THE ROLE OF SMALL ENTERPRISES IN POLAND’S ECONOMIC DEVELOPMENT

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Abstract. The economic transformations taking place in Poland in recent years have been accompanied by changes in companies’ structure. The role of small companies, employing up to 50 persons, has been constantly growing. These companies, particularly in the first half of the 1990s, helped to reduce unemployment. Many employees who had previously been working in state-owned companies set up their own businesses, thus creating new jobs. The dynamic development of these companies at that time was extensive and was to a large extent stimulated by the privatization processes state-owned companies were undergoing and the greater economic freedom. Since the mid-1990s the rate of development of this group of enterprises has been much slower due to the bureaucratization of setting up new companies and lower availability of bank loans. The growing competition from foreign companies also played a role, and all these factors had a negative influence on the competitiveness of small enterprises. Besides the findings for Poland as a whole, some research results about the state of small companies in Lublin region are also included.

Keywords: small enterprises, barriers, financing sources, EU stimuli
JEL Classification: R12, G32
1. Introduction

In every economy small enterprises contribute to the GNP and to creating work places and often specialize in areas that big companies are not interested in. They are very flexible and can react quickly to the changes in the environment. Their functioning is strongly influenced by the person of the owner, his management experience and knowledge of business. Small entrepreneurs often run their companies themselves, relying on their skills of recognizing and taking advantage of opportunities and chances. Small enterprises play a particularly important role in the areas that are hardly attractive for larger companies.

In the times of centrally planned economy entrepreneurship was not particularly welcome, as it was the state that was the major owner and investor. Private enterprise was on the margins of the economy and subject to very strict control. It could not develop without the permission of various state administration units, whose function was to inhibit such development. Only in the 1980s, as the economic crisis deepened, were more rights granted to this group of enterprises. In July 1982 the Seym passed a law concerning the rules of running small businesses in Polish People’s Republic by foreign private entrepreneurs and companies, which was the first opportunity in postwar Poland to attract foreign investment. The sector of small enterprises did begin to develop; however, it did not have a considerable influence on the improvement of the economy. In 1985 the share of private enterprises in industrial production was only 3.21%. In January 1985 a law concerning small-scale production was passed. It did not increase economic freedom considerably; however, it granted equal rights to private and state enterprises and recognized small-scale production as part of the economy.

However, the bill did not translate into some tangible gains as the economic crisis was developing and inflation increasing. Therefore, in 1988 a bill concerning economic activity was passed, according to which everybody had the right to set up their own business and was subject to equal laws. At the same time, the bill concerning foreign enterprises and their business activity was changed, and according to the revised one they could then establish trade law firms (public corporations and limited liability companies with mixed capital, Polish and foreign) or only with foreign capital. Such a company would require the permission of Agencja ds. Inwestycji Zagranicznych [Foreign Investment Agency] to be established. The

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1 See: Rocznik statystyczny przemysłu [The Industry’s Statistical Annals], GUS [Central Statistics Office], Warszawa 1990.
preference was given to modern technologies, new organizational solutions, export and protection of natural environment. The laws increased considerably the scope of economic freedom and provided the stimulus for the development of small enterprises. Their development contributed to dynamizing the privatization process already initiated in Polish economy.

Currently, such companies constitute 99.08% of the total number of companies registered in Poland and the companies employing from 10 to 49 persons constitute 3.96 % of the total number of companies registered in Poland. They employ 17.6% of the employees and generate 21.5% of the total profit. Most of the companies in the small enterprise sector are micro-companies employing up to 9 persons. By the end of 2004, 1 651 200 such companies were registered and they employed 3 389 234 persons. They mainly belonged to natural persons. Companies belonging to legal persons constituted only 4.9% of all the micro-enterprises.

2. **Barriers to Small Enterprises’ Development During the Transformation of Polish Economy**

One of the indicators of small enterprises’ development is the number of self-employed – both employers and employees. The changes in this group are presented in Table 1, according to which at the end of the 1990s the group was by 123.1% bigger than in 1985. The bill from 1988 and system transformations led to the development of Polish society’s enterprise. The number of self-employed was growing rapidly, particularly in the areas that did not require much capital investment, i.e. trade and services. The entities developing most dynamically in the first three years of economic transformations were so called micro-enterprises, employing up to 9 persons.

