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The Impact of Socio-Cultural Factors on the Business Environment

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Abstract

The aim of this paper is to understand the importance of the influence of socio-cultural factors on business performance. Society and culture have a significant impact on business environment. Cultural and social differences between countries are a challenge for managers, as they need to acquire intercultural competence and to anticipate the impact of all socio-cultural factors.

The study was carried out over the period 2010-2020 on a sample of 28 countries in Europe, the results showing that social factors such as education, government spending on R&D or health in GDP or the Gini indicator of population income inequality, as well as cultural factors such as corruption, the rule of law, the companies' innovation level significantly influence their income and their prospects of doing business in that state.

Key terms: social factors, cultural factors, business environment, investment prospects

JEL Classification: E60, E64, C33

1. Introduction

It is well known that a healthy economy is one in which the business environment has the capacity to adapt to changing conditions, in which companies have a high level of resilience regardless of the economic shock. The country in which a company operates has a significant impact on its development and performance. Despite a company's efforts to achieve success, there are some effects, either economic or financial in nature or linked to the characteristics of the country in which it is located, which affect financial performance to a greater or lesser extent. A topic of interest for potential entrepreneurs, managers and investors is understanding the socio-cultural environment in a country, which lies behind the successful economic performance of companies. A socio-cultural environment is a combination of social and cultural factors, which due to the strong interaction between them make it very difficult to assess their influence on the business environment separately. Socio-cultural factors are some of the main factors that significantly affect the performance of companies and are beyond the control of managers.

The aim of this research is to identify and describe the influence of certain socio-cultural factors on the business environment. Based on the results obtained, the paper contributes to determining the fundamental social and cultural factors that companies should consider when implementing, evaluating and forecasting a business in a particular country. The paper considers the analysis of the business environment in the Member

States of the European Union and the European Economic Area. It considers 28 European countries and highlights the connection between the performance of the business environment and socio-cultural factors in each country.

The paper is structured as follows: the next chapter considers the literature that analysed the factors that can influence the business environment, with a focus on social and cultural factors, in chapter 3 we discuss the chosen database and methodology and in the final chapter we present results and draw conclusions.

The main objective of the research is to present policy makers and entrepreneurs with an accurate and detailed picture of what contributes to the performance of the business environment. We have developed this work based on the assumption that socio-cultural factors have a significant impact on every aspect of a company's activity. Although society and culture are not directly included in business operations, they appear indirectly as fundamental elements within companies.

2. Literature review

There are several studies conducted in literature that analyse the performance of the business environment and the macroeconomic factors that have an impact on it. If we look around us, to our daily routine, every action that we take or those around us has an impact on ourselves, the same is true for business performance. The return generated by a firm is influenced by many factors, such as socio-cultural factors specific to a country.

Gaganis *et al.* (2019) examine whether certain country-specific characteristics shape SME profitability. SMEs are considered the backbone of economic activity in most countries. Therefore, the evolution and profitability of these firms are of interest for both the company and the country. The authors used a large sample of about 40,000 firms operating in 25 European Union countries during 2006-2014. The study focused on examining mainly country-specific characteristics of the country where the firm is located, regarding corruption, governance, credit conditions, etc. The results showed that an important role is played by the dimension of national culture, thus individualism, innovation, efficiency of governance have a positive impact on profitability, while power distance and uncertainty avoidance have the opposite effect. It is also counted that the corruption index, a better environment in terms of conditions that contribute to the ease of obtaining credit and fewer government regulations related to starting, stopping and closing a business increase profitability.

Beltramino *et al.* (2020) conducted a paper whose aim is to highlight the main determinants of microenterprise business performance. In this regard, an empirical study is carried out based on information obtained from 468 micro-enterprises. The results show that measuring human capital by education level, previous experiences, management skills and motivation to start a company have a positive impact on microenterprise performance. At the same time, Mertzanis and Said (2019) examine the role of access to skilled labor in explaining firm sales growth under the controlling influence of a wide range of firm-specific characteristics and country-level economic and non-economic factors. The results document a significant positive relationship between access to skilled labor and sales growth.

