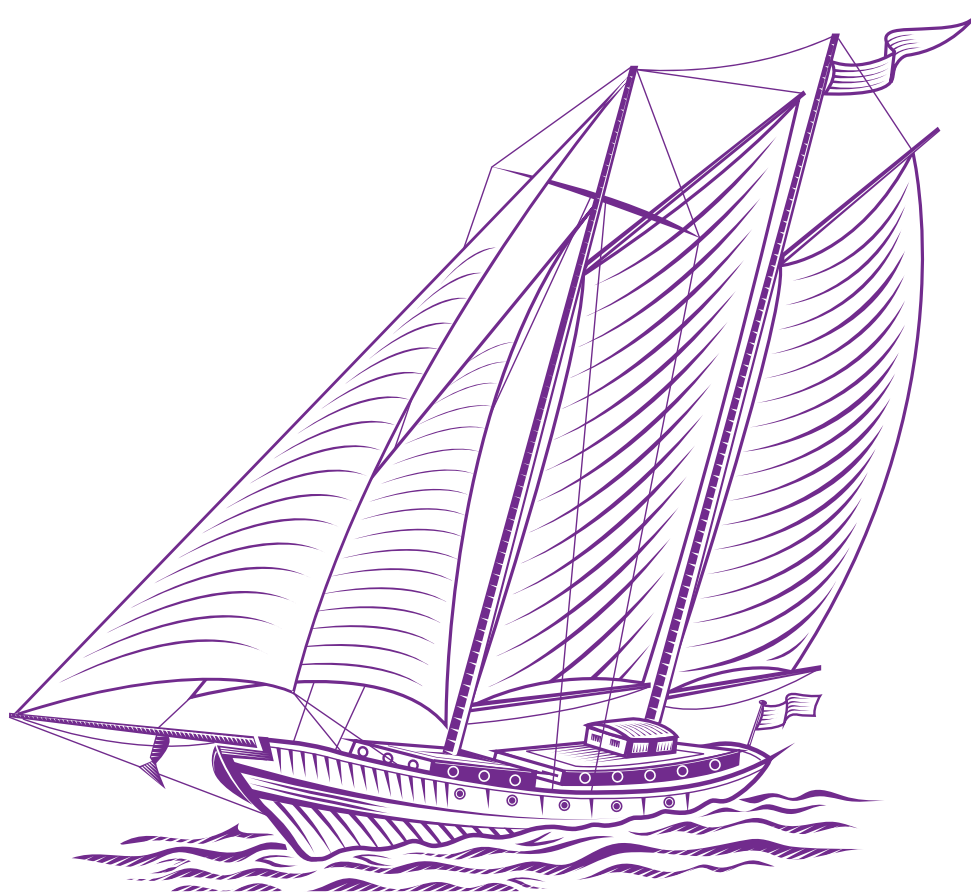




STUDIA UNIVERSITATIS  
BABEŞ-BOLYAI



# NEGOTIA

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4/2009

The current issue of *Studia Negotia* is dedicated to the papers presented at

**THE INTERNATIONAL CONFERENCE**

**SMALL AND MEDIUM SIZED  
ENTERPRISES  
IN EUROPEAN ECONOMIES  
AND ALL OVER THE WORLD**

4th edition

2009 September 24 - 25  
Cluj-Napoca, România

Organized by the Faculty of Business

# STUDIA

## UNIVERSITATIS BABEȘ-BOLYAI

### NEGOTIA

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## CHALLENGES FACING UK SMES IN INTERNATIONAL DEVELOPMENT

ANNE HAMPTON<sup>1</sup>, JAMES ROWELL<sup>2</sup>

**ABSTRACT.** In the UK, Small to Medium Sized Enterprises (SMEs) are encouraged to develop overseas business for a variety of reasons, such as sourcing of products and components, seeking new markets and developing international partnerships. Although the UK government, industry leaders and professional bodies encourage international growth, SMEs themselves also recognise the need and benefits of trading in international markets. One of the major challenges facing SMEs, and particularly owner-managed business, is how to formulate their approach to international markets.

This paper aims to establish key issues UK SMEs are facing in the process of trading internationally. The paper is based on qualitative research exploring the concept of 'global mindsets' and the extent to which this approach is applied in SMEs operating internationally. The research views the concept of a global mindset from a wide perspective and includes: awareness of global issues; knowledge about other countries and cultures; development of competencies and aptitudes needed for working in and operating a business in a global context; and SME responses to cultural perspectives (as managers, employees and customers). The level of awareness of needing deep local knowledge and cultural sensitivity in building good relationships with suppliers, distributors and customers is also discussed.