The number of companies with foreign capital also increased; the capital was used not only for privatizing state companies but also for setting up new economic entities. It should be noted that 90% of the companies with foreign capital registered at that time were new small and medium enterprises. Most of the capital was invested in small enterprises, more flexible and requiring less capital investment; investing in such companies was also less risky. The capital was mainly invested in industrial and trade companies and employment in small
enterprises with foreign capital at the end of 2001 was 100848 persons, which accounted for 10.5% of the total number of employees working for companies with foreign capital.²

Table 1. The number of employers and self-employed in all areas except agriculture.

<table>
<thead>
<tr>
<th>No.</th>
<th>Year</th>
<th>Number in thousands</th>
<th>Previous year = 100%</th>
<th>Year 1988 = 100%</th>
<th>Year 1990 = 100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1985</td>
<td>574.7</td>
<td>100.0</td>
<td>44.8</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>1990</td>
<td>1281.7</td>
<td>223.1</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>1991</td>
<td>1625.2</td>
<td>126.8</td>
<td>126.8</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>1992</td>
<td>1849.4</td>
<td>113.8</td>
<td>144.3</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>1993</td>
<td>1888.4</td>
<td>102.1</td>
<td>147.3</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>1994</td>
<td>1397.2</td>
<td>74.0</td>
<td>109.0</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>1995</td>
<td>1372.5</td>
<td>98.2</td>
<td>107.1</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>1996</td>
<td>1324.2</td>
<td>96.5</td>
<td>103.3</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>1997</td>
<td>1525.5</td>
<td>115.2</td>
<td>119.0</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>1998</td>
<td>1574.4</td>
<td>103.2</td>
<td>122.8</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>1999</td>
<td>1545.1</td>
<td>98.1</td>
<td>120.6</td>
<td></td>
</tr>
<tr>
<td>12.</td>
<td>2000</td>
<td>1505.0</td>
<td>97.4</td>
<td>117.4</td>
<td></td>
</tr>
<tr>
<td>13.</td>
<td>2001</td>
<td>1367.6</td>
<td>90.9</td>
<td>106.7</td>
<td></td>
</tr>
<tr>
<td>14.</td>
<td>2002</td>
<td>1421.5</td>
<td>103.9</td>
<td>110.9</td>
<td></td>
</tr>
<tr>
<td>15.</td>
<td>2003</td>
<td>1380.2</td>
<td>97.1</td>
<td>110.9</td>
<td></td>
</tr>
<tr>
<td>16.</td>
<td>2004</td>
<td>1346.0</td>
<td>97.5</td>
<td>105.0</td>
<td></td>
</tr>
</tbody>
</table>

Table 1 suggests that the development of individual enterprise decreased considerably after 1993. It was the result of more and more limitations being imposed on economic activity by legal regulations.³ The number of required licenses was increased gradually and whereas at the beginning of the 1990s licenses and permits were required in around 20 areas of economic activity, at the end of 1990s they were required in more than 230 areas. The registering

² The author’s own calculations based on the data from GUS, Roczniki statystyczne Rzeczpospolitej Polskiej [Statistical Annals; the Republic of Poland] for the years 1990-2006.

³ Currently economic activity in Poland is regulated by more than 800 legal acts and even the biggest companies have problems obeying them.
process also became longer. In the last decade it took approximately 30-50 days to register a new entity. The system of controlling companies was developed and the companies were often controlled by two or three different controlling groups, which became very inconvenient for the entrepreneurs, as it involved a lot of time and lodging all types of motions and complaints. The reporting system was developed too and the tax system became very complicated. The research conducted by the World Bank shows that in the states admitted to the EU in 2004 the sole entrepreneur has on average to spend approximately 2 months of their legal work time (326 hours) on administration and reporting work. In addition to that, many legal regulations are very imprecise and change very often, particularly detailed tax legislation. A lack of clear interpretation of these rules makes most employers wonder whether these rules are well interpreted by themselves or their employees. And whereas big companies employ professional lawyers or renowned law firms to defend their interests, small companies are fighting a losing battle. It all leads to Poland being classified as a country that does not enjoy maximum economic freedom.