Economic, financial and human development, financial openness and globalisation, the extent of access to and quality of education, and various technological factors appear to have a significant impact on firm performance. Evidence shows that public institutions and their strength, as well as the degree of technologisation, matter. They affect the supply and demand for skilled labour and hence, the performance of society across sectors and regions.

Cherchye and Verriest (2016) capture through their study that firm profitability depends on firm characteristics, industry structure, and firm home country characteristics. Profitability is measured by means of three indicators: economic profitability (return on assets – ROA), financial profitability (return on equity – ROE) and profit margin. The sample consisted of 53 countries over the period 1996 to 2006. The empirical results concluded that country-specific factors such as political and legal factors have a negative impact, explaining this phenomenon by the fact that, as legal and political institutions grow and improve over time, company profitability decreases. It has been shown that increased competition increases the profitability of companies and the efficiency of governance has a positive and significant effect, similarly for market openness, which can

be explained by the fact that good governance, having the interest of encouraging and increasing competition in the market, which implicitly leads to increased profitability, will keep entry barriers low, so as the way of entry to be as easy as possible for companies.

Almaskati *et al.* (2020) study the relationship between country-level social factors and the performance of firms and the business environment. The sample consisted of 43 countries, the period covered being 2010-2017. Among the key factors considered were a score of the country's legal system and strength of law enforcement, important pillars in educational preparation, and health care system (educational attainment and health care spending), market competitiveness index, measuring market efficiency, and business innovation in a given country, two indices for firm-level (GOVI) and country-level (COGI) governance, average a score assessing the degree of media freedom in a given country. The results showed that country-level factors such as the rule of law index, press freedom, social and cultural development, and market competition explain a significant part of the performance of companies operating in a given country. Socio-cultural factors such as education and health have a positive and significant impact on return on equity. A positive impact was also found for the legal law index on the return on equity. Religion and the legal system are included in the model as dummy variables and it is counted that common law countries are associated with increases in performance, while religion has a positive impact. In addition, it finds that the relationship between country-level and firm-level mechanisms is best represented using a moderation model in which country-level factors act as moderators of the relationship between firm-level mechanisms and firm value.

Akhter and Sumi (2014) develop a paper in which they first find that socio-cultural factors can influence both positively and negatively entrepreneurial emergence in a firm. The references in the analysis confirm the views in entrepreneurial emergence theories that are rooted in social behavior theory. The study reveals that the impact of the socio-cultural environment on entrepreneurship poses a challenge regarding the need for society to have new values and an orientation conducive to entrepreneurship and the emergence of entrepreneurs. Every day new challenges are emerging, and society is struggling to accept it and turn it into a facility.

Masovic (2018) discusses the concepts of socio-cultural factors and performance of multinational companies in his paper. Multinational companies face a wide variety of economic, political, legal, socio-cultural and technological factors. One of the significant components of the business environment is the socio-cultural environment. Socio-cultural factors are some of the main environmental factors that significantly affect the economic activity of multinational companies and their performance. The key socio-cultural factors that have a major impact on the performance of multinational companies are culture, language, religion, level of education, customer preferences and society's attitude towards foreign goods and services. The influence of culture on multinational companies is real and widespread, these being affected by several cultures at a time. It can be concluded that successful multinational companies develop acceptance and understanding of cultural differences between different countries and learn how to take advantage of opportunities and deal with disadvantages that arise from different national cultures.

Magoutas *et al.* (2012) demonstrate the importance of education among human capital. In a modern globalised economic environment, firms and national economies alike seek growth and competitive advantages through expertise and innovation. In this context, human capital accumulation plays an exceptionally important role. The positive effects of human capital on economic growth have long been recognised and tested, but the focus has long been on the microeconomic side, especially at the macroeconomic level. In this study we investigate the influence of human capital on firm-level growth rates. The results suggest that after controlling for other variables such as firm size, physical investment, efficiency, human capital has a positive and significant impact on firm-level growth rates.

