by the end of 1991.

Table 3  
Private Sector Shares in GDP and Employment (Percent)

	1989	1990	1991
GDP	100.0	100.0	100.0
Private	4.1	5.3	8.1
Other	95.9	94.7	91.9
Employment	100.0	100.0	100.0
Private <sup>a</sup>	1.2	6.4	16.4
Cooperative <sup>b</sup>	15.5	14.2	12.0
State	83.3	79.4	71.6

<sup>a</sup>Czechoslovak and foreign private firms, joint ventures and sole proprietorships

<sup>b</sup>Includes private and semi-private institutions/political parties, religious institutions, etc.

Source: Federal Statistical Office

In this period, the private sector in the CSFR was almost identical to the sector of SMEs. The number of registered private entrepreneurs grew very rapidly from less than 100,000 at the end of 1989 to 488,000 at the end of 1990, and to 1.338 million at the end of 1991. Nevertheless, the share of SMEs in the total output of manufacturing industry was only about 10 percent in 1991 (and in GDP only 8.1 percent). Comparison concerning the productivity of labour according to legal form shows that the productivity of labour in private SMEs was substantially higher than in the state and cooperative ones (in 1991 by 68 percent in Czechoslovakia and even by 79 percent in the Czech Republic). As a result, the development of SMEs became a stabilizing factor in the economy and contributed to a successful transformation in spite of its small share in GDP.

In this context, we have to stress the role of restitutions and the so-called small privatisation in forming the new SME sector. Restitutions and the small privatisation were unique processes which helped create foundations of an efficient market economy and the middle class in the Czech society. Originally, **restitutions** were not on the agenda of the Czechoslovak economic reformers, who instead concentrated on the idea of privatisation of large state enterprises, and were afraid of a complicated restitution process with many potential trials which could have hampered the preparations of privatisation itself. However, under the strong political pressure, several restitution laws were passed by the Federal Parliament. The property nationalised after February 1948, the date of the communist coup was restituted to the original owners or their heirs. We may state that the former Czechoslovak Republic, with the exception of the former GDR and the Baltic States, had the most extensive restitution programme of all post-communist countries. The former Czech Minister of Privatisation, Tomáš Ježek, estimated the amount of restitutions at 100,000. The majority was real estate; the rest was estimated at some 20,000 units.

Table 4  
Estimated Restituted Units

Sector	Number of units
Ministry of Trade	5,000
Consumer cooperatives	3,500
Other ministries	500
Municipal authorities	8–11,000
TOTAL	17–20,000

*Source: J. Earle, R. Frydman, A. Rapaczynski, J. Turkewitz (1994)*

The so-called **small privatisation** was developed in the first half of 1990. There was a broad consensus in Czechoslovak society concerning the need for that measure. Unlike in all other transforming economies, employees of organisations in question were not favoured in this process. The small privatisation took place in 1990–93. Altogether, 22,345 units were sold in public auctions. The following table gives some details about various price categories:

Table 5  
Sold Units According to Price Categories (December 31, 1993)

No.	Category	Number of units
1	over 50 mil. CZK	37
2	20–50 mil. CZK	139
3	10–20 mil. CZK	295
4	5–10 mil. CZK	757
5	1–5 mil. CZK	4,374
6	0.5–1.0 mil. CZK	3,133
7	0.1–0.5 mil. CZK	6,641
8	up to 0.1 mil. CZK	7,004
9	TOTAL	22,345

*Source: V. Dlouhý, J. Mládek (1994)*

Table 6 illustrates that the core period was between the second quarter of 1991 and the second quarter of 1992. Afterwards, attention was paid mainly to the voucher privatisation.

Table 6  
Small Privatisation in the Czech Republic

Quarter/year	Number of units sold	Sum in bil. CSK/CZK
I/91	925	0.5
II/91	5,882	4.6
III/91	4,280	5.4
IV/91	4,204	7.8
I/92	2,775	4.8
II/92	2,138	3.5
III/92	963	1.9
IV/92	535	0.9
I/93	271	0.4
II/93	184	0.2
III/93	86	0.1
IV/93	99	0.1
TOTAL	22,344	30.2

*Source: V. Dlouhý, J. Mládek (1994)*

The sectoral structure of units privatised by auctions in the small privatisation can be seen in Table 7.

