

## DETERMINANTS OF QUALITY OF THE SLOVAK BUSINESS ENVIRONMENT

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### Abstract

*Enterprises form an inseparable part of market economy. Their products and services meet requirements and needs of population and of various economic, public and non-governmental organizations. Successful operation of an enterprise can be conditioned by an outward and inward corporate environment. Business environment means an outward environment, surrounding of a company where its entrepreneurial activities are done. The environment needs to be created with a supporting effect for the development of enterprises. Experts and researchers focus their attention on monitoring and evaluating global business environment. No attention is focused on partial determinants of the environment. The paper deals with quality evaluation of individual parts of the environment of enterprises. Its goal is to analyse and define key parts of the environment as its determinants so that some improvements can be introduced in the business environment in Slovakia. Stimuli and barriers creating and supporting the business environment are described in the conclusion of the paper as they are the supporters in further development of business operation.*

**Key words:** *entrepreneurial activities, enterprise, determinants of the quality of business environment, achievements in business environment.*

### 1. Introduction

Businesses in the current competitive environment are determined by numerous and often turbulent market changes, imbalances of supply and demand, increasing competition between business entities, frequent legislative changes and government intervention. All of these factors are shaping the business environment in which companies operate and determine its quality. Changes in external business environment have a direct impact on internal environment of the company. While the external business environment can considerably influenced by management, businesses can only adapt the external environment if they want to operate on that particular market.

The business activity is conducted in particular space and time, influenced by various processes, components and impacts. The business environment is formed by all determinants the business interacts with, including impacts and processes the business operates in. Determinants of the business environment include different areas which have a direct and indirect impact on the business environment. A single definition of the business environment does not exist. Despite some common features each business environment is specific and reflects the local circumstances. The business environment can be defined as a location, an area in which the businesses realize their ideas and are looking to succeed on local, regional and even international markets. The business environment is made up of many components

(legislation, political situation, financial system, culture etc.) supporting or acting as barriers to business activities. The term business environment can be summarized as the following:

- 1) immediate business environment (internal environment dominated by the owners, employees, tangible and intangible assets of the company, technology; external environment dominated by political situation, legislation, financial and tax system, social conditions, and culture of the society etc.)
- 2) specific business environment (suppliers, customers, competitors, economic sector the business operates in, position on the market, corporate social responsibility)
- 3) international business environment (this part of the environment is associated with international business activities, phenomenon of globalization and internationalization of business activities, international economic organization and financial institutions etc.).

A different classification distinguishes the micro-environment of the business formed by the internal and external micro-environment of the business and macro-environment.

Internal micro-environment of the business is formed by the management, human resources, sales and marketing, finance, research and development etc.

External micro-environment of the business is formed by suppliers, customers, competitors, intermediaries and public.

Macro-environment of the business is formed by the political, legislative, social, cultural historical and demographic environment.

Small and medium-sized enterprises (SMEs) are especially sensitive to the business environment. In contrary to large companies, SMEs can easily adapt to market changes and take an immediate action to maintain their market position. Simplified organizational structure, simplified management structure, modern technologies and innovations implemented in business practice help them to remain competitive.

There are two elements shaping the business environment: macro-economic (national economy) and micro-economic (company culture). These conditions should be considered when evaluating the business environment. The following part of this study will present theoretical approach to discussed issue, focusing on the evaluation of determinants of the business environment.

## **2. Theoretical Background**

The environment in which businesses operate has impact on their competitiveness and vica versa the businesses also influence their environment, because the business environment is a part of the social environment and proactive approach is expected to solve the problems.

The business activity is realized by business entities, depending on their size. The entrepreneur is initiated to start a business, which depends on conditions designed for entrepreneurship. Most of the countries, Slovakia as well pay attention to monitor the quality of the business environment.

The economic growth of each country is determined by the supply and demand on the market. The business entity is the smallest unit, where these relations are recognized and expand to higher levels of the economy determining the future prospects.

Monitoring the macro-economic conditions having an impact on the economic and business environment was an issue discussed by Boďa et al. (2015), who focused their attention on all the V4 countries and not only Slovakia. The authors Boďa and Úradníček (2016) analysed the impact of macro-economic conditions and predicted them in relation to Slovak businesses. Their analysis clearly shows that environmental changes have enormous impact on financial situation of the business.