The 'soft skills' that MNEs either recruit or develop amongst their international managers, are not readily available to SMEs. SMEs must therefore develop their own understanding of the skills required in order to build their organization's capability. This research focuses on identifying the decisions and actions needed for SME international business development, including the resource implications and timescales needed to develop markets and build relationships.

**Key words:** SME, International Capabilities, Global Mindset, International Business

**JEL Classification:** M16

### Introduction

In the UK and EU Small to Medium Sized Enterprises (SMEs) recognise the need to trade internationally and are encouraged to develop overseas business

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opportunities by governments, industry leaders and professional bodies. There are a variety of reasons for SMEs developing an international approach and growing business overseas, including sourcing of products and components, seeking new markets and developing international partnerships.

Therefore the development of an international stance and developing appropriate management capabilities is vital for SMEs. However, such development also presents a challenge for some SME directors/managers. They may have little or no business experience of managing and operating overseas, and there can often be a degree of uncertainty regarding formulating and managing their business approach to international markets.

This paper explores factors relevant to owner-managers of SMEs focusing on the 'soft skills' that are needed in developing and maintaining international business effectively. The drivers for SMEs to conduct business internationally are discussed, as are the needs to develop, share and exploit capabilities for growing the international business.

For the purposes of our research, we have adopted a broad perspective of the international management issues involved, and include: awareness of global scale issues; knowledge about countries and cultures; development of competencies and aptitudes needed for operating a business in a global context; and responding to the variety of cultural perspectives (as managers, employees and customers).

### **Literature Review**

An examination of the literature establishes that the process of internationalisation has largely been viewed as a series of stages. The Upsalla model traces firms moving from domestic markets to export (either direct or indirect exporting through agents). However, Holmlund et al (2007) propose a need to consider importing as a vehicle to develop overseas business, and suggest links between importing and exporting. They suggest that imports are focused on operations, whilst exports on marketing. As a result, the definition presented by Welch and Luostarinen (1988) may be useful, defining internationalisation as '...the process of increasing involvement in international operations' which implies that inward business activities may have a strong impact on the internationalisation process. The network approach, focusing on exploring the impact of social relationships between individuals and showing how relationships may increase overseas business developments, is therefore a valuable alternative approach to understanding internationalisation, (Holmlund et al, 2007).

This change in focus also suggests a need to understand the ways of thinking of those working in an international context. It is thus helpful to consider perspectives on developing a 'global mindset'. The term 'global mindset' has become increasingly widely used in the business world to describe a way of thinking or understanding the world and its impact on business, but yet there is no

single accepted definition. Whilst it is recognized that companies can structure experiences and plan employee development to increase global thinking and cultural competencies, establishing how this is achieved is of value. Rhinesmith (2001) suggests that a global mindset is developed through both Intellectual and Emotional Intelligence and that this leads to the development of skills suited to the global environment. This is supported by Bonache and Brewster (2001), who identify the importance of tacit knowledge in developing more effective expatriate employees.

Although much of the research on internationalization has studied MNEs, it is important to understand the impact on smaller businesses and the means by which SMEs achieve internationalisation (Hutchinson and Quintas, 2008). McDougall and Oviatt (2000) recognise 'accelerated internationalisation' in SMEs, specifying that 'international entrepreneurship is a combination of innovative, proactive, and risk-seeking behaviour that crosses national boundaries and is intended to create value in organisations'. This definition underlines that company size is not a determinant for having international aspirations.

There is also the important factor when studying SMEs is that they "cannot be considered as smaller clones of larger enterprises" (Majocchi and Zucchella 2003). In particular the available resources – finance and management (Majocchi and Zucchella 2003), and market and competitive information (Hutchinson & Quintas 2008), are limited.

It is worth noting that the term 'born global' has been used to describe companies that recognize the global nature of their business from their inception. Gabrielsson et al (2008) recognize 'born globals' as a subset of international entrepreneurial SMEs, and give a full debate on the different categories concerned. Recognition of such firms shows the need to examine the issues smaller and newer firms face in developing the necessary skills for managing the business.

