THE IMPACT OF THE POLITICAL CRISIS ON SMALL AND LARGE FIRMS IN THE REPUBLIC OF MACEDONIA

Irina Majovski[26]
Zoran Janevski[27]
Elena Davitkovska[28]
DOI: https://doi.org/10.31410/EMAN.2018.82

Abstract: *The recent political instability in the Republic of Macedonia has taken its toll on the business sector. During political instability, firms tend to postpone any major decision regarding future projects or investments as a result of changes in firms' business perceptions and lack of predictability of future policies and trends. In this regard, a research was conducted among small, medium and large firms in the Republic of Macedonia in order to investigate the main consequences of the political crisis in the past few years on the business sector. The research findings reveal that the most severe implications of the political instability on businesses pertain to lack of long-term planning, decline in sales, increased difficulties related to collection of claims and implementation of ongoing contracts, and reluctance to conduct planned investments and recruitments. Results have also highlighted major differences between small and large firms in regard to perceived consequences of the political instability. Research on the effects of political instability on businesses is rather scarce in literature. Hence, the findings of this research are of particular importance for improving the knowledge about the potential implications of political instability on businesses and for identifying the main challenges that businesses face.*

Key words: *political instability, business sector, small and large firms' constraints*

1. INTRODUCTION

Political instability refers to change of institutional status quo or frequent changes in policies. The political instability covers a wide scope of uncertainties on the political scene from national elections and change of government through riots, protests and even civil war. The effects that the political instability can have on the economies and the business sector differs based on the intensity and the duration. However, even in its mildest form as national elections, the political instability imposes a significant degree of uncertainty about possible changes in fiscal, monetary or regulatory policies. Thus, the political instability affects businesses as it changes the environment in which they operate and may affect their corporate profitability and investments. Such uncertainty affects the decision-making process making businesses reluctant to take risk and make decisions related to investments or development activities. For instance, according to IMF [1], the uncertainty about fiscal, monetary and regulatory policy changes related to the 2008 Global Financial Crisis contributed to a sharp economic decline and slow recoveries afterwards.

The recent political crisis in the Republic of Macedonia, which started in its acute form at the beginning of 2014, has taken its toll as well. According to the State Statistical Office [2], the political crisis has resulted in decline of economic growth rate and fall of gross investments by

[26] Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Prolet 1, Skopje, Macedonia
[27] Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Prolet 1, Skopje, Macedonia
[28] Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Prolet 1, Skopje, Macedonia

4.5%, among other. The business sector has continuously emphasized the consequences of the political crisis as stagnation of planned development activities and decline of investment activities that could lead not only to loss of profit and decreased competitiveness but also to the very survival of firms, especially the small ones. Increase of productivity, firms' growth activities, increase of export, new employments and corporate investments are postponed during periods of uncertainty. All of the above undermines the competitiveness of firms and hampers future recovery. Political crises are, however, inevitable, and thus it is of outmost importance to identify the major repercussions they have on business activities.

2. THEORETICAL BACKGROUND

Research on political crisis mainly refers to the impact on macroeconomic outcomes as economic growth, investments including direct investments, capital flows, gross domestic product and productivity rate, among others [3] – [6]. Few studies have investigated the link between political instability and firm-level outcomes, focusing mainly on financial indicators. In this context, several studies [7], [8] found that firms show a significant decline in their corporate investments during political elections. Other studies reveal negative impact of political instability on capital investments [9], stock returns [10], technological innovation [11], asset returns [12], investment-to-stock price sensitivity [13]. Nonetheless, none of the studies on political instability have investigated the specific business activities that are impacted most by political turmoil.