In addition to the bureaucratic burdens discussed above there are also heavy financial burdens imposed on companies. The research from the Lublin province shows that enterprise and the development of SMEs are also inhibited by the fear of risk and lack of environment supporting it. 36.4% of the studied companies pointed to those reasons. One should bear in mind that despite the fact that there is a government programs supporting SMEs, their role in the economy has not been really recognized. The country’s economic policy has favored big companies and that is why a number of this policy’s elements are less favorable for SMEs (for example the line, relatively low tax rate for state companies and capital ventures and progressive tax rates for individual businesses). Only two years ago were micro-business allowed to pay their income tax according to the line rate (19%). Previously, they’d had to pay progressive tax. Labor costs are also very high and employers have to pay quasi-taxes calculated in certain proportions to gross salaries (for example the mandatory fee for the

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4 Ekonomiści apelują o niższe podatki [Economists Appeal for Lower Taxes], in „Ekonomia & rynek” [Economy and Market] the “Rzeczpospolita” daily supplement, 11.06.2007.

5 This opinion is confirmed by the latest research conducted among businessmen which proves that the legal regulations for companies are still too complicated and unclear, which puts economic bureaucracy rather than the entrepreneur in a privileged position. Besides, more than 70% of small enterprises point to too high taxes on profits (see: Przedsiębiorcy bezbronne wobec biurokracji [Businessmen Helpless in the Face of Bureaucracy], in „Ekonomia & Rynek” [Economy and Market], 8 October, 2007).

Rehabilitation Fund for the disabled, etc.). In Poland net salaries of the employees getting the average salary constitute 56% of the employment costs that the employers have to incur.\footnote{See: Ucieczka w inwestycje [Escaping into Investment], „Ekonomia & Rynek” [Economy and Market], 28.05.2007.}

The development of SMEs is very sensitive to the overall economic situation of the country (the dynamics of economic growth, stability of the local currency, supply and demand on the home and foreign markets) and the state’s micro-economic policy and its stability. In the latter case what is particularly important are such elements of the financial-tax system as the following: the tax rate, the rate of tangible assets’ depreciation, foreign exchange rates, insurance rates for individuals and property.

Despite the fact that all these barriers hinder the establishment and development of small enterprises, in the past decade or so their performance and competitiveness has increased, which was mainly caused by increased work performance. The analyses conducted by the Polish Confederation of Private Employers Lewiatan suggest that between 1996-2006 work performance increased by 56% and real pay by 38%.\footnote{See: H. Bochniarz, Gospodarce deklaracje nie wystarczą [Declarations Are Not Enough for the Economy], “Ekonomia & Rynek [Economy and Market],” 22 March, 2007.} It means that labor costs have decreased. The growing competitiveness of Polish companies is reflected in the growing export and the increase has been particularly high since Poland joined the EU. In the past three years the average annual increase in export has been about 20%.

3. **Micro-enterprises as a Dominant Group of SMEs**

Despite the fact that the environment does not seem to support their development, the role of small enterprises in Poland is high. Their share in the total number of economic entities is 99%. In the past year the number of small enterprises has increased by over 20,000, i.e. by 0.56%.

Small enterprises are not a homogenous group. In the Polish statistics there is a group of very small enterprises, employing no more than 9 persons, which are often called micro-enterprises. Their share in the group of small enterprises is 95.04% and they are mainly to be found in the private sector. In the public sector there are only 3.82% small enterprises. The majority of small enterprises in the private sector are owned by physical persons. The share of
this group of enterprises in the private sector is 79.1%. With micro-enterprises the share is higher and amounts to 81.1%\(^9\).

