

Small and Medium-sized Enterprises in Visegrad Countries towards Internationalisation Challenges in the European Union

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9.1. INTRODUCTORY REMARKS

Nowadays, scholars agree that SMEs play a very significant role in modern economies and global economic development. However, under growing global competition and shortening of product life cycle SMEs are often forced to implement various strategies to improve their competitiveness. Many of them try to enter new markets in order to seek international competitive advantage.

Internationalisation of SMEs means both chances and threats for them. Chances result from opportunities to export, enter new markets and foreign cooperation. In turn, threats appear because of increasing number of foreign competitors in their home market. H. Lee *et al.* (2012) state that internationalisation should provide advantages to SMEs by enlarging the markets and shifting competitive dynamics. In turn, McDougall, Oviatt and Shrader ask “why a business already confronting the risk of young age and relatively small size would seek out additional risk of being international?” (McDougall, Oviatt & Shrader, 2003, p.59).

In this chapter, internationalisation is understood widely as “any economic activities undertaken by a company abroad” (Rymarczyk, 2004, p.19).

9.2. THEORETICAL BACKGROUND

Internationalisation is a complex phenomenon which may have many dimensions, levels, theoretical perspectives and as a consequence research directions. The development of the theories of internationalisation began with the development of the theories of foreign trade more than two centuries ago (e.g. Smith, 1954) and continues today. In the meantime, theoretical approaches have evolved along with changes in the economies (Daszkiewicz & Wach, 2012, 2013). The first internationalisation theories concerned the international behavior of large businesses,

especially transnational corporation (TNC) and generally ignored small and medium-sized enterprises (SMEs). This was due to existence of several trade barriers which defeat was beyond the generally smaller businesses. Especially after the Second World War until the late 1970s expansion of transnational corporations into foreign markets was especially intensive. The best known theories of that period include Dunning's Eclectic Theory (OLI Theory), internalization theory (Buckley & Casson 1981) or transaction cost theory (Williamson, 1998; Wach, 2012; Daszkiewicz & Wach, 2013).

While the first theoretical approaches towards internationalisation of SMEs developed only in the mid-1970s. They include classical theories (stage theories) that describe internationalisation of firms as an incremental process (Johanson & Wiedersheim, 1975; Johanson & Vahlne, 1977; Bilkey & Tesar, 1977; Cavusgil, 1980). The Uppsala Model (U-Model) is the most famous and one of the most cited position among stage theories (Johanson & Vahlne, 1977; Johanson & Wiedersheim, 1975). In spite there are quite many stage theories, all of them assume that firms start their international expansion in small steps from close markets to most distant markets (Daszkiewicz & Wach, 2012, 2013). In recent years Johanson and Vahlne (2009) and Schweizer, Vahlne and Johanson (2010) updated their U-model two times giving attention to the role of networks in firm internationalisation process and then the entrepreneurial approach (Wach, 2012).

The new perspective on SME internationalisation process emerged in the 1990. with the INV theory (International New Ventures) which concerned particularly high-techs and high-tech related industries. This approach was based on observations that internationalisation of INV SMEs results from opportunity seeking behavior of entrepreneurs (Oviatt & McDougall, 1994, p. 49). According to the INV theory some SMEs are "international from inception" because entrepreneurs seek growth opportunities in foreign markets. These firms skip stages or not have any stages in all their internationalisation process. Since that time differentiation between two discreet ways that firms internationalise, "international at inception" (Oviatt & McDougall, 1994) or "international by stage" (Johanson & Vahlne, 1977) has become a popular approach among scholars.

The last decade brought further development of approaches towards the internationalisation process of SMEs. Some of them have become almost a new paradigm and they are also the starting point for further seeking among researchers e.g. the integrative approach (Bell *et al.*, 2003), the strategic management approach as well as international entrepreneurship (Wach, 2012).