Whilst Wyer and Smallbone (1999) identified that deciding to enter overseas markets is frequently driven by opportunistic behaviour, Jeannet (2000) found that companies have been shown to take a pro-active approach to identify suitable markets using a range of criteria – economic development, demand for product/services. Bartlett (2006) identified companies that responded to the availability of resources (technical, marketing, research capability) in the target country and Majocchi and Zucchella (2003) identified those basing decisions on the level of risk associated with particular markets.

This begins to show that the selection of markets will be dependent on a range of company and situation dependent factors including market "size or volume, or from their technological development" (Jeannet 2000). Holmlund et al (2007) have documented the motives for developing international business as including: management interest, limited domestic market, and inquiries from buyers, as the major motives for SMEs to start exporting. Importantly, Majocchi and Zucchella (2003) recognise that SMEs identify target markets that are easier to understand and serve; are similar or closer geographically, or as a 'global niche

approach'. In both cases the 'organisation aims to reduce the complexities of foreign market commitment'.

Whilst these studies show a reasoned approach, others have found equally rational approaches but driven by 'softer' management skills. For example, Bjorkman and Kock (1997) show that a manager's social relationships influence the level of interest and possibilities for international trading. In addition, previous international experience of managers and companies is also beneficial; Holmlund et al (2007) cite a reduction in cultural barriers, greater confidence and a more proactive approach towards opportunities, increases the propensity for SMEs to trade internationally. This is supported by Majocchi and Zucchella (2003), who state that "firms that have exported intensely...have generated a value process... from the beneficial effects of accumulated knowledge".

Researchers highlight the significance of taking a strategic approach to developing international capabilities for achieving success in international markets (Ghobadian and O'Regan 2006, Hanna & Walsh 2008,). Roper (1997) reports "a considered strategy enables organisations to develop and maintain competitive advantage". Whilst there are clearly a variety of approaches taken to developing internationally it is worth noting that Ghobadian and O'Regan (2006) found that using a 'formal strategic planning' approach provides a stronger basis for business performance. This is supported by Holmlund et al 2007 and Roper 1997.

According to Majocchi and Zucchella (2003), 'the biggest obstacle for international expansion of SMEs is a "knowledge gap"'. The gap in an SME's knowledge may be in many different areas such as efficient and effective ways of gathering market knowledge about a country, or complexities of entry into a specific market. Another aspect of this challenge is the ability to share relevant information on current and potential markets amongst relevant staff. Further support for these challenges is given by Karagozoglu and Lindell (1998) who cite difficulties in forming international partnerships, lack of managerial experience and competence, and difficulties gathering information as barriers to internationalisation facing SMEs. Majocchi and Zucchella (2003) identify that the entry barriers of some markets are significant, e.g. the North American market having complex entry barriers and competitive internal market. Additionally, Holmlund et al (2007) classified some companies as 'pure-exporters' and thus having only limited experience and information, and finding themselves "more dependent on governmental and/or association support".

A key factor of SMEs is the impact and influence of ownership on the extent of management capability and management approach of the organisation. Ghobadian and O'Regan (2006) quoting Daily and Dollinger (1992) "concluded that ownership (family ownership and professional management) influenced firm size, firm strategy and internal control systems"; effective leaders will "instil confidence, share vision, and be a catalyst for change". This is particularly significant in SMEs because of the limited depth of management resources. Often



responses to changes in the business environment are "shielded by the current culture and beliefs of the owner/manager" (Ghobadian and O'Regan 2006).

Hutchinson and Quintas(2008) state "organisational learning within innovative SMEs is dependent upon the ability (often the owner/manager) to share their knowledge with employees". There is a need to achieve a practical balance (with limited resources) between knowledge acquisition and its' exploitation. Zhang et al (2006) report, success is linked to 'effective environmental scanning and to a greater willingness of owner-mangers to share knowledge with their employees'.

As previously discussed, the concept of a 'global mindset' suggests that companies can structure experiences and plan employee development to increase such global thinking and cultural competencies. Whilst Bonache and Brewster (2001), identify the importance of tacit knowledge in the effectiveness of expatriate employees; Holmlund et al (2007) identify several approaches to developing capabilities within the organisation. They explain "those companies with importing experience benefit from a reduction in cultural barriers" and create leverage through their importing business-partners whilst 'pure-exporters' consider themselves more dependent on formalised external support. Companies deemed to be more capable, encouraged the interchange of information across departments, for example between Purchasing and Marketing. Some organisations actively encourage social contacts to informally share information and develop capability, and are able to make "more strategic import-export choices based on accumulated knowledge" (Holmlund et al 2007).

