



## THE EMERGENCE OF A NEW PARADIGM IN THE INSTITUTIONAL ENVIRONMENT OF INDUSTRIAL ENTERPRISES IN ECONOMIES IN TRANSITION

Raluca Irina CLIPA<sup>1</sup>, Ionel BOSTAN<sup>2</sup>, Flavian CLIPA<sup>3</sup>

<sup>1</sup> Lecturer, Department of Economics and International Relations, Alexandru Ioan Cuza University of Iasi, Romania, [riclipa@gmail.com](mailto:riclipa@gmail.com)

<sup>2</sup> Professor, Ștefan cel Mare University of Suceava, Doctoral School of Economics, Romania, [ionel\\_bostan@yahoo.com](mailto:ionel_bostan@yahoo.com)

<sup>3</sup> PhD in economics, Romanian Court of Accounts, Department, [flaclipa@yahoo.com](mailto:flaclipa@yahoo.com)

**Abstract** *Starting with a short description of institutional environment specific to the period of centralized economies, this study aims to explain that industrial enterprises in economies in transition now require a new paradigm allowing them to overcome the inertia created by the path dependence in order to become more and more competitive. The new paradigm will include mutations in actions of institutional arrangements, as well as a pro-active participation of industrial entrepreneurs.*

**Key words:**

*industrial enterprises,  
institutional environment*

**JEL Codes:**

O43

### 1. Introduction

Different levels of development of different countries may be explained by means of national institutional frameworks making up the primordial matrix of future business operations of industrial enterprises. By incentives provided to entrepreneurs in the institutional environment, there develops an aggregated effect of economy involvement that increases competitiveness and competition capabilities.

Certainly, the effect of total involvement is based on a national entrepreneurial system (including also industrial organizations/enterprises) – to understand how this is manifested requires to define its main features (Acs et al. 2015: 16-18): the actions of the entrepreneurs occur under conditions of uncertainty dictated by market and institutional imperfections; they take certain risks when they set up an industrial organization to benefit from existing opportunities; the entrepreneurship involves the use of own resources or identified in the ownership of other business operators; most undertaken operations are individual or belong to a number of individuals requiring an additional supervision; operations of entrepreneurs aimed to benefit from market opportunities are not necessarily their typical activities but are linked to their feasibility (the development of an industrial enterprise that would cover a large geographic area may be an opportunity but the operation is not feasible due to scarcity of

financial means that could be employed); the possibility to initiate some actions is contextualized by your own capabilities but also by the stock of resources that may be attracted or by the access to different markets; economic growth is given by a dynamic process, with successes and failures of the entrepreneurship based on individual decisions shaped though by a series of (also institutional) factors.

Entrepreneurial behavior that catalyzes the use competition capabilities of industrial enterprises are influenced by formal and informal institutional factors creating path dependence. From this perspective, even if important steps have been taken towards change, the institutional climate in economies in transition bears the flaws of the old Communist regime.

For this purpose, we should identify steps to modify anachronic institutions and to implement institutions stimulating entrepreneurship especially if we take into account that organizations (industrial enterprises) have specific features that need intensive use of technological progress, qualified staff, extensive resources, have to deal with the pressure of competitive climate and the reduction of product life cycle.

The description of anachronic institutional framework typical to planned economy (the first part of our study) will contribute to the suggestion of a new paradigm making it possible to overcome inertia produced by path dependence and will suggest changes in the joint

actions of institutional set-ups and a pro-active participation of industrial entrepreneurs ( the second part of our study).

## 2. Landmarks of planned economy and path dependence

The force of institutional set-ups inducing economic performance through industrial enterprises varies from one country to another being influenced by the internalized power of formal and in formal elements that translates certain socio-economic behaviors of the entrepreneurs that one way or another are linked to the success of the business.

What is interesting here is the way in which, starting from the degree of manifestations of formal and informal institutions, some authors (Williamson, 2009) define types of institutional arrangements. The first category includes arrangements characterized by strong formal and informal institutions, the second includes weak formal and strong informal institutions, the third one is made of strong formal and weak informal institutions and the last category comprises weak formal and informal institutions.

If previous categories are linked to GDP per capita of countries that may be included in one of the four institutional arrangements, it may be noted that countries included in the first two categories exceed highly in terms of GDP per person countries included in the last two categories due to dominance of strong informal institutions.

Symmetrically, countries in which weak informal institutions dominate are not able to impose constraints on deviant entrepreneurial behavior even if there are strong formal institutions. It may be explained by the fact that many times such formal institutions have been

borrowed from countries with developed economy that are not functional in economies of countries where they have been transplanted due to lack of legitimacy and conflict with informal institutions as an *old ethos* determining a path dependence in the view of North (1990). Thus, the informal institutions typical for communist countries survive in spite of efforts to improve institutional frameworks by means of institutional transplant of formal institutions that proved their viability for developed countries.

