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THE GLOBAL CRISIS, MANUFACTURING FIRMS, REGULATIONS AND TAXES

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Abstract: *In this study, we focus on how regulations and taxes affect manufacturing firms in Eastern Europe and Central Asia. We examine whether overall regulations became a bigger obstacle to these firms after the 2008-2009 Global crisis. We also examine whether tax inspections became a bigger obstacle after the Global crisis. Besides regulations and tax inspections, we also look into the prevalence of corruption related to tax officials before and after the Global crisis. Using two large datasets (i.e. the BEEPS IV and BEEPS V surveys), we are able to compare the pre-crisis period to the post-crisis period. Our results show that, in this region, post-crisis, senior managers spent more time on dealing with overall regulations which includes tax-related regulations and other types of regulations. Therefore, we can conclude that, post-crisis, regulations became a bigger obstacle to manufacturing firms' operations. We also find that, post-crisis, there was a significant drop in the percentage of firms that had inspections or meetings with tax officials. Also, post-crisis, each firm on average, had fewer inspections or meetings with tax officials. Therefore, while overall regulations became a bigger obstacle to these firms, tax inspections became a smaller problem. When we examine corruption, we find that there was no significant change in the prevalence of bribes related to tax officials. Before and after the Global crisis, a similar percentage (8-9%) of manufacturing firms had to deal with bribe requests by tax officials.*

Future studies may focus on other types of regulations which include employment regulations, health and safety regulations, licensing regulations, environmental regulations, and zoning regulations, and the corruption related to these regulations.

Keywords: corruption, bribery, regulations, small firm, small business, entrepreneurship, BEEPS.

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1. Introduction

In this study, we focus on manufacturing firms in Eastern Europe and Central Asia. We examine the burden on these firms due to regulations, tax inspections, and corruption. More specifically, we examine how much time does senior management spend on dealing with regulations, what percentage of these firms has a visit by tax officials, and how many inspections do they have per year. We also examine whether bribes are requested by tax officials. While examining all these aspects, we also want to see if the 2008-2009 Global crisis had affected these burdens on manufacturing companies.

Previous studies (i.e. Acs et al. (2009), Dreher and Martin Gassebner (2013), Klapper et al. (2006), Van Stel et al. (2007), and others) show that regulations and the institutional framework have a significant impact on existing and new businesses. A group of papers (i.e. Acs et al. (2009), Kreft and Sobel (2005), Ovaska and Sobel (2005), and others) mainly focus on taxation and argue that taxation is very important. Yet other papers (i.e. Russell et al. (2007), Dreher and Gassebner (2013), Ovaska and Sobel (2005), Parker (2007), and Wilhelm (2002)) specifically focus on corruption. In this current study, we focus on burdens due to all three aspects (i.e. regulations, taxation, and corruption). Our main objective is to find if a big economic crisis amplifies or reduces these burdens on manufacturing firms.

We use the BEEPS Surveys done by EBRD-World Bank in 32 Eastern European and Central Asian countries. We use the BEEPS IV survey (i.e. 2007) findings as our pre-crisis period, and the BEEPS V survey findings (i.e. 2010-2014) as our post-crisis period, and compare the responses in these two surveys.

We make two contributions to the literature. First, we focus on the EECA region where most economies are transition economies. Here, we test to see how the Global crisis had affected the "regulations burden" on these firms. Second, we examine corruption before and after the Global crisis. Did corruption increase due to the economic troubles or were government better in controlling corruption after the crisis? As our findings show, we have interesting results. Our results show that while the burden due to overall regulations increased, the burden due to tax inspections became lighter. This may be due to governments' desire to lessen the burden on these firms from the tax front. Also, there was no significant change in corruption.

The paper's layout is as follows: Section 2 goes over the literature. Section 3 explains our sample and methodology. Section 4 presents our results. Section 5 concludes.

2. Literature Review

Previous literature shows that regulations affect businesses. While some of these papers focus on the relationship between different types of regulations and new firm formation, others focus on the relationship between the overall institutional framework in a country or region and business activity. Several other papers focus on how taxation affects businesses. Taxation is a subset of the institutional framework and regulations; therefore, these papers closely relate to the other papers on regulations and institutional framework. Besides all these studies, there are papers that deal with corruption and business formation. Corruption and bureaucracy do also fall under the institutional framework.

Acs et al. (2009) create a model that include several factors including legal restrictions, bureaucratic constraints, labor market rigidities, taxes, and lack of social acceptance. They show that more regulation, or more administrative burden and government intervention result in less entrepreneurial activity. Acs and Szerb (2007) support this and show that the factors that affect middle-income countries and developed countries are different. For middle-income countries, the quality of human capital, the availability of technology, and the support by institutions are important for new businesses. For developed countries, reforming the labor market and deregulating the financial markets are important, while reducing entry regulations is not important. Dreher and Martin Gassebner (2013) show that the number of procedures required to start a business and larger minimum capital requirements are both detrimental to entrepreneurship.