Taking into consideration all the aspects mentioned above, we can conclude that the business environment can be decisively influenced by the socio-cultural factors of a country. For this reason, as follows we will analyse which of these factors are defining for the evolution of the business environment in a country, along with the methodology and results that are presented below.

3. Database and methodology

In order to determine the impact of socio-cultural factors on the business environment, we have selected a number of social and cultural factors that can influence the total level of revenues (turnover) of companies operating in a given country. We considered the level of company revenues an important factor in quantifying the performance of the business environment. At the same time, the evolution of this indicator from one country to another can be a defining element in the practical analysis of an economy's performance.

Data on the level of company earnings in a country, as well as other macroeconomic data, was taken from Eurostat and Thompson Reuters. The states considered are Austria, Belgium, Bulgaria, Cyprus, Croatia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom.

The dependent variable was considered the level of revenue of companies operating in a given country for the period 2010-2020. Similarly, the explanatory variables were added to the most studied and regularly described in the research, these being: education, R&D (research and development) spending, health spending, corruption control, rule of law, government efficiency, country's level of innovation, business freedom, social inequality and the legal system. The main variables considered are presented in the table below.

Table 1. Variables to the analysis

Name	Explanation	Formula
Turnover	Shows total turnover of companies in one economy (million Euros).	The logarithmic value was used in the regression.
Social factors		
Primary education	Expresses the percentage of employees with completed primary education.	Percentage of the country's population
Tertial education	Expresses the percentage of employees with tertiary (university) education.	Percentage of the country's population
R&D	Shows the expenditure on research and development carried out within business sectors across countries.	Percentage of GDP
Health	Shows the health expenditure, including health goods and services consumed in a year.	Percentage of GDP
Gini index	It captures the extent to which the distribution of income among individuals or households in an economy deviates from a perfectly equal distribution.	A Gini index of 0 implies perfect equality, while an index of 100 implies perfect inequality.
Cultural factors		
Corruption level	It is an indicator of the lack of corruption. The closer to the 100 threshold it is, the lower the corruption is.	A scale from 0 to 100 is used.
Rule of law	Captures perceptions of the extent to which agents trust and respect society's rules, property rights, police and courts, and the likelihood of crime and violence.	The score is between 0 and 100, with 0 being the lowest rank and 100, the highest rank.
Government efficiency	Shows the perceptions of public service quality.	The score is between 0 and 100, with 0 being the lowest rank and 100, the highest rank.

Name	Explanation	Formula
Business freedom score	The purpose of this indicator is to measure the ease of opening a business.	The score is between 0 and 100, with 100 being the freest business environment.
Innovation level	It encompasses the level of innovation on institutions, human capital, research, infrastructure, knowledge, technology.	The scale is from 0 to 100, 100 being the highest level.

Source: Eurostat and World Bank.

Descriptive statistics of the dependent and independent variables are presented below in Table 2.

Table 2. Descriptive statistics

	Average	Median	Standard Deviation	Min	Max
Primary education (%)	43.72	43.55	13.89	14.00	77.50
Tertial education (%)	83.52	84.30	4.94	65.90	93.50
R&D (%)	1.65	1.37	0.91	0.38	3.71
Health (%)	8.47	8.70	1.88	4.70	11.70
Corruption level	79.54	80.77	15.69	46.15	100.00
Rule of law	82.40	84.62	13.58	51.17	100.00
Government efficiency	82.49	83.65	12.69	42.79	100.00
Gini index	31.71	31.87	3.47	24.22	41.28
Business freedom score	78.24	78.00	9.61	55.30	99.70
Innovation level	49.69	49.10	8.28	34.20	68.40

Source: Own analysis.