Observing the functioning of this group of enterprises makes one realize that the decisions of their owners are influenced by many factors.

1. Quite often the owners do not follow a long-term profit strategy but want to establish work places for themselves and members of their family. Such enterprises are often established as a result of something happening in the owner’s life (for instance losing job in the company s/he has been working for a long time).

2. Some set up their companies to be independent and to test themselves in business. They often do not think about long-term consequences of their decisions but follow the current economic situation using their own capital resources.

3. In some cases people realize their hobbies, which is not necessarily very profitable.

4. In small and, particularly, micro-enterprises most decisions are based on short-term goals and opportunities rather than strategic thinking. That is why investment decisions are taken very cautiously. J. Chmiel, who studied the development of private enterprises in Poland between 1990 and 1998, notes that the hypothesis that “new companies are usually born small and then increase employment up to a certain level”\(^10\) cannot be confirmed. Most of the owners of small enterprises are not interested in gaining access to external capital fearing that they might lose control of their firms. If their own financial resources are not enough to finance development investment then they give it up. It is confirmed by the results of the research conducted among small enterprises in the Lublin province. Between 1999-2003 around 90% of the investments made by these companies were financed from retained profits (around 63%) and the owners’ “surcharges” (around 27%).\(^11\)

5. The short-term decisions are often based on saving on taxes rather than generating profit. Most of the companies keep “simplified” books for the purpose of paying taxes. Therefore, some spendings are made to decrease tax base rather than render particular

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\(^9\) The author’s own calculations based on GUS data (see: Zmiany strukturalne grup podmiotów gospodarki narodowej [Structural Changes in the Subject Groups of the National Economy], GUS, Warszawa 2007, Table 2.


economic profits. Therefore, the efficiency of such investments is often very small. The lack of management information systems and scarce information about their financial condition do not help make optimum economic decisions. The owners of many small enterprises are not interested in developing rational systems of information, claiming that this is a very expensive process or that there is no need to such systems to be in place. It suggests that many entrepreneurs are not interested in maximizing their economic profit.

6. Micro-enterprises have a relatively low life cycle. Between 2000 and 2007 approximately 45% of all the enterprises were ones operating for more than 5 years. The characteristics of small and, particularly, very small enterprises discussed above suggest that they function differently from their medium or large counterparts. Analyzing the financial profits of such companies as well as their short- and long-term decisions one can easily notice that the majority of the owners of such companies want to achieve personal and economic independence. Most often they do not have clear development strategies and are interested in maximizing short-term profits, often at the expense of future development. This is reflected in their high-cost policy (for instance using a company car for private purposes or spending a lot for advertising, products and materials at the end of the accounting period).

The situation in bigger companies employing more than 9 persons is slightly different. Even if they do not have clearly defined development strategies, they more often use the management methods that are used by medium and large enterprises. They often employ highly specialized professionals and have to compete against medium or even large enterprises, which makes them implement modern methods of work and management organization.

4. The Sources of Small Enterprises’ Financing

Small enterprises, employing up to 49 persons, contribute considerably to the amount of sales and to creating work places. They generate approximately 18% of income from selling products and create approximately 15% of work places. At the end of 2005 the amount of equity they had was 15.5% of the total book value of the Polish companies. Their level of profitability can be compared with big companies. However, their development in Poland is

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12 See: Bilansowe wyniki podmiotów gospodarczych [Balance Results of Economic Entities]. GUS, Warszawa 2006, Table 34.
inhibited not only by administration barriers and the mentality of many micro-entrepreneurs, but also by lack of capital.

In theory, like other economic entities, these companies can seek external capital if their own capital is scarce. However, the data from Polska Agencja Przedsiębiorczości [Polish Agency for Entrepreneurship] suggests that they hardly take advantage of the external sources of capital. Over 90% small entrepreneurs used their own resources to finance their development. However, both globalization and growing competition lead to higher and higher investment and makes using external sources of capital absolutely indispensible. Since Poland joined the EU, SMEs have been facing more and more serious challenges, having to compete against companies from other EU states and trying to enter new markets in order to sell their products and services.