The research results of other authors point out the fact that financial risk is recognized at micro-enterprises, which are highly sensitive to changes and quality of the business environment (Ključnikov, 2016; Šúbertová, 2015). Similar conclusion considering the financial impact was made by Michalski (2015). Comparison of the financial implications of changes on sustainability and prosperity of the company evaluated the team of authors Tušan et al. (2013). The impact of investment plans was researched in details by Melicherčík et al. (2015).

A high quality and supportive business environment is essential to successful entrepreneurship, which enables businesses to implement innovations in practice. These are responsible for the economic development of the district, region and the country itself.

The innovations strongly support the development of proactive business environment. Havierníková (2013) notes, that the greatest potential for innovation can be found in small and medium enterprises. Detailed research about innovation and cluster activity of Slovak companies was conducted by Kordoš et al. (2016).

The national business environment has become turbulent. Businesses face new realities of the economic cycle, product life cycles, structure and nature of the competition, while new challenges for businesses appeared: constant change of the environment, increased uncertainty, risk of bad decisions. The increasing competitive confrontation developed a style of management that not only responds, but also anticipates the new situation.

Although this paper evaluates the business environment on national level (Slovakia) we have to take into consideration the fact that our country is formed by many regions with different level of economic development. Slovakia can be characterized by significant regional differentiation and regional disparities. These indicate, that the business environment in different regions may be different.

Perhaps the most negatively perceived determinants shaping the business environment in Slovakia are taxes and tax payments. The subject of heated discussion is not the necessity of payment, but the constant change of tax rate. This issue is also highlighted by Srovnalíková (2015). The current tax system is a significant barrier to micro-enterprises. The heavy tax burden is the main barrier for micro-enterprises to maintain their market position, and most of these companies disappear from the market in 1-3 years.

The changing business environment also brings institutional changes, which have further impact on businesses. The fundamental prerequisite of the company is the high quality staff. The process begins by defining the candidate (Jeřábek, 2016) in relation to corporate interests, objectives and business plans. According to Halasi (2016), Vlacseková and Tóbiás Kosár (2016), the motivated employee introduces new ideas, works efficiently and contributes to innovation. The accurate diagnosis of the company's needs and opportunities on the market is a key managerial activity. Hiring employees is limited by the current characteristics of the SME sector as well as the supply in the labour market, not only in Slovakia, but in neighbouring countries as well.

If a business wants to be successful, it must constantly monitor and evaluate the business environment and market conditions. The challenging and rapidly changing environment requires a high quality information system that enables managers to monitor their company as well as analyse and predict possible future development. These needs can be met by implementing modern information systems to apply these activities. Some software solutions can even simulate the possible development of the business environment after defining parameters, so managers can obtain information about potential impact of changes on further development of the business environment.

The business environment can be evaluated based on quality. Various determinants have impact on the quality of the business environment, which determine its development in

positive or negative way. The state should be involved in creation of favourable conditions to initiate and develop the business activity. The state directly and substantially affects the quality of the business environment. Low quality of the business environment acts as a barrier to development and has negative impact on all spheres of the national economy. The quality business environment creates appropriate conditions for business activities and does not provide administrative barriers. The quality of the business environment is determined by the following: 1) stable political situation, 2) clearly defined legislative rules for business, which are not subject of frequent change, 3) tax policy and fund contributions, 4) affordable access to financial support schemes and financial resources, 5) effective access to the capital market, 6) law enforcement, 7) developed infrastructure, 8) access to new technologies, 9) labour market liberalization, 10) motivation.

It is clear from the presented theoretical background that research of the business environment requires multidisciplinary approach and interdisciplinary decisions made by managers. Further part of this study will focus on the evaluation of the business environment in Slovakia in relation to quality and determinants of the business activity.

### **3. Research Methodology**

This paper focuses on the evaluation of the business environment. The main objective is to analyse the determinants that affect the quality of the business environment.

Processing information it was necessary to concentrate on primary data obtained during the solution of the research projects VEGA 1/0381/13 and KEGA 001UCM-4/2016. Within our primary research we approached 1500 small and medium sized companies conducting their business activity in different autonomous regions of Slovakia. 420 enterprises of different organizational-legal form expressed their willingness to participate the survey. Additional data we used was obtained from secondary sources, scientific publications related to the issue.