States where communism collapsed allowing their orientation towards capitalism has been mainly characterized by a single general feature: the existence of planning that amputated market regulatory mechanisms. Planning led to the creation of artificial formal institutions, the prevalence of big enterprises found in state ownership, the inhibition of entrepreneurial initiative and culture through the lack of incentives for such activities and the low share of small and middle-sized enterprises even if it is known that small entrepreneurs contribute to economic growth by identifying new opportunities to produce a good product, new technology resulting in technological spill-over effects. The state that should have supported the well-functioning of market mechanisms by means of an institutional infrastructure proper for contract enforcement, by ensuring ownership rights, impartial justice, had transformed into an interventionist state, the government being made up of a huge bureaucratic staff independent from the supremacy of law, corrupt that followed its own interests (state confiscation by the *elite*), including undue benefits and bribe (Timothy and Shleifer, 1997). This also led to the alteration of social capital (as a vector of trust propagation) by the prevalence of particularism in detriment to universalism.

Table 1. Universalism versus particularism

Typology	Universalism	Particularism
Formal-informal institutional interaction	Prevalence of formal institutions in harmony with informal institutions (or a low degree of divergence)	Prevalence of informal institutions being in conflict with formal institutions
Type of trust	Generalized trust. Social capital.	Particular, only in belonging to a group. The culture of privileges.
Behavior	Formal and predictable for individuals from outside or inside the social framework	Informal, predictable only inside the group
The rule of law	Strong	Weak

Source: adapted after Mungiu-Pippidi, 2005:51.

The centralized system translated the decrease in tendency of big enterprises to be efficient into cost reduction; these did not face budgetary constraints but only a lack of raw materials (Kornai, 1980).

The suffocation of market mechanisms by centralization resulted in the lack of competition pressure and implicitly in the benefit of learning curve from the management perspective, it was named mostly

politically and it had to comply with the requirements of communist ideology. Thus, managers did not develop certain routines (that they would later disseminate to other managers in the organizational hierarchy) allowing them to identify new opportunities and measures needed to reach objectives, they were mainly concerned with developing interpersonal relations with other managers or political or administrative decision-makers that would provide them the necessary raw materials. (Litwack, 1991). We are tributary to the conception of Nelson and Winter (1982) suggesting that opportunities of growth for an enterprise were closely linked with managerial skills.

The system of interpersonal relations developed to get supplied with resources as it partially replaced inexistent formal institutions (rules, laws), acquiring a social dimension and translated into what will be called in business jargon - *networking* (to know the right person to solve a problem, to work together and with other people to reach the set objective) (Peng, Heath, 1996: 513).

Due to institutional path dependence, such networks were designed also during transition to market economy, becoming almost *sui generis* a business strategy both for companies that entered the market recently and for the public companies (or public ones that later were privatized) due to their higher opportunities to generate capital (the contracts concluded with state companies at higher amounts than the market price or false contracts) and the possibility to eliminate barriers upon industry entry of other competitors. It is a classical example of manifestation of destructive entrepreneurship, limitation of competition and demultiplication of investments. Paradoxically, this system did not have just negative effects was also an unorthodox means of decreasing transaction costs and propagation of business trust among industrial enterprises.

Another explanation of gaps between the states with centralized economy and the market economy states has been summarized by Vries (1999) stating that the rise of the West equals with the rise of capitalism and the market appearance as economic darwinism that eliminates inefficient economic measures providing institutional incentives to productive entrepreneurs.

### 3. Towards a change of paradigm

After the dismantling of communist regimes, the beginnings were shy, farmers appearing as entrepreneurs, *dull individuals*, former administrative staff and the liberal professionals (Peng, 2001: 96-98). Paradoxically, even though most economic initiatives were not allowed during centralized system, the farmers continued to survive due to state's lack of interest for their operations. Later, during transition,

even if a part of them did not register as entrepreneurs in avoidance with the legal system, others formed strong associations, these developed by using a significant part of former state agricultural enterprises and by purchasing assets (land, machinery), becoming owners of significant investment capital and important actors in the world of business.

Dull individuals are individuals who during communism were involved in grey economy and accumulated capital (for example from unofficial foreign exchange) and during transition managed to impose contracts outside traditional legal institutions, for instance, security and recovery companies. Former staff (party leaders, beaurocrats) fully benefited from the transition to capitalism, using to the fullest the pre-existent *networking* and the previously accumulated capital. Liberal professional (lawyers, former managers, teachers) could use as entrepreneurs some internalized advantages related to know-how, experience, better qualification and intellect leading to a social legitimacy of the newly created enterprises and generating later the effect of entrepreneurial mimetism.