With the development of the internationalisation theories the research into methods (forms, instruments, methods) of internationalisation of businesses have also been conducted. It was only in the 1990s when this problem was analysed in relation to SMEs by combining a traditional approach to the choice of

internationalisation mode with the theory of international entrepreneurship (Wach, 2012, p. 72). Methods of business internationalisation can be classified in many ways, and literature contains many different classifications. The simplest classification was proposed by R. Luostarinen (1994, p. 10) who divided internationalisation forms into active (inward) and passive (outward). The first ones are related with starting activities in the domestic market in response to the offer of cooperation from the foreign businesses. In turn, active forms are associated with the expansion of domestic enterprises to foreign markets (Wach, 2012, p.72).

9.3. MATERIAL AND METHODS

The main objective of this chapter is to characterize SME sectors in Visegrad countries and to identify the basic differences among them. The detailed objectives include (1) literature review of the key theories of the internationalisation of businesses, (2) basic characteristics of V4 countries' economies, especially their macroeconomic environment, (3) analysis of empirical data. Data analysis was performed using the following reports: Global Competitiveness Report 2013-2014 (WEF, 2014), SBA Fact Sheet for Czech Republic, Hungary, Poland and Slovakia (EC, 2013), Annual Report on European SMEs 2012/2013 (EC, 2013) and Internationalisation of European SMEs. Final Report (EC, 2010). The analysis of the data allows to formulate final conclusions.

9.4. RESULTS AND DISCUSSION

Since economic transformation in Visegrad Countries (V4 countries) SMEs have been important for their economic development. However their role in national economies and internationalisation paths differ from country to country. It is because V4 countries are rather a heterogeneous group in terms of economic potential, macroeconomic situation, pace and course of political changes and market reforms which in turn create different conditions for businesses development.

Thus, according to Global Competitiveness Report, in the Czech Republic the quality of the country's public institutions, with public trust in politicians are ranked an extremely low. Also, the macroeconomic environment is characterized by rising deficits and debt. However, Czech businesses are relatively sophisticated and innovative, supported by a strong uptake of new technologies (Global Competitiveness Report 2013-2014, p. 168-169).

The weaknesses of Hungarian economy include weak institutions, especially burden of government regulations, low efficiency of legal framework and transparency of government policymaking. The macroeconomic environment is characterized by high government debt and inflation. In turn, the strengths of

Hungarian economy include the quality of overall infrastructure, especially quality of railroad infrastructure as well as higher education and training. In addition, innovativeness in Hungary is highly ranked in the areas of quality of scientific research institutions, university-industry collaboration and PTC patents (Global Competitiveness Report 2013-2014, p. 212-213).

The strengths of Polish economy include its large market size, high educational standards and well developed financial sector. On the other hand, further enhancing competitiveness will require a significant upgrading of transport infrastructure and reduction of high burden of government regulations for business sector, developing capacities in R&D and business sophistication. In addition, Polish companies should be more oriented towards R&D and intensify their collaboration with universities (Global Competitiveness Report 2013-2014, pp. 316-317).

The Slovak Republic is a small country. Its weaknesses include institutions, with the focus on the burden of government regulations and efficiency of legal framework. Moreover, the macroeconomic environment is not stable enough with relatively high government deficit and debt. The innovation pillar¹ situates the country at low positions, except PTC. The strengths of the Slovak Republic emerge in the area of financial market development and the technological readiness of the country is quite high, with an emphasis on FDI and technology transfer (Global Competitiveness Report 2013-2014, p. 342-343).

SMEs in Visegrad Countries

SMEs in the Czech Republic

In comparison with the EU average, the Czech SME sector is dominated by micro enterprises with less than 10 employees. These firms create one in three jobs and one fifth of the value added in the entire economy. Although micro enterprises dominate in terms of numbers and jobs, their share of value added is below the EU average. The sectorial distribution of Czech SMEs is heavily skewed towards manufacturing. It is because, the country is attracting foreign investments to create international supply chains involving local SME suppliers, particularly in the motor vehicle sub-sector.