The research methodology was subordinated to the objectives set and the content of the paper. To quantify the level of quality of business environment we applied indices of different structure, depending on the evaluation of the problem studied. The following indices were applied to evaluate the business environment:

- 1) the Business Environment Index, used by the Business Alliance of Slovakia (Podnikateľská aliancia Slovenska, 2016) as a composite index, comprising the most important determinants of the business environment,
- 2) the Doing Business Index, developed by the World Bank (see World Bank, 2016), which is interpreted as follows: a higher score means better, simpler and more transparent regulatory environment for businesses and protection of property rights,
- 3) the Global Competitiveness Index, developed by the World Economic Forum, which examines competitiveness, including institutions, legislation and factors that determine the level of productivity of the country.

There are different other indices that monitor the business environment: the Opacity Index, Capture Index, Aggregate Governance Indicators, Corruption Perception Index etc.

The findings are presented in form of graphs and tables designed with a help of computer software. Additionally we used logico-cognitive methods as well. Based on the analysis we identify the current state of the business environment and define recommendation to improve its quality.

#### 4. Research Results

This part focuses on presentation of research results about the business environment in Slovakia. The first half of the results is gained through primary research.

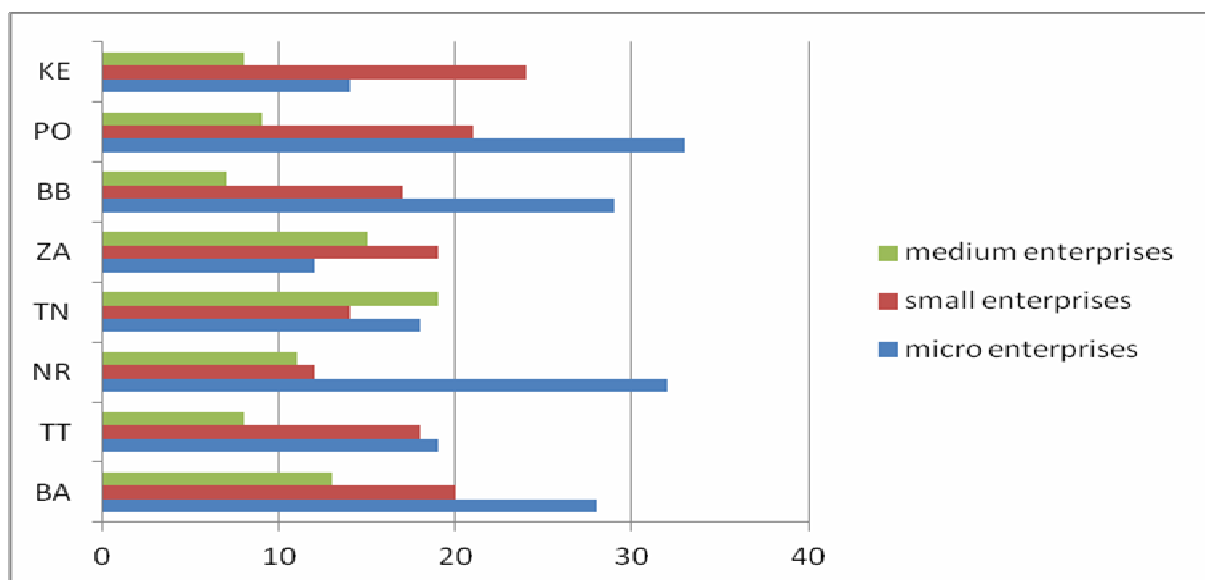
Table 1: Categorization of businesses by region

Region	BA	TT	NR	TN	ZA	BB	PO	KE
Absolute frequency	61	45	55	51	46	53	63	46
Relative frequency	14,52	10,72	13,10	12,14	10,95	12,62	15,00	10,95

Source: the author.

Table 1 shows that most of the businesses involved in our survey are from Prešov and Bratislava region; lower is the number of businesses from Nitra, Banská Bystrica and Trenčín region. The lowest number of companies involved in our survey are from Žilina, Košice and Trnava region.

