THE DEVELOPMENT OF ENTREPRENEURSHIP AND SMALL BUSINESS IN POLAND

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Summary

Small and medium enterprises are a key factor in the economies of the Central and East European transition states, where successful small businesses have been expected to grow larger, create jobs and increase prosperity.

This article examines the emergence of small and medium enterprises (SMEs) in Poland. In the first part we will focus on the institutional framework and reforms in Poland during the system transformation. Subsequently we will describe the actual development of SMEs growth and present the role of SMEs in the sustained economic development. In part three we will describe the main policy approaches followed by the Polish government and finally, we will identify future opportunities and threats for SME and touch upon how government intervention will be necessary to insure further SMEs growth.

Key-words
Small and medium enterprises, entrepreneurship, economic transformation

JEL
M13, P31, L10
1. Introduction

The development of small and medium sized enterprises in Poland has received lately bigger attention in comparison with other aspects of the economic processes. Small and medium enterprises have a key role to play in the restructuring economies. The establishment of a broad ownership through the development of independent commercial enterprises, a good number of which are SMEs, creates the social basis for a competitive economic system. SMEs, moreover, are absorbing a considerable proportion of the labour force released by state firms in their adaptation to the new economic system. The creation of a healthy SME culture also helps to work against the distorted firm size structure typical of central planning, a structure characterized by a dominance of large firms and allocation decisions made by central authorities. Emergence of SMEs needs to evaluate the policies that rendered their growth possible, such as the development of the institutional and macroeconomic framework; the rise of self-employment: limitations and barriers to the development of private sector SMEs; state policies regarding SMEs; the development of support networks.

2. Institutional framework and reforms

After disintegration of centrally planned economies¹, East European countries ended up with an over industrialized system, with a predominance of a state sector employment², over-extensive social welfare, deep pene-

¹. For the main features of the centrally planned model see: Brus, 1972, chapter 3.
². For example, from the ownership's point of view, Polish economy was divided into three sectors: state, cooperative and private. The existence of three sectors was not equivalent to the fact that all of them are equal concerning their economic potential: assets, turnover and employment.
tration of central planning, and in many cases, macroeconomic instability. In the early years of the transformation process, most attention was focused on the macroeconomic level. Price liberalization, currency convertibility, the privatization process and other market reforms were priorities for governments concerned with building the right setting for future stability and sustained growth.

During the processes of macroeconomic reforms Eastern Europe has witnessed a severe recession. This trend had actually begun before the transition, however after the socialist economies have collapsed the fall in output was clearly observed. East European countries, including Poland faced structural problems with excessive size of heavy industry, and corresponding underdevelopment in

<table>
<thead>
<tr>
<th>Sector</th>
<th>Gross output</th>
<th>Value of assets</th>
<th>Employment</th>
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<tbody>
<tr>
<td>State and cooperative</td>
<td>95.2</td>
<td>93.6</td>
<td>90.0</td>
</tr>
<tr>
<td>Private</td>
<td>4.8</td>
<td>6.4</td>
<td>10.0</td>
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Source: Informacja Statystyczna GUS, 1990, p.388

In general, the state and cooperative sector predominated over the private one. On the other hand private farms remained the dominant form of agriculture in Poland covering approximately 70% of the total areas of farms. The share of the private sector in other spheres of economy was much smaller than in agriculture. An example may be some date concerning industry:

4. For example in Poland in 1990 measured output dropped 24.2% over the year. Only in 1992 after three years of output decreasing (1989 -0.5%, 1990 -24.2%, 1991 - 11.9%) was noted increase 4.2% (CUP, 1992).
the service sector. Among others, the main reasons for the recession, were: breakdown of the Council for Mutual Economic Assistance, increased foreign competition, budgetary constrains, reduced fiscal spending leading to fall in aggregated demand etc. Above all, along with the fall of overall output, there was deterioration in the social situation, which could be observed in a high unemployment rate.

The task of economic reform in Poland during the transition to a market economy had two components:
1. Basic institutional reforms, without which a market economy cannot function, had to be implemented. These included the creation of commercial and contractual freedom, legal guarantees for private property, and the establishment of a legal system for a market economy.
2. The problems of economic restructuring had to be addressed. With the collapse of the old system Polish economy was released from the constrains of central planning. It entered into a situation where the mechanisms of a market economy were not yet working properly. Additional difficulties arose from the weakened ability of the state to exercise regulatory and organizational functions.