In 2013 the Czech Republic became less competitive as a place to do business and attract foreign investment. Moreover, business demographics show that there were many exits of firms especially these after more than 15 years of existence. In 2012, about half of closed enterprises were older than 15 years. They disappeared despite being so well established within the local market.

¹ All the factors that are considered to be important for competitiveness and growth are grouped into 12 pillars of competitiveness.

What concerns innovations, the Czech Republic achieves its best performance in this area, whereas training offered by SMEs and micro firms is below the EU average. The most positive indicators are for 'internal' (in-house) and 'external' (sales and marketing or organizational) innovation, backed by a strong use of IT infrastructure by SMEs. These trends are confirmed by 2010 data from the latest version of Community Innovation Survey.

The overall performance of the Czech Republic in the single market is comparable with the EU average. However, Czech SMEs are more likely than the EU firms to export in the single market, but less likely to import from other EU countries. The Czech Republic's overall internationalisation activity remains significantly below the EU average. Especially critical areas are SMEs' share in direct imports and exports (though many export indirectly as suppliers to big industries such as automotive manufacturing) and the administrative burden created by time-consuming procedures (SBA 2013a).

SMEs in Hungary

Hungary's SMEs sector is very similar to the EU average. In Hungary as in the EU overall, the four most important sectors, accounting for almost two-thirds of the value added generated by SMEs, are wholesale and retail trade, manufacturing, professional activities and construction. In terms of the importance of high-tech manufacturing firms and knowledge-intensive services there is little difference between Hungary and the EU average, with the share of these strategic industries only marginally lower than in the EU as a whole. Then again, Hungary possesses a relative dynamic information and communication sector (see below). There are also a few differences between Hungary's SME sector and the EU average. The micro-segment of firms with fewer than ten employees is more prevalent in Hungary's economy as compared to the EU average in terms of numbers (94.6% to 92.2%) of enterprises and employment (35.5% versus 29.7% for the EU). However, this pattern does not extend to the contribution to value added by micro firms. Also, the share of SMEs in value added is significantly below the EU average, while their share in persons employed is considerably above the EU average. In addition, the importance of SMEs in the manufacturing sector is lower than in the rest of the EU. While almost 45% of the sector's value added in the EU is generated by SMEs, in Hungary it is less than a third.

Performance of Hungarian SMEs in the single market has already matched the EU average. However trading performance is below the EU average. This is particularly true on the import side, where only 10% of Hungarian SMEs exploit the benefits of the internal market, while on the export side there are even fewer: only

one in fourteen SMEs are involved in exporting). However, internationalisation of Hungarian SMEs is well below the EU average (SBA 2013b, p.12).

SMEs in Poland

According to SBA Fact Sheet (2013c), conditions for the creation and growth of SMEs in Poland are ambiguous. The business demography outlook for 2013 was positive and dynamic with high numbers of both exits and enters. This was partly due to substantial progress in entrepreneurship development, the removal of many administrative burdens for start-ups, and a sharp decrease in registration costs for businesses. In spite of this, Polish SMEs still underperform in some areas, especially skills and innovation and exploiting potential foreign markets (single market and third countries).

The number of SMEs in Poland (in terms of its share of the total number of firms) is close to EU average. However, the Polish SME sector has comparatively more micro enterprises and fewer small companies. Moreover, although the share of employees in Polish SMEs is slightly higher than the EU average, the value added that is generated is significantly lower. This is the evidence of their lower productivity and a concentration of Polish micro enterprises in low value-added sectors. The performance of Polish SMEs in the knowledge-intensive service sector is below the EU average; only one in five of all service SMEs are knowledge-intensive (EU: 28%) providing 18% of all services jobs (EU: 25%) and 23% of total value added in services (EU: 32%). Sectorial distribution of Polish SMEs is in line with the EU average.