In addition, political instability was found to be one of top three obstacles to doing business in the Western Balkan region. This comes as no surprise as the region has been characterized by frequent political instability since the beginning of 1990s. Namely, the latest joint European Bank for Reconstruction and Development and World Bank survey [14] [15] reveals that firms in the Western Balkans point to three most severe obstacles to doing business: competition from informal sector, political instability and lack of access to finance. Based on these findings, about 24% of the firms in the region perceive political instability to be major or very severe problem to their day-to-day operations. In particular, 34% of firms in Bosnia and

***Irina Majovski**, PhD, Associate professor, Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Skopje*

Irina Majovski graduated from the Faculty of Philology, department of English language and literature at the University "Ss. Cyril and Methodius" in Skopje in 2000. She pursued master's degree in Management at the CITY College, University of Sheffield, Greece. In 2002, upon public defence of her master's thesis "Motivation of employees during organizational change" she obtained master's degree. In 2010, with the doctoral dissertation "The influence of strategic human resource management practices on organizational performance in companies in the Republic of Macedonia", she obtained PhD in Economics from the Institute of Economics-Skopje.

In the period 1999 to 2003, she was working on implementation of projects funded by ECHO, EAR, UNHCR, KfW and Danida. From 2005 to 2006, she was working at the Faculty of social sciences in Skopje, and from 2006 to 2011 at the Integrated Business Faculty in Skopje. She joined the Institute of Economics–Skopje, University "Ss. Cyril and Methodius" in 2012 and her current appointment is Associate professor in Human resource management.

She has actively participated in research and applied projects, as well as in many scientific meetings, conferences, seminars and congresses in the country and abroad. She is an author of numerous papers published in international journals. She teaches at the second cycle study programs at the Institute of Economics-Skopje.

Hercegovina, 31% in Serbia and 22% in Macedonia[29] point to political instability as a severe obstacle to their business activities.

Considering the above said, it is essential to identify the most affected business activities during political turmoil. Hence, the main objective of this research was twofold: to assess the degree of severity of the impact of the latest political instability on businesses and to identify the business activities that have been mostly affected by the political instability in small and large firms.

3. MAJOR EFFECTS OF THE POLITICAL CRISIS ON SMALL AND LARGE FIRMS IN R. MACEDONIA

To meet the objectives of this research, a questionnaire pertaining to firms' perception of the political instability impact on business activities was distributed to business owners or senior managers of private firms in different sectors in R. Macedonia. The questionnaire encompassed questions related to the latest political instability in R. Macedonia and managers' perceptions on its impact on their day-to-day business operations.

The response rate was less than 50%, making the sample smaller than the one anticipated. Hence, 66 private firms in different sectors in R. Macedonia took part in the survey. The share of firms based on size more or less reflects the share of firms in R. Macedonia. In particular, almost 73% of surveyed firms were small, 17% were medium and 10% were large firms (see Figure 1).

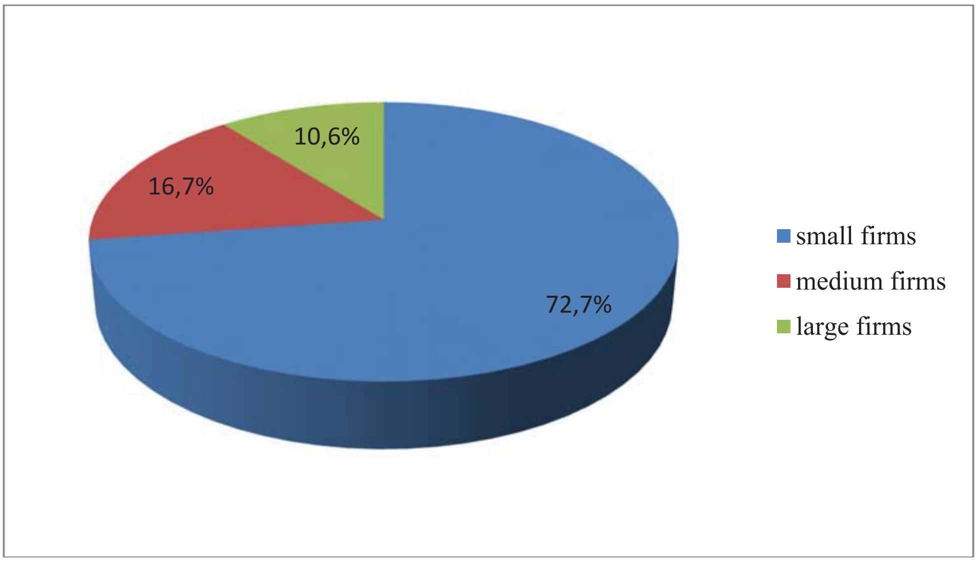

Figure 1: Firm size

About 80% of the firms in the sample have operated in the market more than five years. Namely, 51% of the surveyed firms were more than ten years in the market, while almost 29% were five to ten years (see Figure 2). In such sample, managers can clearly make a distinction about any differences in their day-to-day operations prior and during the political instability. In addition, the majority of the firms in the sample are firms that operate in the domestic market (77%), while about 23% of the firms are export-oriented.

