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**Impact of the European Integration Processes
on Internationalization of Small and Medium-sized Enterprises**

Abstract

Internationalisation of small and medium sized enterprises (SMEs) may develop in different ways. One is a traditional, gradual transition through successive phases of internationalisation (a step-by-step process, like 'rings in the water'). The other one has been labelled „Born Globals”. The foreign market entry choice open to SMEs may include: export activities, co-operation and foreign direct investment (FDI). This choice is determined by the assets and competitive advantages a given SME holds.

The aim of this chapter is to examine the interrelationship between internationalization of SMEs and the European integration processes. Special attention will be paid to FDI as a form of SME internationalization in the new member countries.

1. Introduction

The aim of this paper is to examine the impact of the European integration processes on internationalization of small and medium enterprises (SMEs). Special attention will be paid to foreign direct investment (FDI) as a form of SME internationalization in the new member countries.

The structure of the paper is as follows:

- 1) Modes of SMEs internationalization – theoretical framework;
- 2) Factors stimulating and impeding the internationalization of SMEs;

- 3) Mutual relationship between the European integration processes and SME internationalization;
- 4) European Union's policy towards SMEs as a factor enhancing their internationalization;
- 5) SMEs internationalization in the new member countries;
- 6) FDI made by small and medium-sized enterprises. The case of Poland.

The foreign market entry choice open to SMEs may include: export activities, co-operation and foreign direct investment (FDI). This choice is determined by the assets and competitive advantages held by the particular SME (B.Hegge 2002, p. 3).

At present small firms take also part in global industrial restructuring in several ways, for instance, operating as (OECD 2002, pp. 66-67):

- partners in international strategic alliances;
- participants or targets of cross-border mergers and acquisitions;
- specialised suppliers to multinational enterprises;
- members of globalised informal networks
- participants in electronic networks.

2. Modes of SMEs internationalization – theoretical framework

Internationalization of small and medium sized enterprises (SMEs) is a subject of research. Some models have been constructed that explain this phenomenon. One of them is a traditional model emphasizing gradual internationalisation of firms. According to this model internationalization is treated as a step-by-step process, like 'rings in the water' (T.G.Madsen, P.Servais 1997, pp.561-583; A. Buckley, 2002, s. 96-100). This is known as the Uppsala Model and its version as the Innovation based Internationalisation Model. This so called stages model was criticized and alternative models were built. The holistic model (or Finnish model) stresses the role of inward internationalization through import and activities of foreign investors in domestic economy (A. Kjellman, J. Ramstrom, 2003, p.9; M. Elo, 2003; T. Vissak, 2003, p. 3). The other one has been labelled „Born Globals” and shows that some firms become international at founding (T.G.Madsen, P.Servais, 1997, p.562; T.G.Madsen, E. Rasmussen, P.Servais, 2000, p. 248-265).

Recently two different approaches to SME internationalisation have started turning up in the literature, i.e. a network view (especially social

network) and entrepreneurial view (A.Ch.Sundnas, A. Kjellman, 2003; T.Vissak, 2003, p. 4).

3. Factors stimulating and impeding the internationalization of SMEs - literature review

A number of factors stimulate small- and medium-sized enterprises to go international, but parallel to them there is also a series of determinants that considerably impede the process. Among factors stimulating expansion into international markets are mentioned (P.Matthyssens, P.Pauwels, K.Vandenbempt, 2001):

- customer pull – many SMEs seem to be pulled abroad by the cross-border initiatives of their key customers or due to an overall globalisation of their market;
- cost pressures and the consequential concentration of industry;
- tension between the global vision and local touch in a firm.

According to the research on small firms' motives to launch FDI, important inducements for the firms to invest abroad are: prospects of gaining new markets, stabilisation of the existing markets, low labour costs, taxes, governmental subsidies, following of an important customer, re-import opportunities, lower environmental protection requirements (H.-G. Braun, 1996, p.42; D.J. Storey, 1996, p.55). These motives are similar to motives of overall foreign investors.