Polish economy has made remarkable progress in setting up institutions for a market economy. Decisive steps

5. The service sector in Poland in 1988 was accounted for a share of 35% in GNP (OECD, 1991), while in OECD countries recorded shares of 47-65% (World Bank, 1990).
6. In Poland in 1990 the unemployment was 6.3% of the labour force, and climbed significantly higher at the next years. In the beginning of 1991 2.2 millions people leave without job (11.8% of the labour force), 1992 – 2.5 millions and 13.6% respectively (GUC, 1992) and 1993 – 2.8 and 15.5% (The Economist, 1994, p.36). The decreases in real wages recorded in January 1990 in relation to December 1989 were 41% and in 1992 real wages maintained 26.6% lower than in 1989.
towards the replacement of the centrally planned economic mechanisms of allocations by market-based processes of economic coordination were taken. These steps included the lifting of restrictions of the free exchange of goods and services and on the allocation of factors of production, the liberalization of most prices, the abolition of prevailing foreign trade restrictions for the private sector, the reform of the banking system, and the partial establishment of currency convertibility. Newly created private domestic banks and subsidiaries of foreign banks have now been added to the large commercial banks, which have been taken over by foreign banks in a number of cases. The commercial banks still maintain a dominant position in terms of domestic deposits and credit business. The competitive situation within the banking sector, however, is gradually improving with the appearance of domestic and foreign private banks.

In 1989/1990, the year of transformation, none into private ownership in a relatively short period of time was unknown. The performance of privatized companies shows that the formal transfer of formerly state-owned assets to individuals and corporate bodies does not provide a sufficient guarantee of success for the restructuring of enterprises. In many cases, following privatization, the old relationships and links between managers of former state enterprises, government employees and bank officials have remained intact and are exploited by company representatives in their private interest. The general problem is that the transfer of assets does not automatically create structures of “corporate governance” that could guarantee a thorough restructuring of the enterprise. The new institutional framework for private economic activities – the introduction of commercial and contractual freedom, legal ownership guarantees, the lifting of restrictions on private economic activities – really changed the economic environment for individual economic activity. Private entrepreneurial initiative was allowed to
develop for the first time. This could take place through the formation of new companies, as well as through the restructuring processes taking place within collective and state enterprises. The stimulus for the growth of the private sector from the development of the macroeconomic environment was that private firms were given good development opportunities in a number of economic sectors by the gaps in demand created by the collapse of the centralized economic system. This was particularly true of consumer and production oriented services, transport and construction. The creation of commercial freedom and the abolition of the regulating mechanisms of a centralized economy changed the framework conditions under which private initiative operated. For this reason, the transition to a market economy not only offered potential entrepreneurs opportunities unknown before, but also demanded considerable adaptation by existing private enterprises. Since the beginning of economic liberalization, private firms have gained considerable economic importance in the national economy of Poland.

3. SME sector in Poland

The government policy during the first period of economic transformation was particularly focused on macroeconomic issues. Among the whole number of legislative regulations only a small part was directly determining the activity of the small and medium enterprises. In 1988 was established the Act on Business Activity and there was no other document influencing the development of this sector. The document was not directly focusing on the SMEs, however it permitted entrepreneurs to start their action without any governmental obstacles. That was the beginning of so called entrepreneurship explosion in the beginning of the 90s. In generally, the activity of entrepreneurs within SMEs was favoured, but none of the pri-
orities of the government's socio-economic strategy referred directly to this sector. First attempts to define state policy towards SMEs were undertaken in 1995, when the Council of Ministries approved the document prepared in cross departmental consultations: SME in the national economy: policy towards SMEs – it described the former policy as ineffective. However, first document that was clearly defining as government strategy towards SMEs sector was published in 1999 and was entitled: Government Policy towards Small and Medium size Enterprises until 2002.