[29] The EBRD/World Bank (BEEPS V) Survey was conducted prior to the latest political instability in R. Macedonia.

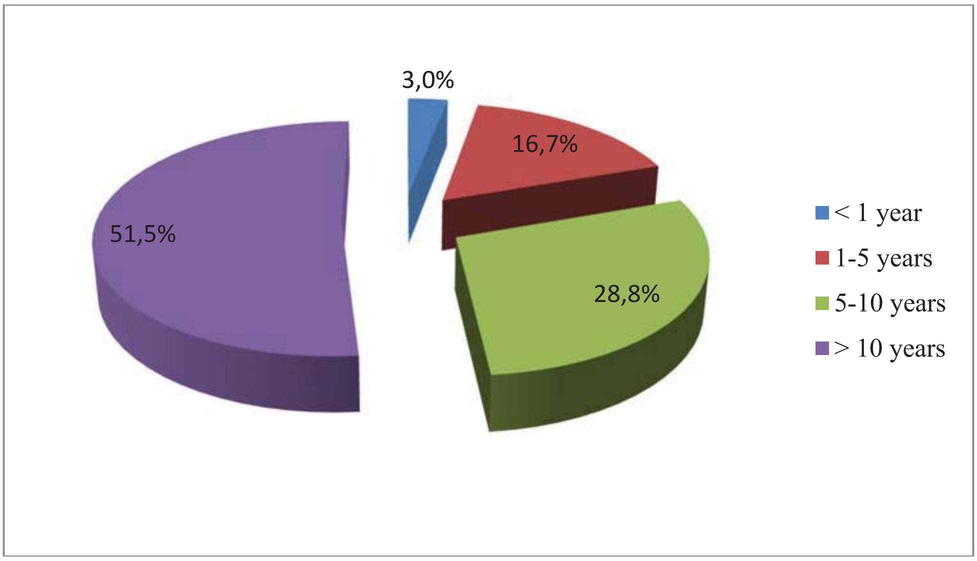

Figure 2: Firm age

For majority of the firms in the sample the impact of the political instability was severe regardless of their age. Namely, more than 70% of the firms that operate more than 10 years in the market reported severe negative impact of the political crisis (Figure 3). Those firms that operate 1 to 5 years and 5 to 10 years on the market reported either severe (55% and 53%) or partial impact (18% and 21%, respectively). The partial impact of the crisis noted among younger firms could be explained by rather limited business activities as opposed to firms that exist longer on the market.