4. Mutual relationship between the European integration processes and SME internationalization

SMEs get under strong competition pressure when barriers in goods, services, capital and labour movements disappear within the integrated area. Internationalization processes of SMEs allow them to stabilise their market position and to overcome some development barriers. The governmental support to SMEs internationalization processes seems to be one of the most important tasks of policies towards SMEs.

All choices related to internationalization modes discussed above are available to SMEs under integration conditions. The European integration seems to enhance all forms of SMEs internationalization. Removal of all non-tariff

barriers (administrative, technical and fiscal) gives a strong impulse to these firms to enter markets of other member countries. It facilitates also all international activities of SMEs (B. Hegge, 2002, p.p12-25 and 173-174).

One could expect that SMEs will be involved in trans-border transactions and participate in export and import. On the other hand the process of creating and enhancing of ownership-specific advantages of SMEs will start. If other conditions of Dunning's Paradigm are fulfilled, foreign direct investment by SMEs will be made in the integrated area.

The introduction of single currency has generally positive influence on international activities of SMEs. This is connected with the elimination of exchange risk in the euro area. Growing transparency of prices encourages to reorganization of some kinds of international involvement by SMEs.

5. European Union's policy towards SMEs as a factor enhancing their internationalization

The European Union has been supporting SMEs and their activities abroad. The UE policy towards SMEs aims: to promote and encourage entrepreneurship, innovation, competitiveness, to improve environment for business and to improve access to markets (European Commission (a), www.europa.eu.int).

Currently, the Multiannual Programme for Enterprise and Entrepreneurship, and in particular for small and medium-sized enterprises (2001-2005) is a framework plan of all these activities. And the approval of the European Charter for Small Enterprises in 2000 demonstrates the Union's commitment to supporting the development of these firms in the integrated area (European Communities 2000; European Commisision (b), www.europa.eu.int/comm/enterprise).

Effectiveness of this policy is difficult to measure. Some statistical data show that SMEs in Europe -19 (EU+EFTA) are involved only to limited extent into international activities. They export only 13% of their turnover, while large enterprises have higher export propensity, i.e. 21%. As SMEs also supply goods and services to large exporting enterprises, the indirect exports of SMEs are significant (European Commission 2002, pp. 9-11). As far as foreign direct investment by European SMEs is concerned, the scale of phenomenon is rather small (M.Fujita, 1995, pp. 183-202). According to the research done by UN, sources of competitive advantages of small and medium-sized European transnational corporations are as follows: flexibility of management, experience

in home markets, organization and marketing capabilities, international reputation and prestige (brand names), access to markets and after-sales services (M. Fujita, 1995a, p.116).

6. Small and Medium Enterprises in Poland

At the end of 2001 almost 3.4 million enterprises were registered in Poland, 99.8% of which were SMEs. According to estimates, only 1.8 million enterprises were in fact economically active. The SME sector employs about 66.4% of total labour in the national economy¹ and generates approximately 50% of GDP, whereas in the EU, where the scale of employment is only slightly higher – as much as two thirds. Small-sized enterprises are the main sources of GDP in Poland – in 2000 they contributed 40% of GDP, while the medium-sized – 10% (Ministry of Economy, www.mg.gov.pl).

The level of internationalisation of SMEs in Poland is relatively low, they operate mainly in the local market. About 14000 exporting SMEs from the total number of 1.8 million SMEs operating in Poland accounted for 46% of total Polish export (i.e. 30% domestic SMEs and 16% foreign owned SMEs). They export goods mainly to developed market economies with special reference to the EU. The structure of their export to the EU is generally labour intensive. Main barriers to their export are ecological and technical norms and standards.