In Poland the 1980s were marked by a steady growth of the private sector. A significant rise in its growth occurred in 1989, when the government removed the majority of administrative barriers preventing private firms from entering the market. Further changes in economic environment caused next increase of the number of private firms. In 1990 the number of private firms increased by 250%, while the number of state enterprises grew by 3%. In 1990 the industrial output of the private sector increased by 8%. At the same time industrial output in State sector fall by 23%. As a result private firm's share in total industrial output was over 11% in 1990, as against only 4.8% in 1989. Some estimates put its importance at about 20%. This difference is caused by the existence of shadow economy in Poland. Employment in the Private sector outside agriculture reached about 16% of total employment in 1990 (GUS, 1991).

In the end of the 90s in the GDP structure a number of 69% of Gross Value Added was generated by private enterprises. Within these 69% of GDP generated by private firms 36% was created by small enterprises and 9% by medium enterprises. These data bring us to the conclusion

9. It is difficult to give straight and precise definition of small enterprise,
that 45% of Polish GDP was generated by the SMEs sector, when only 24% of total GDP was generated by large companies. According to the structure of SMEs output we can observe a trend that great part of them operates with Trade and Repairs Sector (around 40%). The other branches are: construction industry (12%), manufacturing (13%), transport and communication (10%), real estate (12%) and other service activities (13%) (Gemini, 2000).

The second important figure is the number of people working in SMEs comparing to the whole economy. In 1999 there were slightly above 11.4% millions people employed in the economy (excluding agriculture, fishery and forestry) whereas almost 7 millions people, i.e. 61.1%, working in small and medium enterprises (Gemini, 1999). Looking at SMEs essential contribution in generating Polish GDP and the employment of more than half of the working population clearly shows the sectors real importance for the development of the economy.

mainly because of problems with clear identifying criteria. The most common criteria used nowadays is quantitative one, based on general economic ratio, company value and number of employees. Accordingly most of economic literature provides us with definition describing small companies simply as those which employ less than 50 people. Such an approach is actually inconsistent. There are many companies that employ less than 50 people but operate on global market, with significant turnover, as fully automated production plants with great market share. There are also firms acting within the sectors of highly sophisticated technologies that have reached great market share, even if consist of less than 50 people. In the United States a definition delivered in 1953 in the Small Business Act is still valid. It claims small company to be independent ownership unit, with a free choice of action, not dominating on the market on which it operates. European attempts to define meaning of small enterprises go further and there are three main indicators of small business: economic indicators: company has relatively small market share, management indicators: highly personalized way of managing company and informal management structure and other indicators: enterprise acts independently and owners have free decision choice. The European Union's definition was based mainly on the quantitative factors. It assumed that small business enterprise was one that employed less than 50 people, with annual turnover less than 7 mio euro and assets value not more than 5 millions euro. In the same way it described medium size enterprises: less than 250 employees, less than 40 millions euro annual turnover and assets value not higher than 27 millions euro.
The last point is the total number of small firms operating on the market in Poland. In 1999, there were, 1,567,413 small active enterprises. Medium and large enterprises numbered 12,774 and 3,419, respectively (Gemini, 2000).

Over recent years, not only an amazing large number of new firms have been created in the private sector, but many of these enterprises have also been forced in finish their economic activity after only a short period of time. Those private economic activities whose market entry was associated with relatively small investments were particularly affected. The experience of mature market economies shows that it is typical to see high variation rates in sectors dominated by small firms in economic sectors with different size structures. Market turbulence is even more possible in the young market economies where relationships are in general less well established and the setting up of new firms is often associated with very high risks. However, when small and medium-sized companies in many sectors have come under increased competitive pressure, related partly to the continued entrance of new competitors, it shows that newly created firms are characterized by a particularly notable dynamism and ability to adapt. That means, it does not result in large waves of company collapse. This is even more remarkable given that SMEs, in comparison to privatized large firms and state enterprises, cannot usually rely on the helping hand of the state. SMEs are the most important potential solution for labour market problems as progress in the macroeconomic restructuring of large former state firms continues. SMEs act as manufactures in production networks where they produce intermediate and final goods for market niches that increase the flexibility and efficiency of overall production. Furthermore SMEs act as distributors and wholesalers in internal and external trade. In this context it is important to emphasize that SMEs link the larger firms to each other and to the final consumer.
Moreover SMEs ensures a competitive climate whereas Polish economy was burdened with strong monopolies. However the most beneficial contribution of SME sector growth is the notion of entrepreneurship as a key element to reduce unemployment (Vodopives, 1998). Innovative job creation initiatives are responses to the significant job losses entailed by the decline of the industrial sector and the dismantling of former large state enterprises.