SMEs in Poland are less inclined than EU companies to co-operate (2010: Poland: 4%, EU: 9%) and to introduce innovations (2010: Poland 11%, EU: 32%). Moreover, Polish micro-enterprises and SMEs are less likely than their EU peers SMEs to improve the skills of their workforce (2011: Poland: 10%, EU: 19%).

As compared with EU, imports and exports of Polish SMEs are almost the same. However, Polish SMEs are less likely than SMEs in other countries to enter new markets outside the EU (both by importing or exporting). According to SBA Fact Sheets, this can be explained by the size of the domestic market and its attractiveness for national SMEs. General framework conditions are rated as favourable in terms of costs and administrative formalities, even if the administrative burden remains high due to the long procedures.

SMEs in Slovakia

Slovakia's SME sector shows a significantly higher concentration of small and medium-sized businesses in the manufacturing sectors and integrated into Europe-wide supply chains than in other EU countries. The other SME sector

however is much less competitive and needs of support to modernize (SBA Fact Sheet 2013). The manufacturing sector has the highest share of exports to the EU (about 70%). In addition, the wholesale and retail trade and transport sectors are the most important sectors for both imports and exports. In the wholesale and retail trade and transport sectors, the share of exporting SMEs is very high (89% and 99%, respectively). In contrast, SMEs in manufacturing play a subordinate role to large enterprises, with the former having an export share of only 26%.

Slovakia's performance in the single market area is higher than the EU average. This to great extent due to the economic openness and geographical location of Slovakia. In case of internationalisation, Slovakia's performance is well below the EU average (despite its SMEs being more active than average within the single market, both in terms of imports and exports). The overall negative score is mainly driven by the unfavourable general framework conditions for trading, where Slovakia offers a more cumbersome environment than in other EU countries (SBA 2013d).

International Comparisons of SMEs in V4 Countries

In the light of the above characteristics it is possible to point at some key differences between SME sectors in V4 countries (table 9.1):

1. The Czech SME sector is dominated by micro enterprises with the share of value added below the EU average and good level of innovations. The key characteristics of Czech's SMEs is their share in international supply chains which results in sectorial shift towards manufacturing.
2. Hungary's SMEs sector is very similar to the EU average. Almost two-thirds of the value added is generated by SMEs the following sectors: wholesale and retail trade, manufacturing, professional activities and construction. The share of high-tech manufacturing firms and knowledge-intensive services is only marginally lower than in the EU as a whole.
3. The Polish SME sector has more micro enterprises and fewer small companies as compared to EU average. The value added that is generated by Polish SMEs is significantly lower which is the evidence of their lower productivity and a concentration of Polish micro enterprises in low value-added sectors. The performance of Polish SMEs in the knowledge-intensive service sector is also below the EU average. Moreover, Polish SMEs are less inclined than UE companies to co-operate.
4. Slovakia's SME sector shows a significantly higher concentration of small and medium-sized businesses in the manufacturing sectors and integrated into Europe-wide supply chains than in other EU countries. Slovakia's performance in the single market area is higher than the EU average. Also its SMEs are more active than average within the single market.

Table 9.1. Number and share of enterprises in V4 countries according to their size (estimation for 2012)

Size	Poland		Czech Republic		Slovakia		Hungary		EU
	Number	Share	Number	Share	Number	Share	Number	Share	Share
Micro	1 410 335	95.2	897 895	95.5	362 026	95.6	521 981	94.6	92.1
Small	51 129	3.5	34 339	3.7	13 616	3.6	24 883	4.5	6.6
Medium	16 206	1.1	6 815	0.7	2 450	0.6	4 212	0.8	1.1
SMEs	1 477 671	99.8	939 049	99.8	378 092	99.9	551 076	99.9	99.8
Large	3 313	0.2	1 463	0.2	558	0.1	800	0.1	0.2
Total	1 480 984	100	940 513	100	378 650	100	551 876	100	100

Source: own compilation based on (SBA 2013a, p.2; 2013b, p.2; 2013c, p. 2; 2013d, p.2).