Table 7  
Sectoral Structure of Privatised Units

	Number of units	Average starting price (CZK)	Average final price (CZK)	Price index
Shops	13,042	648,000	1,194,000	175
Restaurants	1,861	1,166,000	1,790,000	154
Services	4,007	1,136,000	1,491,000	131
Others	3,435	1,788,000	2,185,000	122
TOTAL	22,345	975,000	1,449,000	149

*Source: J. Earle, R. Frydman, A. Rapaczynski, J. Turkewitz (1994)*

We may conclude this paragraph by stating that restitutions and the small privatisation significantly contributed to the creation of private sector in retail trade, wholesale trade, services, and also small manufacturing industries.



### ***The Main Characteristics of Firms and the Way They Are Operated:***

- As pointed out in Hughes, et al. (1993), one third of all firms operating in the economy in 1992 were new-borns, registering only in the second half of 1991. More than fifty percent were private since start-up (mostly new start-ups and a few pre-reform craftsmen). About forty percent had pre-existed as state enterprises or cooperatives.
- Two thirds of entrepreneurs operating in manufacturing were in five principal industries: textiles, clothing, plastics, metals and machinery. The remaining one-third was in other sectors, most importantly food processing.
- Two thirds of entrepreneurs had arranged a loan within six months of start-up. Three quarters of all entrepreneurs had received at least one bank loan, used to finance everything from land and buildings to equipment. In 1991, 80 percent were long-terms loans.
- Well-performing firms were found more often among new start-ups. They were distributed across sectors. Common strategies adopted by successful firms were product differentiation and niche marketing. Strong firms were identified less by their sectors than by the degree of product differentiation within sectors. They tended to produce sophisticated, high value-added goods as opposed to simple consumer products. Selling in a strong market to solvent clients was a big plus.
- Most insufficiently performing firms descended from state enterprises and cooperatives. They sold mostly to state enterprises. They had problems securing inputs in the desired quantity and time and see themselves as victims of price liberalisation. Typical products included metal parts and containers, simple electronics and pottery.
- A common strategy among firms with cash-flow problems was cooperation with strong, mainly foreign firms, by means of subcontracting.
- Competition in domestic markets was far less developed in the CSFR than, for example, in Poland and Hungary. The smallest firms manufacturing the most homogenous products faced the largest number of competitors, mainly state enterprises exploiting the advantages of economies of scale and, to a lesser extent, new entrants taking advantages of low entry costs. Firms manufacturing more differentiated products had the fewest competitors.
- Less than one half of all SMEs exported some portion of their production.

Ninety-nine percent of exports were in hard currency. Major trading partners were in Austria and Germany. The majority of exporters sold directly to foreign buyers without using intermediaries. About one fifth of exporting companies were doing subcontracting work for Western European firms, primarily from Germany, Switzerland, Austria and Italy.

Preparing a survey of private sector in the CSFR, the Federal Statistical Office asked representatives to identify the biggest problems they were facing in starting up and running SMEs. The most frequently cited—in order of importance—were:

- excessive taxes,
- delayed payments and
- high interest rates.

On the basis of their experience gained so far, SME representatives formulated the following recommendations for governmental action:

- accelerate privatisation,
- improve clarity of applicable laws and regulations and
- offer more credit at lower interest rates with fewer collateral requirements.

## **2.2. A Systemic Approach of the Czech Government to and Principles of the SME Support**

The fundamental systemic measure in regard to SMEs is the law on the state SME support which came into practice in the first half of 1992. It deals with the following forms of state assistance for firms with less than 500 employees:

- providing capital,
- providing training,
- providing consultancy and
- providing information.