Since investments require financial resources, such resources are mainly taken from the savings of these companies; they are usually limited and do not allow for much investment. The companies from the Lublin province point to the lack of capital and low financial stability as the major factors limiting their development. That is why various sources of financing may be so important for their development. They include bank loans, credits, venture capital, subsidies. However, the research conducted by Centrum Badań i Analiz Rynku shows that only half of the studied companies can increase their long-term debt. The other half claims that they cannot increase their debt mainly due to the conditions set by banks. Only 11% of companies say that they are not interested in long-term credits because servicing them may be a problem for them.

In addition to some actual problems related to getting external capital resources, one should also remember that many entrepreneurs decide not to take credits perceiving them as threats rather than opportunities. It is young (up to 40 years) and more educated entrepreneurs who

13 See: D. Ostrowska, Mały pożyczycy, ale z poręczeniem [A Small Will Borrow, but with a Collateral], the „Gazeta Bankowa” daily 2005, nr 3.
14 See: Z. Pastuszak, R. Boguszewski, D. Mazurkiewicz, Lubelski...op. cit. , p. 84.
15 Recently banks have been changing their attitude toward small enterprises. The research conducted by Instytut Badania Opinii i Rynku Pentor [Institute for Opinion & Market Research] between March-October, 2005, the number of entrepreneurs having a positive attitude toward banks increased from 48% to 58%. Many banks became more interested in crediting small enterprises and implemented simplified procedures for evaluating their creditworthiness (see: A. Myczkowska, Banki doceniły małe firmy [Banks Have Appreciated Small Companies], in: “Ekonomia & Rynek,” 3 January, 2006.
16 See: Kondycja sektora MSP w Polsce u progu 2003 r, [Condition of the SME sektor AT the turn of 2003]. Warszawa 2003
are more likely to use credits. The older the entrepreneur and the less educated he or she is, the less likely they are to take credits. Small companies are not particularly interested, either, in using foreign capital. They are not interested in inviting other shareholders into their companies despite the fact that finding an investor who accepts high risk is not currently easy.

Leasing plays an important role in the development of small companies. It is available also for the entities without credit history or capacity. Leasing was developing very dynamically in Poland between 2000 and 2005, when the value of leased objects increased from 9 billion PLN to 16,3 billion. And whereas in the 1990s it was mainly cars (up to 3.5 tones) that were leased, since 2000 more and more machines and equipment have been leased. In 2005 the value of such leasing increased by almost 50% (49.5%). The share of machines and equipment in the total leasing value increased up to 30.8%. This has been caused by the entrepreneurs’ better understanding of the function of leasing (tax benefits from leasing are becoming less and less important) and their becoming more optimistic about the changes in the conditions regulating economic activity.

Therefore, it seems necessary to help this group of entrepreneurs, particularly because of the fact that such help is offered by the E.U. The tool most often used in Poland since Poland’s joining the E.U. has been tax reliefs, delayed tax payments etc. Most help was offered in particular industries (around 75%). Approximately 25% of aid funds have been so far spent on “horizontal” goals and no regional help has been offered. Based on the current experiences and observations one can state that most help has been so far given to big state companies as tax and para-budget remission and delays (for instance fees for social security). The criteria for granting the aid were often unclear and the aid was not offered to those entities that could use it most efficiently (SMEs) but to companies that were able to exert political pressure (having numerous and well organized trade unions). The aid policy was often of immediate character, preceded by strike threats and not based on a coordinated program. Therefore, its social efficiency was low and contributed to prolonging many companies’ “vegetation” rather than to their restructuring.

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Poland’s membership in the E.U. makes it easier for SMEs to have access to structural funds as part of the sector operational program and these resources should increase the companies’ investment capacity.