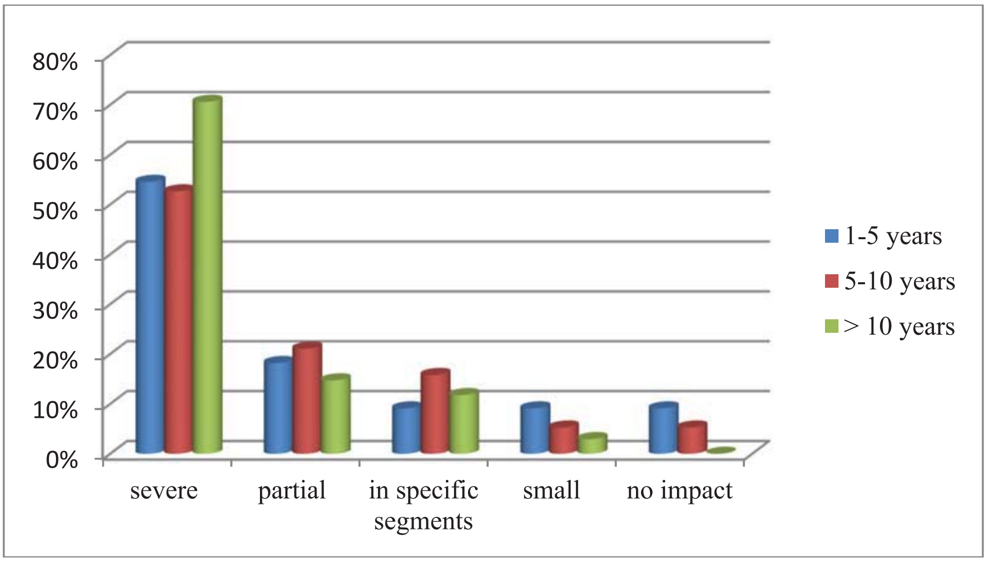

Figure 3: The level of political instability impact, based on firm age

Firm size matters when it comes to the impact of the political crisis on the business sector. Results have revealed that small businesses have suffered most severe impact as perceived by business owners and managers. About 61% of micro and 77% of small firms reported severe impact of the political instability (Figure 4). In the same vein, business owners of approximately 55% of medium firms perceive that the political instability has had severe impact on their business operations. While most of the small firms' managers reported severe negative impact, for large firms the impact was either partial or in specific segments. An equal share of large firms (43%) reported partial impact and impact in specific segments. Hence, the research findings have revealed differences between small and large firms regarding the impact of the most recent political instability in the country. These findings are in line with previous studies [16] that reveal significantly higher negative impact of political instability on small businesses rather than the large ones.

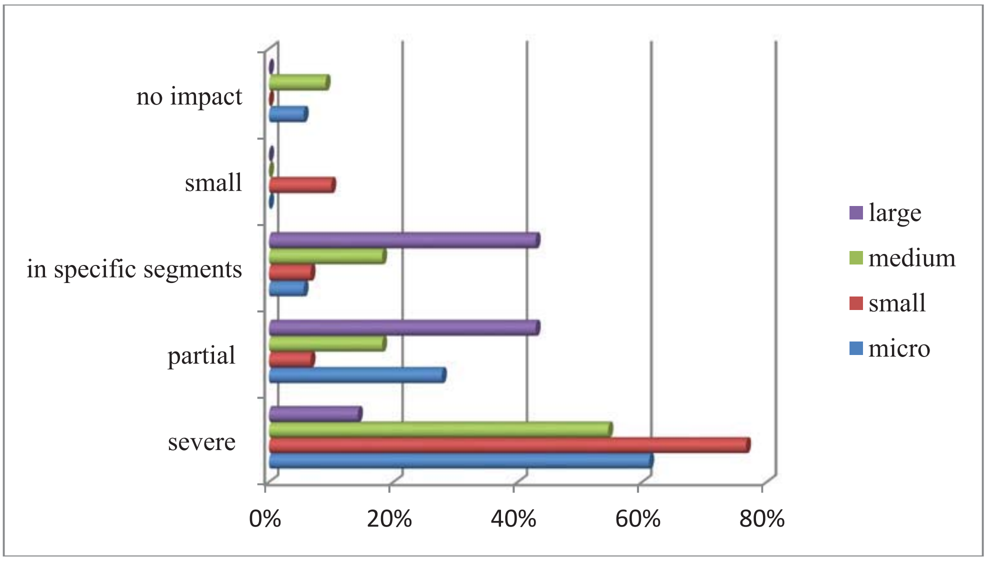

Figure 4: The level of political instability impact, based on firm size

Although prior research [17] has found that export-oriented firms face more negative effects of political uncertainty as opposed to domestically-oriented, this research found no such difference. Indeed, the severity of the impact of the political instability was similar for both domestic and export-oriented firms. In this context, approximately 67% of export-oriented and about 61% of firms operating in the domestic market have been severely influenced by the latest political crisis (Figure 5).