It is worth noting, however, that SMEs work with limited resources, time and 'systems' for sharing information internally (Hutchinson & Quintas 2008). Despite this, Holmlund et al (2007) report that it is possible, and further emphasises the expertise and experience of owner/managers to enable this to happen.

Whilst all international business may be considered as "networking", according to Lorenzoni and Lipparini (1999) the creation of networking capabilities is seen as demanding "strategic intent". They cite the roles of partners in a given network developing and changing - "as companies develop confidence in their partnering capabilities it weakens the boundaries of the enterprise"; thereby achieving positive effects. Hutchinson & Quintas (2008) also report that SMEs can create competitive advantage by collaborating with other companies; but they "must have the ability to search for and share knowledge, particularly across the firm boundary".

The literature suggests that SMEs use a range of approaches to develop knowledge and identify trading partners (Hanna & Walsh 2008; Hutchinson & Quintas 2008; Majocchi and Zucchella 2003), such as government support agencies, trade associations and networks established both in the home country and internationally. Additionally, "trade events play an important role in providing information about competitors, new technology and potential partners" (Hanna & Walsh 2008).

The advantages for these relationships are varied; although all may offer some combination of capability, information or expertise to the SME (Hutchinson

& Quintas 2008); companies are not intending to steal skills or knowledge from their partners, but to apply it to strengthen their own capability and market reach. Further, SMEs with international ambitions actively seek to develop new networks to support their company's capability (Loane & Bell 2006).

To summarise the factors identified which that guided our research:

- A structured approach to leads to greater success
- The role of the owner/manager is significant in building a successful international business
- Greater knowledge, access to information, and experience increases SME's capabilities for conducting international business
- SMEs have limited resources and need to develop global awareness and share knowledge across the business
- Networking provides assistance for international development

### **Research Methodology**

Following earlier research with large/multinational enterprises, it became apparent that the issues which smaller organisations (SMEs) faced were very similar. SMEs are being encouraged to become more pro-active in international markets, and the UK Government provides support and funding, such as trade fairs and consultancy for business development. However, there is little discussion on the "management issues" which SMEs need to address to be successful in international markets. This research is based around establishing the awareness of the need for these skills; and what actions those responsible for international business development are actually taking.

The first stage was to hold a focus group with UKTI (South-East) International Trade Advisors, as they work with businesses with such experience in SMEs. The purpose was to establish that our research interests had sound business relevance and the broad range of relevant questions that needed to be answered. These Trade Advisors fully recognised the issues which our research was investigating and gave their support by introducing us to some of the respondents.

The methodology used in this investigation into the level of development of UK SMEs in the process of internationalization, is semi-structured in-depth interviews with a founder and/or senior manager from each organization. Respondent SMEs were from a range of industries (from industrial machinery, hi-technology, beverages through to a range of service companies) in England. They were not chosen randomly as this exploratory research was attempting to develop in-depth knowledge of specific business activities and approaches needed for international trade. Patton (1987) and Hanna and Walsh (2008) recognise the benefits of such purposive sampling when conducting exploratory qualitative research. Our reasons for taking this approach include gathering data from the eleven interviewees - all key people responsible for international business and with

access to sensitive data. Ghobadian and O'Regan (2006) suggest that high-ranking informants can be more reliable sources of information than lower ranking counterparts. In our study the highest ranking and most knowledgeable in terms of the specific businesses were MDs, Owner/managers and General Managers who have a broad overview of managing the business.

The challenges of accessing these people who are particularly 'time-poor', required a concerted approach (Collins and Cordon 1997). Our first point of contact was by telephone to introduce ourselves, followed by an e-mail confirming our authenticity and the research topics. We have also been meticulous in confirming dates with interviewees to ensure availability. Throughout the research process we have been conscious of the need to build trust between the interviewees and ourselves in order to gain detailed and/or sensitive information about their approach to building their overseas business.

All interviews were recorded to ensure accuracy in establishing what was stated; all interviewees were willing for this to happen.

## **Results**

The findings of the research are presented under a series of headings to clarify the environment and parameters for managing effective international business.