It is obvious that providing the necessary assistance requires a functioning infrastructure in the form of specialised banks, assurance agencies, consulting centres, information networks, etc. One of the first steps was setting up the *Českomoravská záruční a rozvojová banka* (Czech-Moravian Guarantee and Development Bank, or CMZRB)—a bank providing guarantees and financing development of SMEs. This joint stock company, of which the state had a 32 percent share, was designed on the basis of West European experience. The CMZRB offers such services as:

- short-term guarantees on operation credits,
- short-, medium- and long-term guarantees on investment projects,
- contributions to interest payments,
- financial assistance to repay credits in the first year of using them and
- consultancy on the state assistance programmes.

At first, the CMZRB's clients were mostly physical persons (56.4% in 1992), and successful applications represented start-ups with less than 10 employees, in industry less than 25 employees (altogether 49% of projects). Since 1992, the CMZRB has run programmes of direct financial assistance designed by the Ministry of Economy, the most important programmes in the industrial sector being:

**START:** The purpose is 1. to create favourable conditions for start-ups (less than 10 employees) and development (less than 25 employees) of SME's in the field of industrial or artisan production and industrial services, 2. to get promising business plans started and 3. to contribute to a quicker stabilisation of entrepreneurial activities.

**ROZVOJ:** The purpose is to ease access to capital for promising projects. Firms with work forces not exceeding 500 employees are eligible.

**REGION:** This programme was designed with the aim of making some problematic regions (harmed by deep structural changes) more attractive for running businesses.

Some other programmes have been added later on, for example:

**KONZULT,** assisting consulting and information centres which provide services to SMEs;

**TRANSFER,** enabling access to technologies and know-how;

**PARK,** assisting the setting up of science and technology parks.

CMZRB data reveals that more than 50% of the 1,330 guarantees in the period 1992–94 amounted in total to 2 bil. CZK. The sectoral structure of these guarantees is given in Table 8.

Table 8  
Guarantees Provided by the CMZRB

Sector	1992	1993	1994
Industrial production	67.1	58.6	48.9
in: food processing	11.5	12.1	8.0
wood, paper	11.1	7.9	5.6
Constructions	4.0	4.9	9.2
Trading services	14.3	18.0	13.6
Services to citizens	6.2	7.9	23.4
Accommodation services	3.8	1.9	0.4
Transportation	2.3	1.3	0.3
Others	2.3	7.4	4.2
TOTAL	100.0	100.0	100.0

*Source: CMZRB*

More than 4,000 projects in 1992–94, the sectoral structure of which is characterised in Table 9, were supported in the form of financial contributions to interest payments.

Table 9  
Financial Contributions Provided by the CMZRB to Interest Payment

Sector	1992–94
Industrial production	46.9
in: food processing	10.3
wood, paper	8.0
Constructions	7.2
Trading services	14.2
Services to citizens	12.8
Accommodation services	10.1
Others	7.3
TOTAL	100.0

*Source: CMZRB*

It is estimated that the aforementioned financial support provided by the CMZRB helped to create about 3,700 new job opportunities and contributed to an average increase in exports of about 4.7 bil. CZK per year (total exports in 1994 amounted

to 410.2 bil. CZK).

It is interesting to observe that SMEs supported by the CMZRB followed the same structural pattern as the whole economy, characterised by shifts from industrial productions to services. In this respect, it should be stressed that the only criteria implemented by the CMZRB were viability of business plans and adherence to principles of programmes in question. Therefore, the structural adjustments which we are witnessing have been reactions to the market situation.

Regarding the crucial role of R&D and technology transfer in increasing competitiveness of companies, let's be more specific on that subject. The current policy of the government in the field of science and technology is based on Principles No. 123/1991, the amendment to which is being prepared. The responsible body for programmes in question is the Ministry of Economy. The assistance is aimed at applied R&D projects of judicial and physical persons and SMEs in the following spheres:

- modern technology for SMEs,
- energy savings,
- healthy nourishment,
- environment and
- informatisation.

Assistance is provided by means of state subsidies or loans without interest payment. It represented 723.1 mil. CZK in 1991–94. As Table 10 reveals, the amount of financial means steadily decreased.

Table 10  
State R&D Support

Year	Expenditures in mil. CZK
1991	288.6
1992	193.7
1993	150.0
1994	90.8
TOTAL	723.1

*Source: Ministry of Economy*

In this sphere, special attention should be paid to science and technology parks.