Figure 1: Categorization of businesses by region according to their organizational and legal form



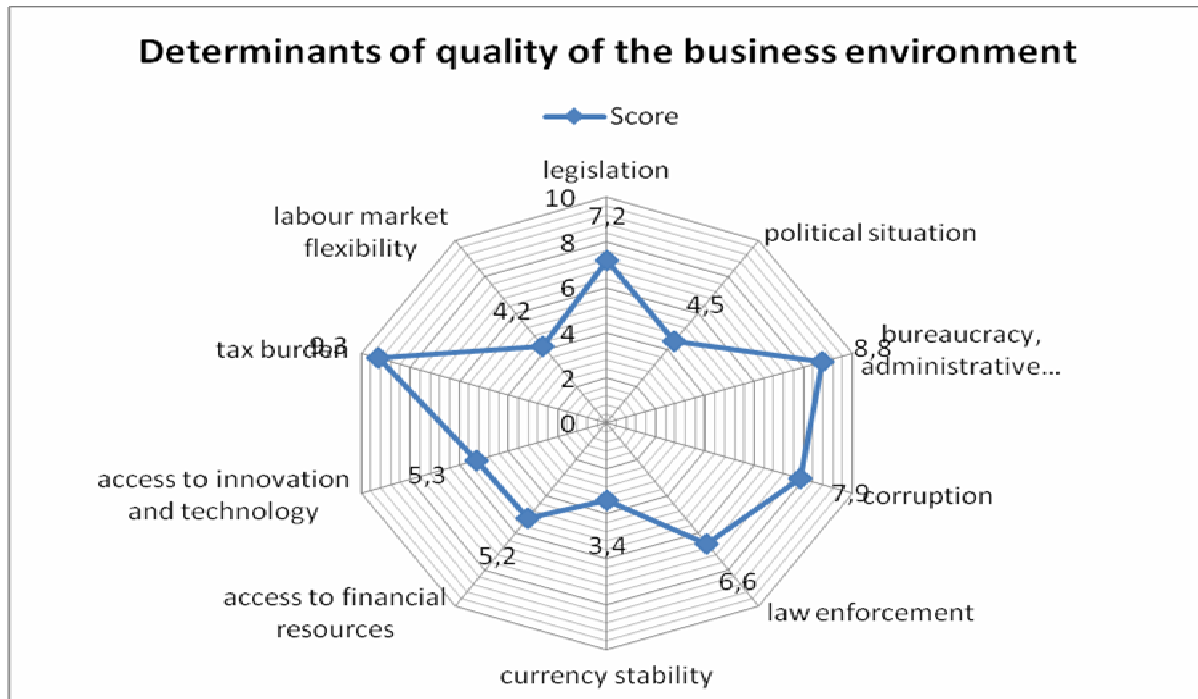
Source: the author.

During the solution of research project VEGA we also identified how businesses perceive the business environment in terms of quality, as quality of the business environment directly determines the success of business activity. Businesses involved in the survey could include several quality determinants and evaluate them on a scale from 1 to 10. The least important factor of quality was marked 1 and the most important was 10. A total of ten determinants assessing the quality of the business environment were involved in our survey. This analysis included the following variables: 1) legislation, 2) political situation, 3) bureaucracy, administrative burden of business, 4) corruption, 5) law enforcement, 6) currency stability, 7) access to financial resources, 8) access to innovation and technology, 9) tax burden, 10) labour market flexibility.

The quality of the business environment is an important determinant of competitiveness for the economy of each country. Creating a positive business environment should be a priority of

each government. Due to limited extent of this paper results of findings are presented in Figure 2.

Figure 2: Determinants of quality of the business environment



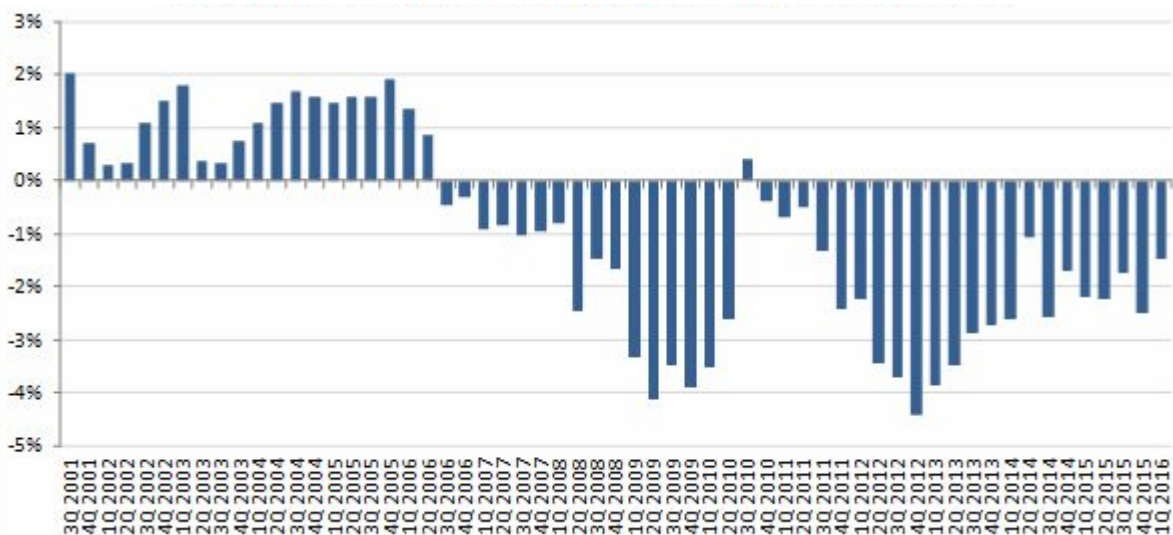
Source: the author.