### **A structured approach to leads to greater success: through qualified market/agent selection, managing agencies; and providing customer service**

In many of the respondent companies international business opportunities involved consideration with respect to: scale and scope, product development or adaptation, and either ongoing logistics or service support. Therefore for many it can be characterised as the development of a business relationship rather than simply 'receiving an order'. However, the time commitment to manage business relationships is significant, and even more so for SMEs with limited management resources. It is therefore important that companies recognise this and make a strong commitment to a long-term strategy for developing international business. Companies need to pay attention consistently to existing markets and customers, and at the same time being alert to future opportunities in other countries.

Amongst the respondents, long-term commitment for developing international business was recognised as vital. One respondent stated that it could take up to 5 years before winning business with some clients. This was particularly due to their business sector - manufacturing and installing display and security systems. Not all international contracts take this long, but respondents noted that it does take time to build trust with customers and agents, and develop applicable products and services relevant for international markets.

The need to qualify markets and/or agents is especially important because of the limited resources, and an increased loss of opportunity if the 'wrong' markets

are pursued. Respondents identified a range of key qualification parameters, including: geographic proximity/accessibility; language; size of market; levels of finance; political stability; and country procedures and legislation.

Where the companies interviewed conduct business through agents, they recognised that agent companies may have different trading objectives to their own. For example, an agent may wish to carry the company's products, in order to offer a comprehensive range on its portfolio, but it may be directed by its own commercial targets to give priority to competitor products. It is therefore important that the company qualifies the prospective agent, supports it in promoting and selling its products, and manages agency agreements diligently to achieve business success. One important qualifying factor is the 'scalability' of the agent - do they themselves have the ability to grow? and grow your business opportunities in the international territory?

More broadly the factors/capabilities which are important for assessing agents include: size and market presence; motivation to 'carry' your brand; commitment to identifying further business opportunities; and willingness to communicate with your company. As for the supplying company, it is important to continue to develop the relationship with the agent, to encourage them to support your own business environment scanning. Similarly it is important to train and support the agent, to enable them to promote your products and services effectively.

Whilst every respondent company recognised the need to adapt products and services to match the requirements of international markets, this had a stronger impact on some than others. Companies identified the need to adapt their products or product ranges to meet 'local' tastes, or found that their agents would select products, by default, themselves to match local requirements. The factors concerning the need for adaptation, or at least the need to adapt its operational perspective, present themselves in a number of forms. For example, respondents emphasised the extra effort required to present a credible business case for its products and services.

In a different context, a software developer, identified a number of factors which it had to deal with as part of its international market development. A major concern was the need to adapt the product itself - i.e. a library of terms within the software had to be "translated" into those used in the foreign market. This did not mean translation of words, but their application in a technical context, which was quite different even between the UK and the US markets.

Instances like these can lead to misunderstanding, confusion, and difficulties in "winning over" prospective customers. This can also lead to higher costs and ongoing support issues, which must be recognised by the service company to achieve profitable business, and a sustainable support capability.

Whilst there is a need to adapt company processes and procedures, it is essential to establish realistic customer expectations regarding communications and response times. With the SME's limited resources this is important for achieving successful and manageable international business in the long-term. Therefore the

evidence suggests the need to take a structured approach to the selection and development of international markets in order to enable the company to operate effectively in those markets.

**The role of the owner/manager is significant in building a successful international business**

SMEs recognise that the world has become much more competitive - "customers now expect the highest quality products to be delivered at the lowest market price". Thus creating a driving force that led many respondents to recognise the need for clear leadership and for developing an effective international strategy.

There was also clear acknowledgement and recognition of the need for a long-term commitment to developing successful international business. However, for SMEs, putting that commitment into practice over a period of time is very demanding. Other business pressures cause conflicts of priorities, detracting from the concentrated focus needed for building overseas business.

Amongst the respondents most had had significant international business experience, half with over 20 years or more, and for others throughout their career; their expertise often developed in much larger companies. Whether this overseas experience was gained in the countries in which they now operated doesn't appear to be crucial. What is important is that it had increased their awareness for adapting to cultural and commercial differences.

Beyond this, a significant factor for international managers was a strong desire to "control their own destiny", which also showed up in their personal commitment to their role, and their personal commitment as owner/managers to the international success of their business. In the interviewed companies it was clear that it is the owner/manager who drives the direction of its international business. Whilst qualification parameters of various types are applied the selection of markets and approaches to those markets is determined in the MD's office.