Bransetter et al. (2014) examine Portugal and show that entry regulations only help with marginal firms which are smaller, low-tech firms that are established by a poorly-educated person. Gartner and Shane (1995) show that regulations as well as values, attitudes, and technology are important factors. Klapper et al. (2006) examine European firms and show that entry regulations deter new firm formation and slow growth in existing firms. Lee (1991) shows that competition promotes freedom from regulations. Ovaska and Sobel (2005) show that several factors including contract enforcement, sound monetary policy, less regulation, credit availability and foreign direct investment support businesses and new business formation. Stephen et al. (2009) examine the impact of working time regulations on business formation and show that more enforcement reduces the negative impact of rigid working time regulations. Van Stel et al. (2007) show that labor market regulations and minimum capital requirement deters new business formation, while bureaucratic work (time, cost, or the number of procedures) do

not affect it. In this current study, we examine how regulations take senior management's time. We also look at whether the Global crisis increased the burden of regulations on senior management.

A group of papers take on a broader view and discuss the role of the whole institutional framework on businesses. Ruta et al. (2008) examine Russia and show that Russia's institutional environment deters new business formation. Ruta et al. (2007) compare Ukraine and Lithuania and show that both formal institutions (i.e. rules and regulations) and informal institutions (i.e. norms and values) are important. Garcia-Posada and Mora-Sanguinetti (2015) examine Spain and show that higher judicial efficacy increases the entry rate, while it has no effect on the exit rate. Tatiana et al. (2008) examine Hungary, Latvia and Bulgaria and show that entrepreneurs in each country worry about different things. In Bulgaria, they were dissatisfied with laws and regulations, while in Latvia, they were worried about their skill level, and in Hungary, they were worried about their skill level as well as societal attitudes toward entrepreneurship. Khaled et al. (2011) find that, in Iran, laws, regulations, and motivational factors were all seen as important. Nyström (2008) examines the relationship between economic freedom and entrepreneurship and show that fewer regulations, smaller government sector, and better legal structure are essential in business formation. Parker (2007) argues that laws interact with business formation in two ways. The laws shape organizational forms plus they establish specific regulatory framework, including bankruptcy legislation as well as property rights, corruption and efficiency of courts. Smallbone et al. (2010) argue that governments establish the institutional framework which in turn determines the viability of the entrepreneurial environment. Russell et al. (2007) discuss how successful firms lobby against new entries (i.e. corruption). Stephan and Uhlaner (2010) show that the existence of opportunities and the quality of the framework determines the viability of the entrepreneurial environment. Valdez and Richardson (2013) find that normative and cultural-cognitive institutions are more important than regulative institutions, although all three are important. Sander and Thurik (1999) argue that culture, institutional framework, availability of technology, demography, and economic forces are all important for businesses. Zahra and Garvis (2000) show that too much government intervention and fierce local rivalries deter international entrepreneurship. Welter (2004) argues that there are shortcomings in the institutional (societal and political) environment in Germany and these restrict female entrepreneurship.

Some papers argue that policymakers should have a regional focus because each region has different characteristics. In other words, applying the same rules to the while country will not work well if a country has different regions with different characteristics. Bergmann and Sternberg (2007) show that each region in Germany have different factors, therefore policies should have a regional focus. The startup rate is different in regions with rising unemployment versus in regions with stable or decreasing unemployment. Ghani et al. (2014) show that different regions in India have different factors that explain business formation. Local education levels and quality of physical infrastructure are different across India and these factors important. Therefore, some regions do better than others. As mentioned earlier, Tatiana et al. (2008) show how the important determinants of entrepreneurship vary across countries like Hungary, Latvia and Bulgaria. Bock (2004) argue that rural development policies do not work well across different genders, therefore women should have special policies that support them. In this study, we focus on firms in 32 Eastern European and Central Asian countries. How did the Global crisis affect the regulation/taxation burden in this region?

Some papers argue that taxation is very important. Acs et al. (2009) argue that more regulation (and taxation) is an important determinant of entrepreneurship which would be included in models that predict new business formation. Aristidis and Nito (2005) examine Albania and show that changes in taxation procedures as well as unfair competition, lack of financial resources, and lack of public order are important barriers. Kreft and Sobel (2005) contend that low taxes, low regulations, and secure private property rights are important. Ovaska and Sobel (2005) also show that low regulations and taxes are important. In this current study, we examine how the tax burden (in the form of visits by tax officials) was affected due to the Global crisis.