Internationalisation of European SMEs

As K. Wach (2014a; 2014b) predicts the processes of European integration is likely to develop and the Europeanisation of European SMEs has intensified their internationalisation processes, adding that “it has been observed particularly in recent years, while comparing the data in this field a decade ago, or even two decades, the significant progress in this regard can be noticed”.

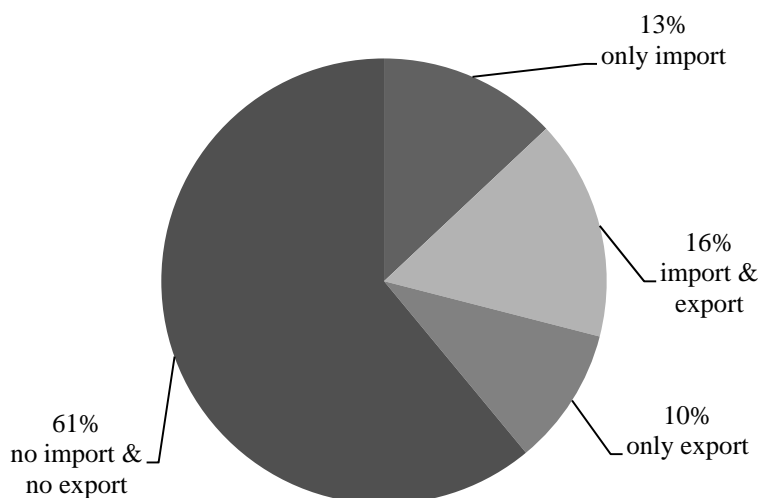
The majority (99.8%) of active enterprises within the non-financial business economy enterprise population in EU27 are small and medium sized enterprises (SMEs). What is more, over 92% are micro enterprises. Small enterprises represent almost 7% of the stock and about 1% European enterprises are medium-sized. On average, an enterprise in the EU employs 6.4 persons; within individual size-classes, the average size of an enterprise varies between only 2 in micro enterprises and about 1 000 in large scale enterprises (LSEs). In Europe SMEs in 2012 employed approximately 86.8 million people which represents 66.5% of all European jobs for that year. Micro-enterprises provide just under a third of that total employment figure. The SME sector as a whole delivered 57.6% of the gross value added generated by the private, non-financial economy in Europe during 2012 (table 8.2).

Nowadays, more than 40% of European SMEs are involved in some form of international activity. The percentages vary from nearly 30% of SMEs that import to only 2% of SMEs having foreign direct investments. Only 4% of SMEs have plans to become internationally active in the coming years (table 8.3). Importing and exporting very often coincide within the same enterprises. Of all enterprises that either import or export, more than 40% are active with both modes as shown in figure 9.1.

The percentage of SMEs that is involved in international activities is related to the size of the firm (in terms of number of workers). For each mode of internationalisation the percentage of SMEs increases by firm size (figure 9.2).

Table 9.2. Enterprises, Employment and Gross Value Added of SMEs in the EU-27 in 2012

Criterion	Micro	Small	Medium	SMEs	Large	Total
Enterprises						
Number	18 783 480	1 349 730	222 628	20 355 839	43 454 20 399 291	
%	92.1	6.6	1.1	99.8	0.2	100.0
Employment						
Number	37 494 458	26 704 352	22 615 906	86 814 717	43 787 013	130 601 730
%	28.7	20.5	17.3	66.5	33.5	100.0
Value added at factor costs						
%	21.1	18.3	18.3	57.6	42.4	100

Source: (Gagliardi *et al.*, 2013, p. 9).