7. Foreign direct investment by small and medium-sized enterprises. The case of Poland

Activities of the foreign-owned SMEs in Poland in the years 1994-2001 were analysed using unpublished Central Statistical Office (GUS) data. 95% of firms with foreign ownership operating in Poland and examined by the GUS were so-called micro firms employing less than 10 persons, and small-and medium-sized enterprises. From the total of 14,469 firms with foreign capital covered by the survey in 2001 only 696 were large-sized, employing over 250 workers. Table 1 shows the characteristics of firms with foreign ownership, according to number of workers. The share of the foreign-owned SMEs in the total core capital of firms with foreign ownership in Poland is presented in Table 2. SMEs have about 45% of this capital.

¹ Excepting agriculture, forestry and fisheries.

The branch structure of FDI undertaken by SMEs in Poland shows that they seek development opportunities in market niches. Small firms invested mainly in transport, warehousing and telecommunication, real estate and business services, wholesale and retail. Medium investors were involved both in manufacturing and services (products from non-metallic raw materials, production of foodstuffs and beverages, production of rubber and synthetic products, wholesale, retail and in real estate services).

The analysed firms were very active in international trade, exporting and importing goods and services. They were net importers into the Polish economy. The exports to imports ratio was 1:3 in the case of small firms and 1:2.4 for the medium-sized. In the years 1994-2001 small firms' imports increased 2.6 times and exports only 36%. Between 1994 and 1999 foreign trade transactions of the medium-sized firms grew dramatically, i.e. 4.1 times in the case of imports and 3.3 times for exports, respectively.

SMEs with foreign ownership have higher export propensity than domestic ones. Among small firms the rate was over 23%, and 33% for the medium-sized. Considering the relatively low propensity to export among all foreign-owned firms in Poland, the medium-sized firms reveal more than average internationalisation of their sales.

Total export of foreign-owned small- and medium-sized enterprises was important for the total export from Poland, as it accounted for 15.5% of all 2001 exports. Its product structure is relatively diversified. The most important exports in both groups of exporters were machinery and equipment – making up over 17% of totalled export values for both groups. Shares of other groups of products such as furniture, synthetics, non-rail vehicles, cast iron and steel products, wood and wooden products represented around 5-8 %. The outstanding item 'machines and equipment' among the foreign-owned SMEs' exports should be viewed as a favourable trend, supportive of long-term adjustments in Polish foreign trade.

The export structure of foreign owned SMEs is more capital intensive than domestic ones. SMEs with foreign ownership import mainly machinery and equipment. This purchases amounted to about 30% of their total import. This plays the important role in inward internationalization of Poland as a recipient country.

8. Conclusions

- Internationalization of SMEs may develop in different ways. Foreign direct investment is one of these possibilities.
- European integration processes enhance and modify transnational activities undertaken by SMEs.
- EU policy towards SMEs promotes their international involvement.
- Foreign direct investment in Central and Eastern Europe made also by SMEs strengthens inward internationalization of their economies.
- SMEs with foreign ownership are very active in international trade by Poland.

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Table 1. Firms with foreign ownership in Poland, according to the number of workers

Specification	1994	1999	2001
Total number of firms with foreign ownership, surveyed by Main Statistical Office	8775	13400	14469
Number of large firms in the survey – more than 250 workers	262	680	696
Number of SMEs in the survey	8513	12720	13773
Share of SMEs in the total number of firms with foreign ownership	97,0	94,9	95,2

Source: Data of Main Statistical Office and own calculations.

Table 2. Core capital of firms with foreign ownership in Poland, 1994-2001, %

Specification	1994	1999	2001
Share of the foreign owned small enterprises in the total core capital of firms with foreign ownership in Poland	20,1	23,1	25,5
Share of the foreign owned medium enterprises in the total core capital of firms with foreign ownership in Poland	23,2	20,2	19,3
Share of the foreign owned SMEs in the total core capital of firms with foreign ownership in Poland	43,2	43,3	44,8

Source: As in the Table 1.