Some other papers specifically focus on corruption. Russell et al. (2007) explain how successful firms lobby against new entries (i.e. corruption). Dreher and Gassebner (2013) show that corruption facilitates firm entry in highly regulated economies. Ovaska and Sobel (2005) show that low government corruption is good for entrepreneurship. Parker (2007) explains how laws deter corruption. Wilhelm (2002) argues that fighting against corruption promotes trust and innovation. On the other hand, Aristidis and Nito (2005) argue that bureaucracy and corruption are not barriers to entrepreneurship. In this paper, we examine whether corruption with tax officials was an issue for these firms before and after the Global crisis.

In the next section, we will explain our data and methodology.

3. Data and Methodology

We use the BEEPS IV and BEEPS V surveys by ERBD-World Bank. The BEEPS IV survey was conducted in 32 Eastern European and Central Asia countries in fiscal year 2007. The BEEPS V survey was conducted among the same countries in years 2010-2014. We use the BEEPS IV survey results as our "pre-crisis" data and the BEEPS V survey results as our "post-crisis" data.
The questions in these surveys that are related to our objectives are as shown below:

1. "In a typical week over the last year, what percentage of total senior management's time was spent on dealing with requirements imposed by government regulations?"
Here, by senior management, the survey refers to managers, directors, and officers above direct supervisors of production/sales workers.
2. "Over the last year, was this establishment visited or inspected by tax officials? (Yes/No)"
3. "Over the last year, how many times was this establishment either inspected by tax officials or required to meet with them?"
4. "In any of these inspections or meetings was a gift or informal payment expected or requested? (Yes/No)"

In order to compare the pre-crisis period to the post-crisis period, we use the Mann-Whitney-Wilcoxon test. In each table, the result of this test is shown on the last column.

In the next section, we present our results.

4. Empirical Results

Table 1 shows the results of our test that compares senior management's time spent on dealing with regulations pre- and post-crisis (question №1). In the pre-crisis period, on average, 16.089% of senior management's time was spent on dealing with regulations in a typical week. The corresponding percentage in the post-crisis period is 16.838%. The difference is statistically significant at 0.1% level (p=0.0007). Therefore, we can conclude that, post-crisis, senior management spent more time on dealing with regulations.

Table 1. Senior Management's Time Spent on Dealing with Regulations

	Pre-Crisis			Post-Crisis			Mann-W.
Variables	**N**	**Mean**	**Std**	**N**	**Mean**	**Std**	**p-value**
Time spent (%)	4.315	16.089	22.63	5.778	16.838	21.79	0.0007

Source: Author's own work.

Table 2 shows the results of our test that compares the percentage of firms that were visited or inspected by tax officials pre- and post-crisis (question №2). In the pre-crisis period (during the previous year), on average, 58.83% of firms were visited or inspected by tax officials. The corresponding percentage in the post-crisis period is only 54.46%. This drop is statistically significant at 0.01% level (p<0.0001). Post-crisis, significantly fewer firms were visited or inspected by tax officials.

Table 2. Was Visited or Inspected by Tax Officials?

	Pre-Crisis		Post-Crisis	
Variables	**N**	**%**	**N**	**%**
Yes	2,924	58.83	3,486	54.46
No	2,046	41.17	2,915	45.54
Total	4,970	100%	6,401	100%
Statistic	**df**	**Value**	**Prob**	
Chi-Square	1	21.7514	<0.0001	

Source: Author's own work.

Table 3 shows the results of our test that compares the number of inspections or meetings with tax officials in the pre-crisis period vs in the post-crisis period (question №3). In the pre-crisis period (during the previous year), each firm on average had 5.2979% of inspections/meetings with tax officials. The corresponding number in the post-crisis period is only 2.7845. This drop is statistically significant at 0.01% level (p<0.0001). Therefore, there was a significant decline in the number of visits or meetings with tax officials after the crisis.

Table 3. Number of Inspections or Meetings with Tax Officials

	Pre-Crisis			Post-Crisis			Mann-W.
Variables	**N**	**Mean**	**Std**	**N**	**Mean**	**Std**	**p-value**
Number of inspections	2,786	5.2979	54.83	3,300	2.7845	5.19	<0.0001

Source: Author's own work.

Table 4 shows the results of our test that compares the percentage of inspections or meetings where a gift or informal payment was expected or requested in the pre-crisis period vs in the post-crisis period (question №4). In other words, the frequency of bribes in pre- vs post-crisis periods is examined. In the pre-crisis period (during the previous year), on average, 8.99% of inspections/meetings involved corruption. The corresponding percentage in the post-crisis period is 8.04%. This drop is not statistically significant (p=0.1946). Therefore, with regard to bribery, there was no significant change after the crisis happened.