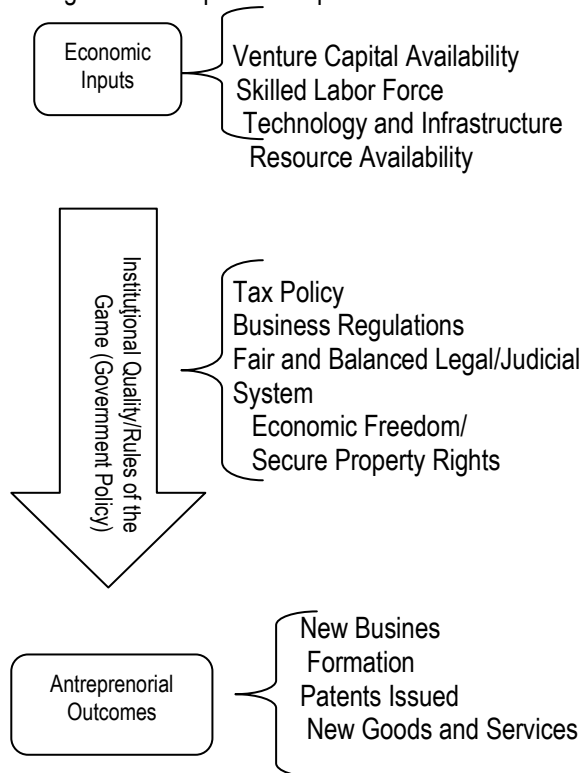
Former state industrial enterprises were mostly privatized and bought by former staff, professionals or were left in state ownership. The enterprises left in state ownership disconnected from commercial exchanges of the former Council for Mutual Economic Assistance faced the pressure of competition of the new comers in the sector and had to meet technical and quality requirements of the home and foreign market. It stimulated entrepreneurial development in terms of searching new opportunities to produce the increase of competitiveness by means of expenses supported by research and development, by intensification of strategic alliances with foreign partners and by appealing to the well-known *networking*.

The intensification of strategic alliances resulted in the dissemination of managerial routines, entrepreneurial technology and culture, in the orientation of managerial behaviors towards risk taking. But in front of social pressure generated by the promotion of industrial enterprises efficiency through unemployment, the state became again interventionist, altering the market signs. Budgetary efforts had to be counter-balanced by high taxes that discouraged entrepreneurial initiatives to launch into business having to choose between a relatively high level of taxation and a huge beurocratic system that was many times ambiguous, unpredictable, and dense and the migration towards grey economy. The entrepreneurship was also discouraged when the state set specific minimal wages for employees, even if it was known that such measures affect the budgets of small industrial enterprises.

Even if the period of transition to capitalism reflects institutional progress, the survival of anachronic

behavior altering the rules of the game cannot be left unnoted. For industrial enterprises and entrepreneurs, a change of paradigm was felt that would increase the institutional quality and concentrate on the entire entrepreneurial process. (figure 1).

Figure 1. Entrepreneurial process



Source: Sobel, 2008: 644

As it may be seen in the previous figure, we need efforts that would focus on both the optimization of resources used by the entrepreneurs and increase of institutional infrastructure on which industrial enterprises rely taking into account the effect of economy involvement by initiating new businesses, improving technology by research and development, patents and new types of products. It is necessary that institutional arrangements (taxation, legal framework for business, effective legal and court system, economic freedom and ownership rights protection) supported a certain availability of investment capital, qualified workforce, and infrastructure, support of research and resource allocation.

The availability of capital and the involvement of political decision-makers to provide subsidized interests for enterprise or public loans financing start-ups or business incubators have some nuances. First, insurance of needed amounts to finance research and development expenses may be translated for entrepreneurs by a slowdown of scientific effort as they become assisted and their own funds will be directed

towards unproductive activities. Then, some critics (Wallsten, 2000) sustain that governmental funding agencies tend to select virtual beneficiaries by subjective assessment of business success probability, even if that enterprise would not need such resources. Moreover, the rate of company survival is hard to be calculated by any decision-maker if we have a mature economy with a competitive market that is defined by multiple entries and exists of entrepreneurs on the market.