Regarding descriptive statistics, we can observe that the variables are uniformly distributed, with states where the indicators have higher values, but also states with lower values. In terms of social factors, specifically the percentage of the population with primary and secondary education, the European average is 43.72%, with higher values in countries such as Denmark, Cyprus, Sweden, Poland, while the number of employees working in positions where higher education is generally required is quite high in all EU countries (83.52%). The Gini index, one of the most widely used to quantify social disparities in a country, has a European average of 31.71, with lower values, i.e. better placed countries, in Finland, Malta, the Netherlands, and higher values in Portugal, Bulgaria, Romania, Spain, etc. In terms of cultural factors, the index measuring perceptions of corruption has a European average of 79.54 points, with higher values, i.e. less corrupt countries, in Luxembourg, the Netherlands, Ireland, and lower values in Romania, Bulgaria, Slovakia. If we were to look at the effectiveness of government in enforcing existing legislation and business policies, we see an average score of 82.49, with Austria, Sweden and Denmark having higher scores and Romania, Bulgaria, Greece having lower scores.

In the following we will make a detailed analysis of these to see the concrete effect on the business environment.

For the accuracy of the panel data analysis, we have to keep in mind an important aspect that concerns all panel series, namely autocorrelation. Among the assumptions used in panel data analysis is the assumption that we do not need to have a correlation between independent variables in order to say that multicollinearity does not exist. To eliminate multicollinearity, a common solution is to keep only one of the correlated variables in the model. Thus, to see in our situation the correlation, we will consider the standard values of the range -0.4 and 0.4. The results are shown in Table 3.

Table 3. Correlation matrix

	Primary education (%)	Tertial education (%)	R&D (%)	Health (%)	Corruption level	Rule of law	Govern efficiency	Gini index	Business freedom score	Innovation level
Primary education (%)	1.00									
Tertial education (%)	0.95	1.00								
R&D (%)	0.19	0.14	1.00							
Health (%)	0.20	0.12	0.76	1.00						
Corruption level	0.13	0.04	0.75	0.59	1.00					
Rule of law	0.16	0.08	0.72	0.57	0.96	1.00				
Government efficiency	0.10	0.02	0.72	0.60	0.94	0.94	1.00			
Gini index	-0.02	-0.16	-0.40	-0.21	-0.31	-0.34	-0.33	1.00		
Business freedom score	0.11	0.05	0.61	0.56	0.65	0.63	0.63	-0.19	1.00	
Innovation level	0.30	0.19	0.73	0.63	0.87	0.85	0.86	-0.28	0.59	1.00

Source: Own analysis.

4. Results

In this section we discuss and analyse the results of the linear regression model with panel data used to study the impact of socio-cultural factors on firm performance. The study was conducted in 28 countries in Europe, with the level of business income in a given country as the dependent variable. Referring to the defining components for each country and period of analysis, it is recommended to use fixed or random effects estimation for the regression model. We used the Hausmann test whereby we decided to consider period variable effects given the correlations between national economies in Europe over certain periods. The results are presented in the table below.

Table 4. Results of panel data regression analysis
(dependent variable – level of income of firms in an economy (logarithm))

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Primary education (%)	0.015*** (4.32)		0.014*** (4.40)		0.021*** (5.34)		
Tertial education (%)		0.009* (1.89)		0.01*** (3.93)		0.009*** (4.04)	0.01*** (3.54)
R&D (%)	105.23*** (12.39)						
Health (%)			54.09*** (15.25)				
Rule of law				0.04*** (6.42)			
Corruption level		0.04*** (3.64)					
Government efficiency					0.04*** (6.39)		

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Gini index	0.122***	0.08*	0.07***	0.07***	0.06***	0.05**	0.06**
	(5.60)	(1.67)	(3.92)	(3.13)	(2.65)	(2.32)	(2.77)
Business freedom score						0.05***	
						(6.80)	
Innovation level							0.08***
							(7.79)
Intercept	7.04	6.21	5.75	6.72	6.98	6.31	6.64
	(9.25)	(2.83)	(7.96)	(6.06)	(6.37)	(5.68)	(6.60)
R-Squared	40.62%	23.63%	49.37%	16.23%	20.70%	17.54%	25.07%
No observation	308	308	308	308	308	308	308

Symbols *, **, *** represent 10%, 5% and 1% significance levels.

