By law and by custom: Factors affecting small and medium-sized enterprises during the transition in Lithuania
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Chapter 8: Theoretical implications

In the preceding chapters, institutional theory, gender issues and theories regarding entrepreneurship were applied in order to investigate the factors affecting SME development under economic transition. In this chapter, some relevant issues both in terms of positive and negative aspects of using this eclectic approach are discussed.

New institutional theory emphasizes the need to address each institutional setting as a unique set of circumstances requiring a unique strategic approach. Our institutional-theory based analysis was grounded to a large extent on the perceptions of SME owners and related officials with regards to the barriers effecting existing SME operations in Lithuania. The resulting data was both rich in detail and context-specific and, a clear understanding of the Lithuanian case could be developed. Generalizability of the results, however are questionable and this is one of the disadvantages of our methodology and the institutional approach vis-à-vis a more neoclassical-based approach. In spite of these limitations, the institutional approach and methodology seems especially relevant for dynamic situations such as transition economies where important changes are taking place to the institutional framework.

The lack of a single theory for entrepreneurship allowed for a certain flexibility in developing an appropriate definition for the transition context. In general, definitions of entrepreneurship reflect the context in which they are created. For example, definitions developed for advanced western economies place less emphasis on the possibilities for unproductive entrepreneurship since the formal and informal institutional constraints are already in place and functioning. This is not the case in transition economies where in many cases new institutions are developing and institutional enforcement is weak. The working definition developed in Chapter 2 for productive entrepreneurship in transition economies is a result of the adaptation of existing entrepreneurship definitions and Baumol’s productive/unproductive entrepreneurship distinction placed within an institutional framework. The definition and model developed and applied in this thesis for
productive entrepreneurship seems a useful tool for addressing entrepreneurial development in a transitional context.

Open-air market activities analyzed in Chapter 4, illustrate the influence of path dependence and transition in terms of creating a unique form of entrepreneurship development. The main influencing factors in the case analyzed seem to be historical, environmental (such as consumer price sensitivity) and labor market position of traders (disadvantaged due to ethnic background, language ability, sex and age).

In spite of a boom in hypermarkets in and around Vilnius, trading at Gariunai not only continues to survive but is becoming institutionalized. An important influence is Gariunai’s reputation for low prices. When buyers come from other countries, they know what they can expect at Gariunai; they do not know what they can expect if they go shopping at a nearby hypermarket. Though the traders themselves feel that they do not build up relationships with their clients, the clients seem to build a relationship with the market. Since the Gariunai market is known, it reduces uncertainty and transaction costs even though other alternatives are present.

The further institutionalization of the Gariunai market seems to be taking place as evidenced by the construction underway around the Gariunai market. More permanent stalls and storage spaces are being built. Two banks have also set up branch offices near the market entrance. Given these new developments, it seems Gariunai will not disappear any time soon.

The characteristics of the traders at the Gariunai market provide some support to the displacement theory of immigrant entrepreneurs. Similar to other immigrants, non-native-Lithuanian speakers seem to be discriminated against on the formal labor market. However, Slavic-speaking residents in Lithuania also differ from immigrants in advanced western countries. Many Slavic speakers came to Lithuania with secured employment (usually blue collar) and enjoyed a more privileged status in Soviet Lithuania than native Lithuanians. For many of these individuals, Lithuania’s independence has resulted in
three important changes: unemployment (due to the closing and downsizing of state-owned enterprises), loss of status, but also the new opportunity (previously nonexistent) to start a private business. Their predicament and choices have clearly been formed by the transition process. Further theory building and research in this area could provide important new insights to this process.

The interviews in Chapter 5 seem to support the institutional view that 'ideas matter' (North 1997a:7). The effects of 'residual communism' on informal rules both in terms of cultural and personal 'embeddedness' are evident from the viewpoints expressed by both SME owners and related officials. Informal rules seem to not simply present in the environment but individual stakeholders and personal convictions can maintain an outdated system of values and norms that may be beneficial for the individual but detrimental to the economy as a whole. Douglass North identifies this type of behavior as path dependent influenced by the interests of individual stakeholders (1997a).

In chapter 6 we examined the interrelated nature of business barriers to SME operations using an empirical analysis. Though North refers to the interactions between formal and informal rules (1990), it is never empirically tested. In our model, we further extend North's institutional categories to include environmental and skill factors as possible barriers to existing SME operations in Lithuania. The extension of North's categorization seems justified in the transitional setting and in our analysis it generates significant results. We find that a perceived change in one barrier type can lead to a change the perception of another type of barrier. Though these results are obtained specifically from Lithuanian data, it seems likely that the situation may be similar in other transition and established market economies.