In theory, these companies should have easiest access to these sources; however, this is not always the case. Some initial research proves that big companies are still in a privileged position. For example, approximately 75% of the 1.2 billion PLN granted by the Ministry of Economy between 2004-2006 went to the biggest and not to the small and medium companies, which illustrated the practice of supporting big companies in Poland. With the EU aid, the conditions that a project had to meet to apply for aid funds seemed to favor large companies. Big companies have qualified employees who are able to prepare professionally all the documents. Small companies do not usually have such employees and have to resort to external help, which is usually very expensive.

Another barrier preventing small enterprises from applying for such funds are the existing procedures and formal requirements. The PKPP report suggests that in 2004 66% of the applications were rejected due to formal faults. Besides, many applications were rejected due to subject matter reasons problems (low evaluation of their technical-economic content). The situation improved in 2005, because 40% of the applications were rejected due to formal reasons and 15% less applications than in the previous year were rejected due to content-related problems. This was influenced by some simplification of the formal requirements, however, the availability of these funds is still low. More than half of the studied entrepreneurs gave negative or very negative evaluation of the rules of granting EU aid. Almost 57% of the studied companies are not going to apply for EU funds. The report suggests that in 2005 only less than 5% of investment was made from EU funds.

The research conducted so far and the opinions of people seem to suggest that despite the fact that SMEs are really interested in these funds, they have not yet been able to make use of them. There are lots of formal barriers preventing many entrepreneurs from applying for such aid. Preparing applications is very time-consuming and expensive and many companies are not able to prepare them themselves. They have to use consulting companies charging high fees for their services without guaranteeing that a company will receive the aid they are

18 After the intervention of the European Commission the legal regulations favoring so far big companies will be changed. The goal of these changes is to prevent big companies from applying for EU help.
applying for. Quite often the consulting companies, in addition to the fees for preparing applications, ask for an extra fee if the company gets the aid it’s applying for. This means that the money the companies receive from the E.U. is no longer “free capital” and the costs of such aid are very high, particularly for micro and small companies.

The risk related to using such aid is also an important factor here. The strict criteria used at the stage of financial accounting for the project may lead to a company becoming not eligible for the aid, even if the problems during the project’s implementation stage are very minor. In such cases, some companies, particularly small ones, may go bankrupt. It seems then that the control at the project’s final stage should be more subject and content related than strictly formal.

One should also realize when the financial aid is actually paid. The payment is usually delayed, which, in the case of SMEs, may lead losing their financial flow. It usually takes from four to five months before entrepreneurs are reimbursed with the EU money.\(^\text{19}\) During this time, many companies, particularly small ones, may go bankrupt. It is small wonder then that current over 1/3 of the researched entrepreneurs is of the opinion that access to EU financial resources is still difficult for small companies.\(^\text{20}\)

### 4. Conclusions

It seems that the role of small enterprises in economic development has not been appreciated in Poland so far. In the centrally-regulated economy such companies were usually on the margins of the market and their development was discouraged.

The best time for these enterprises was the beginning of market economy in Poland, between 1989 and 1993, when very few licenses and permits were needed to engage in economic activity. The number of such enterprises increased considerably then as many people leaving privatized and bankrupt state companies set up their own businesses of found employment in small enterprises. The sector played an important role in absorbing the negative consequences of the changes in Polish economy.


\(^{20}\) See: *Przedsiębiorcy bezbroni...op. cit.*
Then the number of licenses and permits required to run such businesses began to increase and more administrative-legal and financial limitations were introduced. It was reflected in the relatively complex tax system and developed reporting and control system. Besides, these companies lack capital for their development, which has led decreasing the development of this sector and thus to higher unemployment.

Joining the E.U. has become an important stimulus for the development of these companies, which can now join other markets. Small enterprises have taken advantage of this opportunity, which is reflected in their average 20% annual export increase. However, their further development requires more investment, mainly for improving their economic potential and innovativeness. The scarce resources these companies have can be supplemented by EU resources; however, access to these resources is limited and the existing procedures are too complicated and difficult to meet for many entrepreneurs. Despite that, small enterprises are becoming more and more interested in EU aid and the announced simplification of the procedures will certainly make access to these resources easier for the entrepreneurs, which will lead to their more dynamic development and to becoming more competitive on international markets.

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