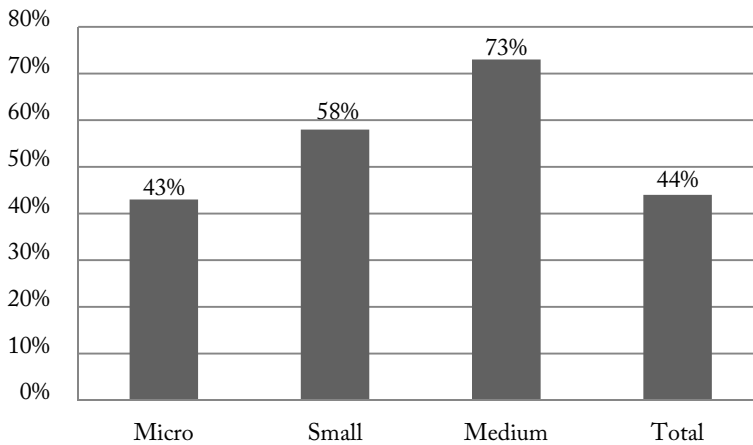
*Non EU- Members refers exclusively to the countries considered in this survey: Croatia, Iceland, Liechtenstein, FYROM, Norway and Turkey.

Figure 9.1. Percentage of European SMEs (E-33) with Direct Exports and/or Direct Imports in 2009

Source: (EIM 2010, p. 17).

The percentage of SMEs that is involved in international activities is related to the size of the firm (in terms of number of workers). For each mode of internationalisation the percentage of SMEs increases by firm size (figure 9.2).

The results of the key EU study on SME internationalisation i.e. Internationalisation of European SMEs (2010) show significant differences on the degree of internationalisation of European SMEs. Analysis of the data show that the smaller the country, the more SMEs undertake international activities.



*EU-27 + Non-EU-6 while Non EU- Members refers exclusively to the countries considered in this survey: Croatia, Iceland, Liechtenstein, FYROM, Norway and Turkey.

Figure 9.2. Percentage of internationalised SMEs in E-33 in 2009 by the size of the firm
Source: (EIM 2010, p. 18).

Countries such as Estonia, Denmark, Sweden, the Czech Republic and Slovenia have a much higher percentage of exporters than the EU average of 25%. In turn Germany, France and UK score is below average. There is also negative correlation between size of SME's home country population and its level of internationalisation. Moreover SMEs located close to a border show much higher activity rates with their cross border regions. Further analysis shows that exporting and importing activities increase in intensity by age of enterprise. The percentages of SMEs that are exporting gradually increases from just over 15% for enterprises up to 4 years of age to nearly 30% for enterprises that have existed for 25 years or more. Most often SMEs start international activities by importing.

9.5. CONCLUSIONS

In the 1990s the role of the SME sector in a globalized economy significantly increased. At the beginning of the twenty-first century, about one third of SMEs were internationalised while a decade later, in the EU and associated countries this rate was already 44% (Daszkiewicz & Wach, 2013, p. 9). This demonstrates clearly the importance of SMEs in international trade and in foreign investments (Horská *et al.*, 2007). In response to the growing involvement of SMEs in international activities there has also been rapid development of internationalisation theories

explaining the behaviour of international companies within the SME sector (Najda & Wach, 2005).

However there exist significant differences on the degree of internationalisation of European SMEs. Generally smaller countries, located close to a border are more internationalised. Also older SMEs undertake more international activities. Even though all V4 countries are transformed economies, their SMEs differ significantly across the sectors, innovativeness, size, ways they operate and international behaviour. As compared with EU, imports and exports of Polish SMEs are almost the same. However, Polish SMEs are less likely than SMEs in other countries to enter new markets outside the EU (both by importing or exporting). The overall performance of the Czech Republic in the single market is comparable with the EU average. However, Czech SMEs are more likely than the EU firms to export in the single market, but less likely to import from other EU countries. The Czech Republic's overall internationalisation activity remains significantly below the EU average. Slovakia's performance is well below the EU average despite the SMEs being more active than average within the single market, both in terms of imports and exports. Performance of Hungarian SMEs in the single market has already matched the UE average but internationalisation of Hungarian SMEs is well below the EU average.

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