4. Barriers to small and medium sized enterprises development

One of the most important conditions for the success of the economic transformation is the existence of entrepreneurial talent in the population and the influence of the cultural and social environment (Cornwall, 1998). Some experts consider that the era of central administration and economic planning has considerably shaped the norms, value judgments and social orientation of the population, and in consequence has negatively influenced their entrepreneurial spirit. The opposite view concludes that cultural influences do not have a fundamental effect on the entrepreneurial ability is evident in many types of society. Differences are caused rather by the framework conditions for economic activity such as the nature of property rights.

In Poland, for instance, relatively small steps towards liberalization in the 1980s led to a rapid increase in private economic activity. The population, therefore, was reacting positively to changes in the framework conditions. However, many preconditions, which would allow entrepreneurial potential to develop and grow freely, are not met. Problems can be identified in lack of human capital with marketing or business management know-how, strategic planning, experience of an enterprise culture, employee motivation, training systems, lack of qualified
instructors as well as in the financing of SMEs. A further serious obstacle to development entrepreneurial potential is the continued deformed market structure in the industrial sector and the resulting lack of competition. Other obstacles are state bureaucracy and administration and the difficulties of applying new economic laws. The employees of the state administration were as unable to deal with the new economic legislation as the owners of private firms and potential entrepreneurs. The essential problem still is the rather stressed relationship between state employees and the commercial sector. Individual entrepreneurs, who often suffer mistreatment by representatives of state institutions, have great difficulty in recognizing in their counterparts the supposed helping hand of the state for private initiative.

During the era of central planning, private savings and capital achievements were permitted in Poland, though they were limited in range. Entrepreneurs cannot usually develop a long-term stable financial basis from personal savings, nor does self-financing tend to provide sufficient capital for investment. The access of small and medium sized enterprises to credit facilities from banks and financial support programmes is still limited. In addition, there remains a general lack of risk capital. This situation not only slows down the creation of firms, but also it has a negative impact on business operations such as financing working capital or investment (Ribnikar, 1997). There are a number of reasons for the financial difficulties faced by SMEs. A large part of the problem is rooted in the role of the banking system. Many of the new banks were illiquid as they had inadequate equity capital and unwilling or unable to service their loans. The lack of institutional infrastructure at the regional level, the absence of branch office, creates further difficulties for SMEs. The still underdeveloped competitive structures in the banking industry create a further financial blockage. The lack of expertise in the banks in small-scale credit provision, as well as the
continued existence in many banks of centralized and inflexible decision-making mechanisms are important factors in the frequent negative credit decisions against small and medium sized enterprises. As they are usually to provide the demanded level of security, the banks are often cautious in their negotiations with the firms and tend to avoid risk.

If the starting point of market structure, far reaching restructuring of the markets is necessary before real competitive relationships are realizable. Decisive stimuli for overcoming competitive absences, which are obvious in all economic sectors at the start of market economic development, can be expected from four principal developments:

- Market entry of many private SMEs
- Opening of markets to foreign competitors,
- Denationalization or privatization of the economy
- Competition legislation and a functioning authority for competition control as supporting measures for the process of restructuring.

In all four areas significant progress has been made since 1990 in the transition economy of Poland. The market entry of private firms led relatively quickly to major changes in market structures and in this manner the competitive situation of substantial parts of the young market economy. Dynamic growth of new start-ups since 1990 has been the most important factor in the creation of market. The opening of market to foreign competitors, a policy practiced particularly in Poland has resulted in significant improvements in the competitive situation in Polish economy. Privatization measures have contributed very much to the competitive situation in individual sectors. Loby authorities were created which have gained considerable experience. They are mostly faced with the task of contributing to the realization of competitive market structures. In summary, a significant improvement in the competitive situation has been achieved over the course
of recent restructuring efforts, certainly in comparison with the initial position at the beginning of the 1990s. This has been based principally on the market entry of numerous small and medium sized enterprises, the opening of the markets and progress in denationalization.