According to the research the most significant determinant affecting the quality of the business environment is a tax and contribution burden. This determinant appears in international surveys as well, as the most significant negative factor affecting business development. In our research on a scale of 1-10 it reached a score of 9,3. The second most significant determinant affecting the business environment is bureaucracy and high administrative burden. This determinant has been perceived highly negative for 25 years. It acts as a barrier to development despite several reforms have been adopted. The third most important determinant is corruption (score 7,9), followed by the level and dynamics of legislative change with a score of 7,2. Law enforcement is also a leading determinant that has impact on the quality of the business environment. In our survey it has reached a score of 6,6. Moderately significant elements affecting the quality of the business environment are access to innovation and technology (score 5,3) and an access to financial resources reached a score of 5,2. This shows a qualitative step ahead, which is perceived positively by entrepreneurs. The access to medium term external financial resources has improved, as well as a decrease in interest rates could be recognized. According to small business, the interest rate for short-term external resources is still high. As an interesting fact we can mention that political situation is not actually considered to be an important determinant of the business environment (score 4,5). A number of changes in labour law would bring positive change, in form of increasing flexibility of the labour market. Our survey confirmed that the flexibility of the labour market is no longer the most significant barrier to business development and the current legislative environment is favourable. The score reached a value of 4,2. Entrepreneurs marked the currency stability the most stable determinant of the business environment (score 3,4). As the major turbulence of currency is not recognized, entrepreneurs consider it the least significant

determinant affecting their business activities. Other factors make higher barrier to business activity.

The second part of our research findings deals with the results on national level. The data was collected from the report of the Business Alliance of Slovakia. The BAS compiles the Business Environment Index on a quarterly basis. This index reflects the development of the business environment as it is perceived by entrepreneurs. Graph 3 demonstrates the development of the index on quarterly basis over the past 15 years. The measured positive results indicate satisfaction (higher is the value, higher the satisfaction is), while negative values represent dissatisfaction. Over the past ten years entrepreneurs have not expressed positive opinion regarding the level of business environment. The only positive sign is that the negative perception has not widened and it can be gradually improved. While in the fourth quarter of 2012 the figures reached the highest positive values, in 2016 the index is close to zero, which indicates improving business environment. The development of the Business Environment Index can be followed in Figure 3.

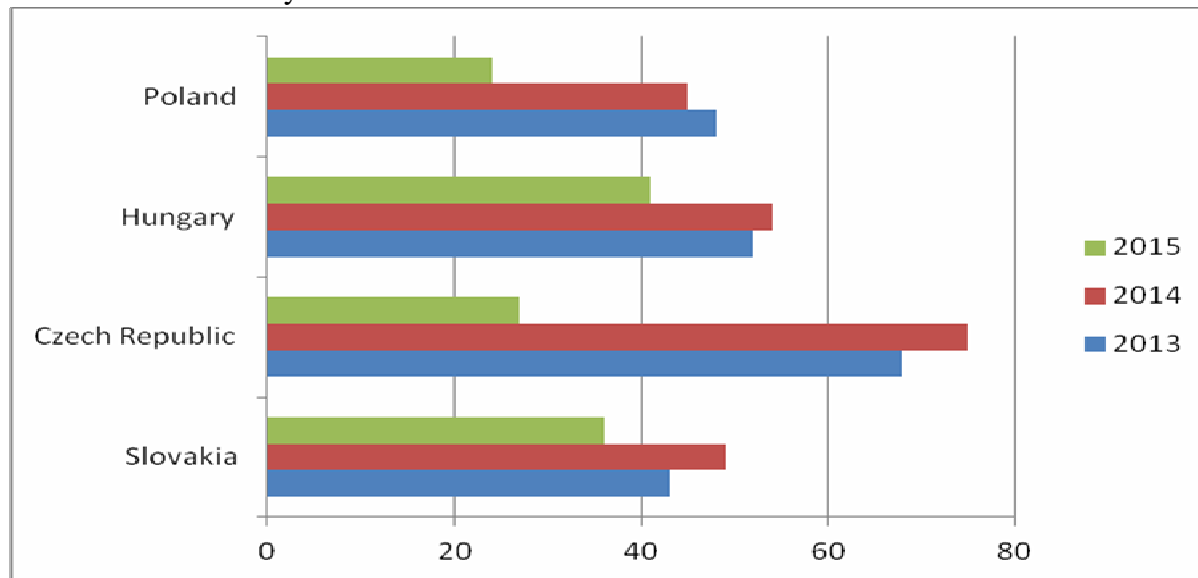
Figure 3: The Business Environment Index in Slovakia