Table 4. Was a Gift or Informal Payment Expected or Requested?

	Pre-Crisis		Post-Crisis	
Variables	**N**	**%**	**N**	**%**
Yes	241	8.99	262	8.04
No	2,441	91.01	2,995	91.96
Total	2,682	100%	3,257	100%
Statistic	**df**	**Value**	**Prob**	
Chi-Square	1	1.6823	0.1946	

Source: Author's own work.

5. Conclusion

Previous studies show that regulations have a significant impact on businesses. Tax code and tax-related regulations also have a significant impact on firms. In this study, we focus on Eastern Europe and Central Asia and examine how the 2008-2009 Global crisis affected this relationship. We focus on the time spent by senior managers on dealing with regulations, the percentage of firms that were visited or inspected by tax officials, the number of inspections or meetings with tax officials, and the bribes paid to tax officials before and after the Global crisis.

First, we examine the time spent by senior managers on dealing with regulations. Our test shows that, in this region, senior managers spent more time on dealing with regulations in general after the Global crisis (includes tax-related regulations and other types of regulations). Clearly, post-crisis, regulations became a bigger obstacle to these firms' operations.

Then, we examine the percentage of firms that were inspected or visited by tax officials during the pre- and post-crisis periods. We find that, post-crisis, there was a significant drop in the percentage of firms that had inspections or meetings with tax officials. This finding is also supported by our next test, which compares the number of inspections or meetings with tax officials before and after the crisis. We find that, post-crisis, each firm on average, had fewer inspections or meetings with tax officials. Therefore, we conclude that while overall regulations became a bigger obstacle to these firms, tax inspections became a smaller problem.

Finally, we examine corruption. We examine whether more firms had to deal with bribe requests by tax officials after the crisis. We find that there was no significant change in bribes related to tax officials.

Overall, our results show that while overall regulations became a bigger obstacle to these firms, tax inspections became less of a concern. With respect to bribery, we find that 8-9% of these firms had to deal with bribe requests by tax officials before and after the crisis.

Future studies may expand this research by focusing on different types of regulations like employment regulations, health and safety regulations, licensing regulations, environmental regulations, and zoning regulations, and the corruption related to these regulations. That way, we would have a clearer picture of how an economic crisis may change how a firm is affected by regulations.

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KNOWLEDGE ASSET AS COMPETITIVE RESOURCE

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Abstract: *Knowledge is a strategic, high-quality source of power. Knowledge assets – technological and human capital - have been recognized as key resource for sustaining competitive advantage in a dynamic turbulent environment. Past research argued that knowledge is important to facilitate and leverage knowledge assets. Most of the firm's knowledge and skills reside in its human capital, often in tacit and explicit knowledge. Existing knowledge is not enough to be competitive on the future market. Firms must collect, disseminate and create knowledge capital. According to the theory of dynamic organization knowledge creation (SECI; processes of socialization, externalization, combination and internalization), knowledge assets are the key elements that facilitate knowledge creation processes. Knowledge can be created on personal / organizational level, and also externally, such as with customers, partners and suppliers. Nonaka, Toyama and Konno (2005) identified four dimensions of construct of organizational knowledge capital: experimental knowledge assets, conceptual knowledge assets, routine knowledge assets and system knowledge assets. Each form of knowledge has specific individual support in process of knowledge creation. The firms needs vision and synchronized entire team.*

This paper employed a survey instrument and collected data in Slovenia. Our research confirmed Nonaka, Toyama and Konno (2005) research, we confirmed all four dimensions of organizational knowledge capital. Total 195 responses were analysed. The study shows importance to create learning environment, networking between professionals, to build trust encourage open, share / disseminate knowledge and create new knowledge.

Key words: small and medium sized business (SMEs), competitiveness, knowledge capital, knowledge creation.

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1. Introduction

Everyone constantly faces some kind of competition (Korposh, Lee, Wei, Wei, 2011). Developing successful innovations is essential for creating and sustaining a firm's competitive advantage. The environment is changing constantly and rapidly as well as the market and customer's needs (Prajogo, Ahmed, 2006). Firm's sustainable competitive advantages and superior performance are determined by the procession of valuable, rare, and imperfectly imitable resources (Barney, 1991). Companies need to develop flexibility and learn how to deal with growing complexity. They need not only to adapt to the current environment but also to anticipate future trends. Changes in present networked, knowledge society raise new challenges to human competences (Paavaola, Hakkarainen, 2005). Knowledge is a strategic, high-quality source of power (Grant, 1996) and the lever of progress (Toffer, 1991), it provides better performance and adapts to market conditions (Miller, Shamsie, 1996),