Competition policy in the transitional economies is essential to the long-term development of a free market and should be regarded as a vital supporting measure to the change in the system of ownership and to microeconomic restructuring. In spite of this, interaction with the state bureaucracy and administration can cause many difficulties for small and medium sized enterprises in the market economy. Despite the establishment of commercial and market freedom soon after liberalization, Poland could not demand too much from a rooted government administration that was confident with the procedural regulations of state activity within a market economy. The state administration therefore cannot satisfactorily adopt the role of provider of public services in the economy. This would, for instance, include the registration of companies, approval procedures, the acquisition of industrial land, planning permission, the provision of public goods, industry control, and activities of the tax authorities. The public administration had to regulate itself to new requirements created by either completely new circumstance.

5. Policies for the development of SMEs

An original entrepreneurial class can only develop when potential entrepreneurs have a positive institutional and economic environment for their activity. Policies aimed at improving the institutional and macroeconomic framework conditions are of primary importance for the development of a local small and medium sized enterprises sector. The state should establish active measures for the
support of private firms on top of shaping the framework conditions. The intervention of the state in supporting the development of the private sector is necessary for the following reasons:

1. Private initiative has been systematically suppressed over past decades. The restrictions on private economic activity have had an important influence in shaping the training and vocational orientation of commercially talented individuals and the accumulation of private savings.

2. As much of the dynamic for the market economy can be expected to come from the newly created small and medium sized enterprises.

3. In all young market economies the state uses considerable financial resources to support the transformation of state enterprises.

4. SMEs are structurally disadvantaged compared to large former or still state-owned companies. Assistance is therefore justified on the basis of compensating for this disadvantage.

In relation to the development chances for small and medium sized enterprises it must be assumed that these firms are considered as key to the successful development of the market economy. Assistance measures for the SME sector are more important under the conditions of system change than in develop market economy. An orientation of SME policy is required towards help for self-help and creation of positive framework conditions (e.g. equal opportunities in access to capital markets, provisions of industrial estates, consultancy services).

Private entrepreneurs in market economies can usually rely on a wide network of support from self-help organizations, commercial business related services and institutions providing state assistance. Such networks are very important for the creation, growth and restructuring of private firms (Greve, Salaff, 2003). A support network includes the following organizations:
1. Providers of advisory services such as training and further education facilities, including both non-profit making organizations and commercially active service firms.

2. Economic infrastructure institutions, particularly in the financial sector.

3. Industry and economic associations that represent business interests.

4. New firm or incubator centers, and technology transfer centers in state, private or mixed ownership.

5. State development agencies at national, regional and local levels.

In relation to these support networks, two significant problems can be identified:

1. The existing institutions are not sufficiently adapted to the requirements of a market economy, both in qualitative and quantitative terms.

2. Certain support organizations, such as employers associations and technology centers are widely lacking.

The elimination of restrictions of the centrally planned economy stimulated widespread growth of entrepreneurial initiative in Poland. However those SMEs that have been created in recent years now face the task of consolidating their economic situation and strengthening their market position.

As shown in facts about SME sector, these enterprises have come to play an increasingly important role as the driving engines to economic growth. In this context it is important to emphasize SMEs growth ability in employment creation, and thus promoting entrepreneurship is essential. Moreover looking at the identified obstacles to SMEs, policy considerations for developing this sector are becoming urgent and important for transition economies (OECD, 1997).

The optimal contribution of policy towards the expansion of the private sector is further improvement of the economic and legal framework conditions. In this re-
spect, there must be a development and consolidation of what has already been achieved.

However the OECD 1996 report argue that economic policy cannot focus solely on the creation of an institutional and macroeconomic framework for the economic activity of SMEs. The authors argue that the conditions in the transition countries necessitate measures designed to support actively the development of private firms. In continuation of this Ian Hamilton Fazey (OECD, 1997) emphasizes that entrepreneurship promotion must entail finance and supported education and training. Moreover economic associations, development agencies, etc. are crucial in creating the right structures.

Kanichiro Suzuki and Michael Lacktorin (OECD, 1999) support the above and go a bit further in their elaboration of what government can do. According to their findings policy makers in transition countries should help remove capital constrains for SMEs. In other words, governments should participate in risk-taking investments by insuring credit-guarantees. David Storey has also elaborated on this issue. He sees that an efficient marketplace needs to have competition among financial intermediaries, which is the case in the developed countries. Therefore David Storey justified state intervention when it comes to financial programmes in transition economies due to their lack of financial competition (OECD, 1999). Furthermore the authors see these policy actions as being fully consistent with global trends towards privatizations. Global consen-
sus seems to be forming around the fact that the proper role of state should be to smooth the way for private sectors, which offer the most economic promises.