**Greater knowledge, access to information, experience increases SME's capabilities for conducting international business**

An essential requirement of all companies setting out to 'break into' international markets is access to good marketing information on the target countries; yet gathering information can be either time consuming or expensive, or both. Many respondents recognise the value of the assistance offered by consultancy and networking support groups, such as those programmes delivered by UKTI. Even so, a small number of respondents suggest that more 'government' support - both financial and resource-orientated, should be available to encourage early stages in international development activities.

However experienced companies are able to adapt its 'market' research methods over time. Initially, one company purchased commercially produced

market-profiling data. As it gained experience and having refined its needs, it uses web-based sources as an effective means of gathering relevant information; hence reducing costs. They also subscribe to "Google Alert" to identify specific business opportunities. Others emphasised the imperative to gather market intelligence on each overseas visit.

Regarding the subject of commercial contracts, respondents raised the issue of their own company's perspective on understanding the role and nature of a contract. One respondent identified different types of understanding - that in the UK a contract set out the actual terms of business, whilst in other market areas that it is really a formal agreement to work together. More significantly they identified that a contract in China, even though signed by the customer, "wouldn't be looked at, at all"; and yet the supplier would be expected to respond to any new requirement of the customer company. It is important that companies trading internationally understand these perspectives; otherwise friction can occur between companies, especially at critical times in service delivery.

#### **Networking – External partners for international development**

One company, a 'born global', has created a network of supporting partners for a range of business expertise and capability. This network includes resources for Marketing and Financial Management whilst the operational activities of Production and Distribution had been outsourced at its inception. In addition, it operates in a loose network with other suppliers working in similar markets, to identify and share business intelligence and potential opportunities.

Building relationships with customers/agents and joint suppliers requires a strong emphasis on building trust, and the associated implications varied depending on the country. Some respondents reported developing personal/family contacts with their international business associates. Other companies related how they make practical use of their relationships with international partners, for example jointly sharing trade stands at exhibitions. Thus, they are able to offer a wider range of products and capabilities and have access to more markets. Indeed, one respondent emphasised these forms of benefit; they and their overseas partners were able to share knowledge, and both project more confidence when presented with business opportunities.

One company, in the engineering sector had identified the significance of one of its major customers who themselves operate across the world. They recognised the power of the "lead customer" and used this to leverage their own opportunities in international markets. Where SMEs have such customers, this offers the opportunity to reduce the significant costs of developing overseas business.

Company respondents underlined the need to select and qualify all relationship partners carefully, even contractual; recognising that these should be

considered as long-term relationships. Once, having developed these "trusting" relationships, it becomes necessary to maintain and develop them often over a period of many years.

Where business relationships have been developed through personal contacts/relationships, time and effort has been essential. Repeatedly, respondents gave examples of developing social relationships with their business colleagues (e.g. staying in family homes whilst making a business visit, in India, or China), thereby strengthening the business relationship.

**SMEs have limited resources, and need to share the load across staff to successfully address business and market requirements**

Whilst all respondents recognised the need for a long-term development, putting the commitment into practice over a period of time is very demanding, often on the part of just one or two senior managers in an SME. Whilst some companies sell their products direct to customers, others use agents to act on their behalf; whichever is the case, the need to maintain customer contact and manage the agent is obviously crucial for ongoing success. Many companies were owner-managed, which means that the MD needs to carefully balance the time allocated to international visits against the other management activities necessary to run the business.

This challenge can be characterised by one company working through agents. In the first year of a contract they would visit up to 4 times; in subsequent years, assuming no particular issues needed addressing, they would still make 2 visits per year. If this is multiplied by a number of agents in the different countries it becomes a significant commitment, both at a personal level and for the company. Another respondent reported making between 15-20 visits per year (to the Middle East and China) to maintain business relationships. These examples show the significant strain on the management resources of SMEs.

In most companies there is often either one single or lead contact person for their international business. However, the concentration of international activities on one person limits both the time available and the possibility of sharing the international business load. Of particular concern is that it can restrict the company's ability to explore new opportunities in different markets.

Most respondents understood the constraints of resources available to support its international business, and were grappling with how they could overcome these limitations - capability and availability of staff. Two illustrations highlight these needs; firstly a simple case - when an overseas customer rings the receptionist calls for *the one* person able to deal professionally with international customers. Secondly, a more complex situation, one respondent in a "technical product" organisation, commented on the difference between technical and commercial negotiations. The point being made here, that whilst staff may have

international experience, their expertise lies in the technical aspects of the product; and they did not have the business acumen or authority to deal with commercial negotiations.