An analysis of the gendered aspects of business performance as presented in Chapter 7 indicates that there are significant differences between male and female SME owners even within an environment of rapid economic, social and political change. Existing gender relations in this context seem to illustrate the tenacious ability of informal norms and values to be maintained even when they are in conflict with the new economic
context and newly established formal rules. Gender relations have not been given much attention by North or the new institutionalist school. Further theory building and research in this area would be useful.

Our analysis also suggests that a slight modification of the new institutional theory’s focus on transaction costs may be in order. Gender issues seem to have less to do with ‘transaction costs’ than with ‘interaction costs’ i.e. maintaining fixed and reliable role distinctions between men and women according to gendered expectations in order to reduce uncertainty in a dynamically changing environment. Our study indicates that these gendered expectations seem to play a role in influencing differing business outcomes for male and female SME owners.
**Justinas comments**

*J: It was interesting to read your analysis. I had not realized that SMEs were playing such an important role in Lithuania's economic development. I also had not realized that they were encountering so many different barriers.*

*R: Yes, and many of the barriers seem linked to the clash of a new economic system with the attitudes and values inherited from the Soviet period.*

*J: I found it very interesting to read that there are individuals willing to uphold the principles of business ethics even within the transitional setting. These seem to be the individuals that need to be further encouraged and supported.*

*R: Yes, I agree. Due to their personal principles, these business owners embody the principles of productive entrepreneurship which provides benefits both to the entrepreneur and to the general economic situation. But there are many impediments such as corruption... that's a big barrier.*

*J: There always is corruption under these types of conditions. You need to learn to work with it.*

*R: You can't be serious.*

*J: I am. I hate to burst your bubble but it's a realistic approach. I don't mean that you should support corrupt activities, you should fight it every step of the way. But corruption will not simply disappear - it has been developing over a long period of time, to break the cycle abruptly would cause chaos. Real change takes time and must occur in the hearts and minds of the population. In this case, in the hearts and minds of SME owners and related government officials.*

*R: How do you think policies should be formulated?*

*J: Your argument must focus on what the government has to gain from SMEs, i.e. what they would gain from promoting a really free economy.*

*R: What about for SME owners themselves?*

*J: SME owners have been too individualistic in their approach. In chapter 5 you presented the importance of forming and building alliances between NGOs. Business owners must learn to do the same. They need to learn to cooperate, they need to network and form councils according to their business sector or industry. Real change will also take place from the grassroots level, SME owners need to be a part of this change. In order to build a sense of community and responsibility which has completely been destroyed.*

*Ruta, I also have a question, I was wondering about the influence of the European Union on Lithuanian SMEs. I know that Lithuania is one of the accession countries earmarked to join the EU in 2004. It seems crazy to me for Lithuania to throw away her sovereignty in order to join another union!*
R: I can understand your concerns, Justinas. In fact, many Lithuanians would agree with you. They too are concerned about giving up Lithuania’s sovereignty to join another union. But in today’s globalized economy Lithuania has little choice. The world is being split up into trading blocs. Those countries who find themselves outside of the blocs suffer. For such a small country as Lithuania, it would be very difficult to economically survive on her own. Further, the EU is not the USSR, it is based on a market-oriented system and democratic decision-making.

I also think that the EU could provide Lithuania with a number of benefits. Look at how well Ireland has done since it became an EU member. Ireland was an economically depressed country, but it has experienced phenomenal economic growth fueled by high levels of foreign direct investment and in part by SME growth since becoming a EU member.

J: Do you think the same could happen in Lithuania?

R: The conditions are different for Lithuania. Ireland became extremely attractive to foreign investors in the 1970’s in part because of its favorable taxation climate for foreign direct investment. Ireland has also benefited from very large EU transfers. Lithuania has been invited to join the EU with a number of other transition countries which will mean direct foreign investment being spread over all the new member countries. Lithuania will probably receive much lower levels of foreign investment than Ireland did. Joining the EU may also have negative consequences for SMEs in terms of increased competition and increased regulations.

J: So it will bring its share of problems...

R: In the short-term yes, but in the long-term it should provide increased opportunities. The introduction of standardized EU legislation should also have a positive effect on Lithuania’s internal legislation. More positive short-term benefits especially for the SME sector necessitate an active role of the government. Not only in terms of creating policies but most importantly in implementing them. As you will see in chapter 9, I have some suggestions for ways to improve the situation for SMEs in Lithuania.

J: Let’s read them together.