Such policy proposals stand in strong contrast to the early 90s viewpoints from the World Bank, OECD and IMF. These international institutions have emphasized the negative outcome of state intervention. As regards to the build up of material infrastructure, communication systems, power and water supply etc. have shown expen-
sive and inefficient. Empirical evidence even proves that the private sector had to establish parallel structures and supplies. Moreover and even more important the international institutions criticize the idea of direct state participation in production. The critic especially emphasizes the poor management of capacities and excess employment in the public industry sector, and how this situation has hindered for efficient utilization of the scarce resources (John Mastinussen, 1999).

6. Proposal for a national policy on SME development

A number of transitional economies of central and Eastern Europe, including Poland have started a fundamental administrative and legal reorganization in order to create the conditions for a prosperous market oriented economy to develop. However, a government can only attempt to create the necessary conditions for this to happen: it cannot develop the economy by itself. Now there is a need for institutions, which will enable entrepreneurs to seek out and take advantage of the conditions available in order to create and build up prosperous, wealth creating enterprises, in consequence benefiting not only themselves, but also the nation as a whole (USAID, 1995).

These institutions have a very important task to perform:
1. Implement the government's policy on SME development
2. Represent SMEs themselves and bring their views and aspirations to the attention of the government, and advise on the best ways to stimulate SME development.
3. Actively promote and facilitate a business environment, in which SMEs have access to individual opportunities, national as well as international
4. Support all this, it arranges for the education and training of a new class of entrepreneurs and professionals.

On a national level, the policy on SME development should include assistance for the creation and delivery of a fully integrated business support programme. This programme could then provide a range of national programmes in support of business creation and development, facilitating particularly those difficulties relating to: access to appropriate credit/capital, access to business information (suppliers, competitors and markets), up-to-date business management techniques, management accounting, budgeting and cost control, market research and marketing, access to export markets, access to suitable premises and land, quality assurance and control, access to government and large enterprise contracts, competitive access to inputs, human resource development

7. Conclusion

The rapid expansion of the small business sector is proving to be a dynamic factor in support of economic revival. Despite the persistence of obstacles to small business development, remarkable progress is being made in constructing a macroeconomic and legal framework within which private entrepreneurs can prosper. The next step that policy-makers should do is to consolidate these achievements and design specific policies for SMEs to reduce the remaining barriers to small business expansion. Good legal and economic framework conditions are required to support the entrepreneurial spirit that has developed since economic reforms were introduced. The barriers, however, to the development of an effective SME sector are various:
1. There are gaps in the financing of small and medium sized enterprises, both in the start-up phase and in lat-
er growth. Although considerable progress has been made in the banking and financial system since the abolition of monopoly banks and central planning, financial systems have not yet fully developed to meet the new needs of business financing. Small and medium sized enterprises are in a more difficult credit position than the large state enterprises.

2. Vocational and technical training systems have improved substantially. Considerable gaps still exist in the area of finance, commerce, business management and entrepreneurial training.

3. The competitive situation is far from positive for small and medium sized enterprises, in particular in the manufacturing sector, which is still dominated by large companies.

4. The practical implementation of the legal framework for a market economy is still lacking. Long periods of adaptation should be expected before the new legal norms are rooted in the thinking of entrepreneurs and the population in general, and before they are fully implemented by legal authorities.

In most recent years, national government as well as regional administrative authorities have implemented local state consultancy facilities, business development centers, technology parks and economic development agencies in economically disadvantaged regions. The effective implementation of assistance measures has been in many cases stopped by financial and administrative difficulties. Despite these obstacles, more effort has to be made to include the local and regional dimension of small and medium sized enterprises policies by adapting assistance measures to specific needs and situations. The partnership between support institutions, banks, private suppliers of business related services and further training facilities, in particular at the local level, needs to be notably improved. The same applies to combined action
between municipal, local, regional and national facilities in the vertical cooperation between support institutions, economic self-help organizations and authorities of the state administration.
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