Three main types of parks have arisen so far:

- science parks (centres),
- technology parks and
- business and innovation centres.

At present, the aforementioned parks and centres operate through out the whole country, but the highest concentration is in the Prague region. They are often connected with already existing firms or with technical universities or high schools.

During the four years of its existence, the Association of Science and Technology Parks (ASTP) has assisted in starting nearly 20 parks and preparing some 30 others. The long-term goal of the ASTP has been to assist innovative SMEs in order to significantly contribute to the economic growth of the country. The important sub-goals are the following:

- a flexible transfer of R&D results into practise and overcoming the technological backwardness,
- increasing competitiveness in domestic and international markets.
- fostering perspective production programmes replacing outdated and ineffective means of production and
- revitalisation of problematic regions by creating new jobs.

The main strategic mean to reach the aforementioned goals is the institution of science and technology, innovation parks or centres aiming at:

- fostering the privatisation process in the field of science activities,
- making the R&D sector more efficient,
- speeding start-ups of innovative SME which do not have sufficient space, equipment or starting capital at their disposal,
- reducing risk of failure stemming from the lack of experience,
- mediating professional consultancy services and
- reducing fixed cost by sharing and providing some specialised services.

There are also programmes financed from foreign resources, such as for example: GARANT (PHARE) enlarging possibilities to get bank guarantees in selected spheres, and mainly for longer-term credits. Besides the above-mentioned programmes, there are various information services provided by specialised centres, as well as a network of regional centres. The total amount of financial means from the state budget devoted to SME assistance since 1991 is given in

Table 11.

Table 11  
State Financial Means Spent on SMEs

Institution	Expenditures							
	1991		1992		1993		1994	
	mil. CSK	%	mil. CSK	%	mil. CZK	%	mil. CZK	%
Min. of Economy	809	13.4	74	0.6	75	0.6	46	1.5
CMZRB	–	–	558	4.6	1,335*	9.7	1301	41.3
Min. of Agriculture	3,404	56.2	3013	24.7	4485	32.7	1229	39.1
Min. of Labour and Soc. Affairs	670	10.8	860	7	218	1.6	533	16.9
Min. of Finance	1,241	19.6	7700	58.5	7520	54.9	–	–
Energy Agency	–	–	–	–	63	0.5	37	1.2
<b>TOTAL</b>	<b>6,204</b>	<b>100</b>	<b>12205</b>	<b>100</b>	<b>13696</b>	<b>100</b>	<b>3146</b>	<b>100</b>

\*including transfers from 1992 (227 mil.) and savings from Ministry of Economy (108 mil.)  
Source: Ministry of Economy

The difference between 1993 and 1994 is caused by changes in income tax payment (the tax holiday period expired and the new tax law came into practice) and changes in the agricultural sector.

Details on state financial means spending in various sectors of SMEs are given in Table 12.

Table 12  
Financial Means by Sectors in 1991–94

Sector	Total (mil. CZK)	Purpose (mil. CZK)						Number of projects
		Industr. prod.	Agri- culture	Trade, services	Techno- logies	Energy savings	Active empl. policy	
Min. of Economy	46	–	–	–	46	–	–	60
CMZRB	1,301	703	–	598	–	–	–	1,557
Min. of Agricult.	1,229	–	1,229	–	–	–	–	8,440
Min. of Labour and Soc. Affairs	533	–	–	–	–	–	533	*
Energy Agency	37	–	–	–	–	37	–	84
TOTAL	3,146	703	1,229	598	46	37	533	10,141

\*Not reported

Source: Ministry of Economy

In 1994, 3.15 bil. CZK from the state budget was spent in order to support more than 10,000 entrepreneurs. (This figure does not include projects supported by the Ministry of Labour and Social Affairs, where numbers of projects are not reported.) More than 60 percent of financial means went to the most problematic regions with the highest unemployment rate. The PHARE programme has been the major foreign source of financial means so far. It provided the Czech SMEs with 12.3 mil. ECU (430 mil. CZK) in 1992–94. Besides, PHARE assisted the Regional Entrepreneurship Fund in Ostrava in the first days of its existence with 7.4 mil. ECU in 1994. The Czech-American Fund invested into Czech firms 15.7 mil. USD (424 mil. CZK) by the end of 1994, and Germany—in the framework of bilateral cooperation—contributed 200,000 DEM (3.5 mil. CZK) to Czech firms participating in German trade fairs.