The development of qualified labor force may be obtained by a better institutionalization of the framework of public private partnerships between entrepreneurs and academic organizations (that will provide even a better legitimacy to entrepreneurship), by stimulating the set-up of business incubators in the academic context, a better correlation of study programs with labor market requirements (leading to a better insertion of graduates). Using innovation clusters amplifies the technological level existent at a specific time in a country; they provide professional complex assistance to technological start-ups based on collaboration with other corporate research labs.

Also, M. Porter (1998) described the impact of company clusters on competitiveness (and industrial enterprises) in three ways: the contribution to the growth of productivity of neighboring companies, stimulation of innovation, creation of new businesses. For instance, we may obtain an increase of productivity due to gains De (called „agglomeration economies”) of neighboring companies by their access to qualified labor force pool, to technology and new knowledge or by closeness to suppliers and clients. The partnership with other companies or organizations within a cluster enables companies to benefit from competitive advantages of that they could not have obtained on their own. Last, the competition among companies is beneficial for the quality of products and services and for managerial activities having an impact on productivity. The innovation is stimulated in a cluster as companies get easier access to knowledge and new technology. Due to diffusion of knowledge and ideas, better understanding of market needs and existent resources within a cluster (suppliers, workers, information, capital); it is easier for entrepreneurs to develop industrial enterprises.

## Conclusions

The centralized system had in terms of entrepreneurship a handicap compared to developed economies. This system, on the one hand, neglected the market regulatory mechanisms and, on the other, led to the persistence of anachronic institutional arrangements kept also during transition.

Some informal institutions (the networking) became a *second-best* due to absence or unavailability of those who had to support contract enforcement, provision of ownership rights, technological innovation, decrease of transaction costs. These institutions have rooted deeply into society generating routine and path dependence.

These rules of the game were imposed also to industrial enterprises that in the process of transition to capitalism faced challenges related to compliance with profit and loss budgets, development of new managerial behavior and creation of operational routines, increase of competitiveness under pressure of competition, elimination of technological gap, developing employee loyalty, employing highly qualified labor force. As we have seen, the beginning of capitalism and entrepreneurship did not produce a context typical for a mature economy that would self-regulate the mechanisms of entrepreneurial risk-taking but witnessed the existence of hybrid actors confronted institutionally by the heritage of planned economy.

Therefore, industrial enterprises in transition countries need a new paradigm allowing them to overcome inertia created by path dependence translated into measures of institutional arrangements and a pro-active involvement of involved actors. In our view, the efforts must be focused on the optimization of resources used by entrepreneurs (public private partnerships, involvement of academia) and improvement of institutional infrastructure (cautious use of governmental funding mechanisms, minimal state intervention) on which industrial enterprises operations rely.

### **Bibliography**

Acs, Z. J. [Szerb](#), L. and [Autio](#), E. (2015), Global Entrepreneurship and Development Index 2014, *Springer Briefs in Economics*, 12 March 2015: 39-64.

Kornai, J. (1980), *Economics of shortage*, North-Holland, Amsterdam.

Litwack, J. M. (1991), Legality and market reform in Soviet-type economies, *Journal of Economic Perspectives*, 5(4): 77-89.

Mungiu-Pippidi, A. (2005), Deconstructing Balkan Particularism: The Ambiguous Social Capital of Southeastern Europe, *Southeast European and Black Sea Studies*, Vol 5, No 1: 49-68.

Nelson, R. and Winter, S. (1982), *An evolutionary theory of economic change*. MA: Belknap Press, Cambridge.

North, D.C. (1990), *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, New York.

Peng, M. and Heath, P. (1996), The Growth of the Firm in Planned Economies in Transition: Institutions, Organizations, and Strategic Choice, *The Academy of*

*Management Review*, Vol. 21, No. 2 (Apr., 1996): 492-528.

Peng, M. and Shekshnia, S. V. (2001), How Entrepreneurs Create Wealth in Transition Economies, *The Academy of Management Executive*, Vol. 15, No. 1: 95-110.

Porter, M. E. (1998), Cluster and the new economics of competition, *Harvard Business Review*, Vol 76, No 6 (Nov/Dec, 1998): 77-90.

Sobel, R.S. (2008), Testing Baumol: Institutional quality and the productivity of entrepreneurship, *Journal of Business Venturing*, 23: 641–655

Timothy, F. and Shleifer, A. (1997), The Invisible Hand and the Grabbing Hand, *American Economic Review*, Vol 87, No 2: 354-358.

Vries, P. H. (1999), The role of culture and institutions in economic history: can economics be of any help?, *Geschichte und Gesellschaft* 25: 276-301.

Wallsten, S. J. (2000), The Effects of Government-Industry R&D Programs on Private R&D: The Case of the Small Business Innovation Research Program, *Rand Journal of Economics*, 31(1): 82-100.