In some companies, where the operation of its international business was more widely understood by staff, regular (even weekly) communications meetings were held. However, even with this approach to information dissemination, senior managers still regarded its operation as "islands of business", rather than creating synergy across its international activities.

As many respondents stated, it is clearly important to be able to communicate quickly and effectively with customers, and obviously email and phone communications assist this process. But it is important to establish realistic customer expectations regarding communications and response times. Even so, it puts pressure on companies, and often it is just one or two managers in the company need to be available to respond to direct customers' or agents' requests. In one service organisation, it became necessary to implement support services to cover the customers' support needs, which were outside of the normal UK working day. This company took the initiative by recruiting staff to create a "round the clock" support capability. Where the business is principally product rather than service-based, the need for 24-hour cover was less acute.

### **Discussion**

This research identifies a broad range of issues which have an impact on UK SMEs trading internationally. The findings highlight the significance of the length and nature of experience most of the managers have had of operating in international markets. Whilst others have less experience, they have developed capabilities through their own initiative in gaining international experience in their own businesses. In both cases they have developed their capability through "international" exposure rather than through a formalised training programme, supporting Bonache and Brewster's (2001) view on the importance of developing tacit knowledge.

The owner/managers showed a high degree of understanding of global business and its impact on their companies without necessarily being aware of the term 'global mindset'. However, as the respondents reported, this same understanding is not always shared amongst their staff.

The literature indicates that companies are more successful when adopting a strategic approach to developing international business. Most respondents had clearly adopted some form of structured approach - through choice of channels to market (via agents), partnering organisations in their target countries, working in a loose network of suppliers, or following the needs of a "lead customer". In some cases the strategy is to build relationships with potential customers where purchases may be made in the longer-term. Whichever strategy is adopted, within the limited resources of SMEs, the imperative is to qualify markets/agents/customers adequately as a crucial aspect in developing a successful international business portfolio.



All business is a relational activity, however in the international context this extends further. Our findings supports Lorenzoni and Lipparini (1999) suggestion that strategic intent is necessary to create 'network capability'. Examples of the range of relationship types were encountered:

- external (sales agents)
- external (partners closely/loosely connected to the company)
- internal (knowledge of products/markets/opportunities and expertise disseminated across the organisation).

Our findings show that the depth of international expertise across the company is limited; in response to this, the challenge for SMEs is to develop capability and international awareness within the company. It is also important that companies recognise the different forms of expertise which come into play, for example, contrasting technical expertise as against commercial acumen, and decision-making authority.

In many instances only one or two people have responsibility or authority for managing international business. In extreme cases it is the owner/manager who carries the responsibility for the whole company, as well as all of its international efforts, reflecting Ghobadian and O'Regan (2006). With such pressures placed on companies to be competitive in the global market, it is clearly a high-risk strategy to have no other international capability within the organisation. Supporting the views of Hutchinson and Quintas (2008) our research showed that sharing activities with managers/staff internally helps develop a stronger infrastructure, increases support capabilities, and confidence in identifying and pursuing international opportunities and projects a stronger face in the marketplace.

### **Conclusions**

The understanding of an international perspective by the key/seniors managers in SMEs, and the development of the organisation's resources, is crucial to the development of sustainable international business. Taking a structured approach to developing business is important for creating an effective and sustainable international business portfolio.

We have demonstrated the need for companies to broaden the capabilities of people across the business, especially relating to detailed knowledge of the potential markets, and how they operate. Access to marketing information is important, and SMEs benefit from using a wide range of sources. Those most comfortable with this aspect have identified effective approaches to meet their needs.

Although respondents recognised the challenges of resource and capability constraints within their own companies, only some were able to perceive how this situation could be addressed internally. In other companies these constraints were overcome by developing an external supporting infrastructure of partners, agents, and business associates.

Whilst this research has been conducted on a small number of UK SMEs there are opportunities to confirm and develop understanding of the issues, using a larger sample of companies. Additionally comparisons with equivalent organisations in other countries could develop a broader base of knowledge across EU countries.