### 3. Performance of and Barriers to SMEs

As a result of the massive privatisation (large-scale privatisation) using both



standard and non-standard methods, as well as the systemic approach to SME development dated from the second half of 1992 (from 1993 effectively), the picture of the Czech manufacturing industry has changed dramatically.

Table 13  
Employment and Productivity Dynamics in the Czech Industry (in %)

	1992	1993	1994
Total number of employees	-9.5	-5.3	-2.7
• in firms with less than 25 employees	10.0	-3.6	6.9
Total labour productivity	-1.2	0.0	11.1
• in firms with less than 25 employees	263.6	24.2	9.4

Source: *Statistická řada Průmysl, ČSÚ*

Table 14  
Shares of Firms with Less Than 25 Employees in the Czech Industry (in %)

	1991	1992	1993	1994
Share in production	3.8	6.7	10.3	11.6
Share in employment	17.6	16.9	17.5	20.0

Source: *Statistická řada Průmysl, ČSÚ*

Data on Czech manufacturing companies for 1993 and 1994 suggest that smaller companies, who were predominantly looking for niches in the domestic market, achieved the highest labour productivity mainly by cost-cutting and by effective management. Meanwhile, the best exporters recruited from larger companies oriented more on economy of scale (often companies with a long tradition, including a more or less successful export tradition).<sup>1</sup>

High interest rates, together with difficulties of getting credit, are the major problem. Although credits to the private sector have grown rapidly in the past

<sup>1</sup> For details, see Bohatá, Fischer and Ratering (1995).

years, all the credit needs demanded by the SME sector may not have been met. Moreover, credit alone is insufficient for the promotion of SMEs. Financing private enterprises can take different forms, such as foreign participation in the capital of privatised enterprises, development of new joint ventures and/or entirely foreign-owned companies or massive support in the form of loan guarantees (from the CMZRB) and support from the European Bank for Reconstruction and Development.

As far as the CMZRB is concerned, it does not have the investment and legal and financial resources needed to promote the effective and rapid development of the private sector. It quite simply lacks the risk capital needed to implement the sort of active promotion policy it should. While there is a desire to promote SMEs, the principal means for doing so—the provision of risk venture capital in the form of equity investment—is practically non-existent. There are programmes for lending to SMEs, but loans are a poor means for financing new emerging businesses. Such businesses, even if profitable, and especially if they are growing rapidly, do not generate the cash flow needed to service debt, especially debt carrying interest rates in excess of 15 percent. What such firms need is infusions of equity capital from outside investors. As the OECD report on Czech and Slovak industry (OECD, 1994) points out, investors who invest in emerging firms do not earn returns from interest payments or dividends. Rather, they seek capital gains from the sale of their ownership stake when the firm becomes successful. In return for this, they invest their funds, even if no returns are to be earned for the first several years. Such an investment is of inestimably greater value to the SME than is a loan of a similar amount of money because it imposes no drain on the firm's cash flow.

In the Czech Republic there are neither venture equity investors nor venture capital funds. Nor is there a true market for SMEs, that is, a capital market on which their shares, or the SMEs themselves, are sold to new owners once they have achieved some success. While it is not the responsibility of the authorities to create either venture funds or markets for small firms, the legal conditions governing the sale of firms and the tax treatment of capital gains should be prepared and implemented.

Despite many improvements in the performance of the state bureaucracy (including financial, customs and labour offices), a lot of imperfections have survived which cause additional cost and hamper the favourable development of the SME sector in the Czech Republic. Recently, an amendment to the entrepreneurial law has been heavily discussed. Two tendencies may be identified: the need to achieve minimal standards and ethics for people with trade

permission (taxi drivers are the extreme case) and further liberalisation of trade-permission issuing. A temporal compromise has been reached, but the whole system has not been settled yet.

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