Source: Own Eviews processing.

According to the above analysis we can observe that social and cultural factors have a significant influence on the business environment, and more specifically on the total level of revenues (turnover) of companies operating in a given country.

From a social point of view, the states where the level of people (employees) with primary and secondary education, as well as the level of employees with tertiary education, are the states where companies systematically record higher turnover. It is well known that investing in education brings benefits.

At the same time, the level of research and development also has a positive influence. The countries with the highest funding in the research area are the countries where companies do better, with research often being the key to success.

Medical systems have always been an important factor in a country's progress. In general, countries with a strong and well-functioning healthcare system, where there is substantial government funding, are also countries where companies can generate more turnover. As a social factor, a high level of health protection leads to a better working capacity of employees.

A surprising result is in terms of the Gini index. According to the conducted analysis, the influence is positive, which indicates that countries where this indicator has a higher value, i.e. countries where there is a greater social gap between citizens in terms of income, are also countries where companies are able to generate higher turnover. If we were to analyse this aspect, we could say that in economically developed countries (France, Germany, Italy, etc.), where companies also have high turnover figures, there are significant social differences between citizens, countries characterised by a relatively high number of employees compared to entrepreneurs or self-employed people. All the results obtained in terms of social factors are in line with the literature (Gaganis *et al.*, 2019; Mertzanis and Said, 2019).

From a cultural point of view, we observe that factors significantly influence the business environment. The level of corruption and the effectiveness of the government in enforcing existing legislation and business environment policies have a positive effect on the total level of revenues of companies operating in a given state. These indicators have been quantified as the level of perception among the population, and countries where citizens' perception is better are also countries where companies can generate better results.

The ease of starting a business is a key indicator in any economy. In our analysis it was clear that countries where the freedom and ease of starting a business is higher are also countries where citizens will be more involved in entrepreneurship and consequently the business environment will gain. Countries where the level of innovation in terms of technology, human capital, infrastructure, etc. is higher seem to be countries where business will gain the most.

What's more in terms of culture, the rule of law has always been a key element influencing the level of economic development of a country. We are familiar to the fact that many EU policies take into account the rule of law in terms of funding, often this factor attracting foreign investment and capital injection. Considering our study case, it emerged that the rule of law has a significant and positive influence on the business environment. States where the rule of law is respected are those where companies will be more inclined to invest and perform better.

5. Conclusions

The aim of this paper was to understand the importance of the influence of socio-cultural factors on business performance, society and culture having a significant impact on the business environment. Cultural and social differences between countries are a challenge for managers as they need to acquire intercultural competences and anticipate the impact of all socio-cultural factors.

According to the above analysis, it can be concluded that social and cultural factors have a significant influence on the business environment and, more specifically, on the total level of revenue (turnover) of the companies operating in a given country. This applies at European level over the last 10 years, according to the results obtained in this study.

The study showed that social factors such as education, government spending on R&D or health as a share of GDP or the Gini indicator of population income inequality significantly influence companies' revenues and their prospects of doing business in the country. At the same time, cultural factors such as corruption, the rule of law, the level of business innovation or the ease with which a business can be started also have a positive influence on the business environment.

Therefore, in order to base an investment decision, companies should look beyond business characteristics to specific economic and financial factors. Socio-cultural factors can be an advantage or a disadvantage for a company, depending on the country in which it is located, as the level of these factors differs and each country has its own social and cultural particularities.

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