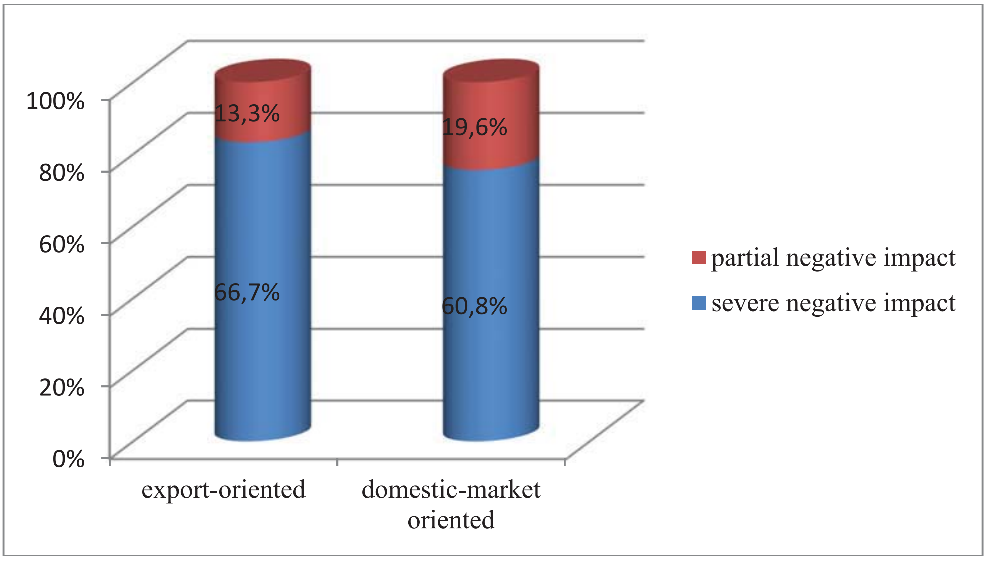

Figure 5: The level of political instability impact in export- and domestic-oriented firms

Noting the differences in the impact of the political instability between small and large firms, it is paramount to identify the business activities that had been mostly affected. Hence, the survey entailed perceptions of business owners and managers on the effects that the political crisis had on their business operations and day-to-day activities.