Source: the author.

It is interesting to follow the position of Slovakia among V4 countries in evaluation of Doing Business conducted by the World Bank. Overall and partial position of Slovakia among V4 countries during the past four years is illustrated in Figure 4 and Table 2 demonstrates the data available for the first half of 2016.

Figure 4: Slovakia's position among the V4 countries according to evaluation of Doing Business conducted by the World Bank



Source: the author.

Six major areas that entrepreneurs must focus on is presented in the following table. These are: starting a business, obtaining license proceedings, access to electricity, access to property registration, tax obligations and solutions for insolvency. The position of V4 countries is marked among the countries involved in Doing Business ranking.

Table 2: Slovakia's position among the V4 countries in terms of six major business indicators

	Starting a business	Obtaining license	Access to electricity	Property registration	Tax obligations	Insolvency
Slovakia	108	53	65	11	102	38
Czech Republic	146	86	146	37	122	29
Hungary	59	47	112	45	124	70
Poland	116	88	137	54	113	37

Source: the author.

Table 2 clearly shows the results of the survey assessing the quality of the business environment conducted by Doing Business. Slovakia is ranked 11th in property registration among 189 countries involved in ranking. The worst ranking, 108th position Slovakia achieved in category of starting a business. Although recent years have brought simplification for start-ups – registration of start-up and trade license can be obtained in one place – there are still numerous requirements that business start-ups have to handle to start operation in Slovakia. Similar negative ranking Slovakia achieved concerning tax obligations, where we reached the 102th position. In recent years the government steps have not made the tax system more transparent, new taxes were introduced and tax rates of different types of tax have increased (income tax, VAT, excise duties). These factors have negative impact on the development of the business activity. Decreasing insolvency of businesses is a positive sign. Slovakia is ranked among countries with low level of business insolvency. Insolvency acts as a barrier to development of the business environment. The current position of Slovakia can be highly appreciated. Obtaining business license cannot be considered to be a strength of the Slovak business environment, but we are ranked among the countries where obtaining



business license is moderately complicated. In access to electricity Slovakia reached the 65th position in ranking, so further steps are necessary to make to improve the business environment.

## 5. Conclusion

The business environment is closely connected to the competitive environment in which businesses operate. Several determinants forming the business environment have direct or indirect influence on business activity, which can stimulate or hinder the business development. Quality of the business environment is measured by the Business Environment Index. Several indicators can be applied to evaluate the business environment.

This paper evaluates determinants that affect the quality of the business environment. The first part introduces the research results of primary survey, data obtained during solution of research projects VEGA 1/0381/13 and KEGA 001UCM-4/2016. The second part is based on monitoring the findings of the World Bank and the Business Alliance of Slovakia. We can summarize the following research findings:

- 1) The determinants that positively influence the business environment in Slovakia are: stable currency, property registration, relative flexibility of the labour market, low level of business insolvency.
- 2) The determinants that negatively influence the business environment in Slovakia are: tax burden, bureaucracy and administrative burden of start-ups, persistent corruption, frequent legislative change.

In order to ensure positive development of the business environment, the Slovak Government should consider the findings of primary research as well as the findings of the Business Alliance of Slovakia and adopt measures to remove administrative barriers; take steps to stabilize the regulatory environment, reduce tax burden (consider the re-introduction of flat tax); make judicial procedures flexible and improve law enforcement; actively cooperate with professional business organizations and enter an effective dialogue.

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