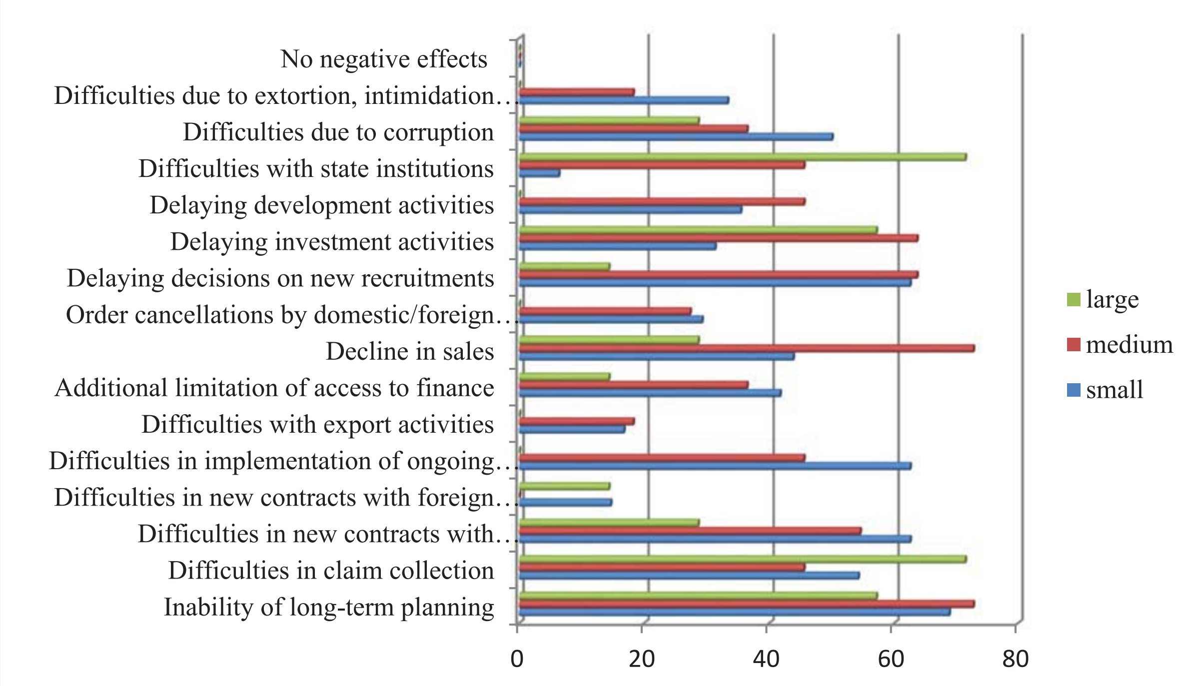

Figure 6: Major effects of political instability on business activities, based on firm size

Zoran Janevski, *PhD, Associate professor, Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Skopje*

Zoran Janevski graduated from the Faculty of Electrical Engineering, University "Ss. Cyril and Methodius", at the Department of Electronics and Telecommunications, with the thesis "Business reengineering" in 1997. In 2008, he obtained a Master degree from the Institute of Economics– Skopje, with a master thesis "Electronic commerce: opportunities and prospects for small and medium enterprises", while in 2011, he obtained Ph.D. in Economics upon defence of the doctoral thesis "Electronic commerce and entrepreneurship as factors of competitiveness of enterprises".

In the period from 1990-2001, he was professionally engaged as a specialist and a member of the management teams of several companies in the information and communications technology (ICT) indistry. Since 2001, as an independent consultant specializing in ICT he was actively involved in the implementation of projects in the private and public sector in the country and abroad. In 2001, he was hired by the Belgian company Business & Strategies in Europe, and later on as a business consultant he was working for the National Bank of Greece. Up to 2006, he designed and implemented projects for UNDP, OSCE, the European Agency for Reconstruction, several ministries and the Government of the Republic of Macedonia.

Since June 2007, Dr. Janevski has been working at the Institute of Economics-Skopje, and his current appointment is Assocciate Professor in Entrepreneurship. During his working experience, Dr. Zoran Janevski has undertaken several short study visits at: eGovernance Academy in Tallinn, Estonia; UNDP - Kiev office in Ukraine; University "Paisius Hilendarski", Plovdiv, Bulgaria, and other.

He has participated in numerous research conferences and trainings in the field of Electronic Business and Entrepreneurship and has published several scientific and research papers in the country and abroad on the same topics.

Large firms cite claim collection difficulties, difficulties in working with state institutions (permits, licenses, and alike), inability of long-term planning and delaying investment activities as business activities that have been mostly affected by the political instability. These findings also confirm that the impact of the crisis on large firms was mainly in specific segments. In particular, 71% of large firms report difficulties with claim collection and working with state institutions as major constraints generated from the political crisis, whereas 57% of large firms report inability of long-term planning and a delay in investments as main consequences of the crisis (see Figure 6).

The impact on small and medium firms is however much more diverse. Small firms' managers perceive negative impact from the political instability on several business activities as: inability of long-term planning (69%), difficulties in signing new contracts with domestic firms (62%) and in implementing ongoing contracts (62%), delaying decisions on new recruitments (62%), and difficulties with claim collection (54%), followed by difficulties due to corruption and decline in sales, among others. For medium firms, the impact of the political instability was mainly reflected on decline in sales and inability of long-term planning (73%), delaying investment activities and decisions on new recruitments (63%) and difficulties in signing new contracts with domestic firms (54%), followed by difficulties in working with state institutions, delaying development activities and difficulties with claim collection.

Elena Davitkovska, *PhD, Associate professor, Institute of Economics-Skopje, University "Ss. Cyril and Methodius", Skopje*

Elena Davitkovska, graduated from "Iustinianus Primus" Faculty of Law, University "Ss. Cyril and Methodius" in 2006, and completed her postgraduate studies in Administrative Law and Public Administration. She earned her master's degree in 2009 upon public defence of the thesis "Administrative Protection of the Right to Free Access to Public Information". In 2012, at the "Iustinianus Primus" Faculty of Law, Skopje, she defended the doctoral dissertation "Basic components of contemporary clerical system" and obtained PhD in Law.
From 2006 to 2013, she worked at the Faculty of Law and the Faculty of Political Sciences, University American College, Skopje. She has worked at the Institute of Economics-Skopje, University "Ss. Cyril and Methodius" since May 2013 and her current appointment is Associate professor in Economics of Public Organizations.
She has published several books and significant number of papers in national and international journals. She has actively participated in scientific and applied projects as well as in scientific meetings, conferences, seminars, congresses and symposia in the country and abroad.

4. CONCLUSION

The recent political crisis in the Republic of Macedonia has had a severe negative impact on the business sector in the country. Most of the firms that participated in the research reported severe consequences in their day-to-day operations as a result of the instability. The research findings reveal that the most severe implications of the political instability on businesses pertain to lack of long-term planning, increased difficulties related to collection of claims and implementation of ongoing contracts or signing new contracts, decline in sales, and reluctance to conduct planned investments and recruitments.

Although some of the affected business activities were common for firms regardless of their size, yet certain major differences in regard to perceived consequences of the political instability were observed between small and large firms. Indeed, the impact of the political crisis on large firms, although severe, was found to be only in specific segments. On the other hand, the impact on small firms was not only severe but much more diverse as well, covering a wide scope of business activities. The difference in the impact of the political instability between small and large firms could be partly due to their different market and political power in the economy. Thus, in times of external influences and potential threats, such as a political turmoil, small firms are much more fragile than large firms since they have lower bargaining power.

REFERENCES

[1] International Monetary Fund. (2013) *World Economic Outlook: Hopes, Realities, Risks*, IMF Press.
[2] State Statistics Office of the Republic of Macedonia. [https://www.stat.gov.mk]
[3] Aisen, A., Veiga, F. (2013) How does political instability affect economic growth?, *European Journal of Political Economy* 29, pp. 151-167.
[4] Alesina A., Perotti R. (1996) Income distribution, political instability, and investment, *European Economic Review* 40, pp.1203-1228.
[5] Barro R. (1991) Economic growth in a cross section of countries. *Quarterly Journal of Economics* 106, pp. 407-443.
[6] Hermes N., Lensink R. (2001) Capital flight and the uncertainty of government policies. *Economics Letters* 71, pp. 377-381.
[7] Jens C. (2016) *Political uncertainty and investment: Causal evidence from U.S. gubernatorial elections*, [https://ssrn.com/abstract=2176855]
[8] Julio B., Yook Y. (2012) Political uncertainty and corporate investment cycles, *Journal of Finance* 67, pp.45-84.
[9] Amore, M.D., Minichilli, A. (2016) *Local political uncertainty, family control and investment behavior*, Working paper.
[10] Belo F., Gala V., Li J. (2013) Government spending, political cycles, and the cross section of stock returns, *Journal of Financial Economics* 107, pp. 305-324.
[11] Bhattacharya U., Hsu P.H., Tian X., Xu Y. (2014) *What affects innovation more: Policy or policy uncertainty?*, Working paper.
[12] Brogaard J. and Detzel A. (2015) The asset pricing implications of government economic policy uncertainty, *Management Science* 61, pp. 3-18.
[13] Durnev, A. (2011) *The real effects of political uncertainty: Elections and investment sensitivity to stock prices*, Working paper.
[14] European Bank for Reconstruction and Development / World Bank (2014) *Business Environment and Enterprise Performance Survey* (BEEPS V), [http://ebrd-beeps.com/reports/beeps-v/beeps-v-report/]
[15] Kresic, A., Milatovic, J., Sanfey, P. (2017) *Firm performance and obstacles to doing business in the Western Balkans: Evidence from BEEPS*, European Bank for Reconstruction and Development, Working paper.
[16] Spencer, J.W., Gomez, C. (2003) *How political environments affect the growth of firms: Evidence from small and large enterprises in Latin America*, The George Washington University, Working paper.
[17] Collier, P., Duponchel, M. (2013) The Economic legacy of civil war: Firm-level evidence from Sierra Leone, *Journal of Conflict Resolution*, 57(1), pp. 65–88.