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## EMPLOYMENT GENERATION BY SMALL PRODUCERS IN SPAIN

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**ABSTRACT.** Despite the relevance in terms of policy, we still know little in Spain about where and by whom jobs are created, and how that is affecting the size distribution of firms. The main innovation of this paper is to use a rich database that overcomes the problems encountered by other firm-level studies to shed some light on the employment generation of small firms in Spain. We find that small firms contribute to employment disproportionately across all sectors of the economy although the difference between their employment and job creation share is largest in the manufacturing sector. The job creators in that sector are both new and established firms whereas only new small firms outperform their larger counterparts in the service sector. The large annual job creation of the small firm size class is shifting the firm size distribution towards the very small production units, although not uniformly across industries of different technology intensity.

**Key words:** Firm-level data; employment creation and destruction; firm size distribution

**JEL Classification:** L11; L53; J21

### 1. Introduction

During the 1970s two lines of research, complementary but independent at the time, resulted in an increasing attention to the employment creation potential of small firms. The first line of research used cross-sectional data to compute the employment share of small producers to find overwhelming evidence of a change in the size distribution of production units. Large firms were reducing their share of total employment whereas small firms were increasing their importance. The most impressive and cited piece of evidence of the shift of activity towards the small firm segment is the drop in the share of the 500 largest American firms (Fortune 500) in employment: from 20% in 1970 to 8.5% in 1996. What was so remarkable about this finding was not that it meant the reversal of a long-time trend towards the

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concentration of production in large production units, but rather that the increasing importance of small firms was so robust over a wide sample of countries, sectors, size distributions and institutional frameworks.<sup>4</sup>

The second line of research was started by David Birch, who used the Dun & Bradstreet database to classify establishments according to their size and location in the base year, 1969, and in each succeeding wave of data (four in total) until 1976. This longitudinal database contained around 80% of all establishments, although the very small and/or young firms were under-represented due to the firms' registration criteria. Even so, Birch found and reported in 1979 that around 80% of net new jobs were created by firms with 100 employees or less [Birch (1979): *The job creation process*. The main results are also in Birch (1981)].

Up to that moment, labour economists had analysed published labour statistics for many years and consistently found that most new jobs were created by firms in the largest size classes. The analysis was done by counting the number of jobs in the same size class in two periods. The assumption behind this methodology was that interclass movement of firms was negligible. However, Birch's findings implied that the growth of small firms until they are classified as large firms were a major factor in determining aggregate net employment growth. Although Birch's methodology has been contested [see Davis, Haltiwanger and Schuh (1996)], it is by now a stylised fact that gross job creation and destruction in small production units is disproportionately large; more importantly, rates of net job change (job creation minus job destruction) are largest in small firms and smallest in large producers.

Both types of studies, the ones using macro or aggregate data and those using micro or firm-level information, are fully complementary. The increasing share of small firms in total employment could be the result of very different underlying phenomena such as, for example, a net employment decline of large firms or a surge of new small firms. Hence, the analysis of job creation and destruction at the firm level helps understanding what is causing the observed aggregate phenomenon. In turn, rates of net job creation fail by themselves to capture the importance of a size class. Small producers can create jobs at a larger rate than large producers but still make a rather small contribution to aggregate employment. In order to evaluate the real impact of small firms on employment, a study of the development of the size distribution of production units along time is required. Furthermore, such an analysis can help understanding what type of structural change might be causing the job creation differential between small and large firms.

The statistical observation that small firms create the majority of new jobs has had an enormous impact on public policy which has actively supported and promoted the creation, survival and expansion of small and medium enterprises (SMEs). The rationale behind these policies has been the belief that, above all

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<sup>4</sup> See for example Acs and Audretsch (1993), Loverman and Sengenberger (1991), Storey and Johnson (1987) and OECD (1985).

during times of economic slowdown, small firms are the employment locomotive of developed economies. The resulting observed shift of firm size distribution is also of great interest from a policy point of view for reasons other than the concern with job creation. Without getting into the debate of whether the increasing concentration of employment and production in small production units is desirable or not,<sup>5</sup> the fact that it is occurring in most developed countries means that the production and working conditions in SMEs must be a primary target and concern for policy-makers.<sup>6</sup>

Despite the relevance in terms of policy of these issues, we still know little in Spain about where and by whom jobs are created, and how that is affecting the size distribution of firms due to a lack of appropriate data. Dolado and Gómez (1995) and Dolado, García and Gómez (1997), for example, study gross job flows of large manufacturing existing firms collaborating with the “Central de Balances” of the Bank of Spain to find that the reallocation rate (gross job creation plus gross job destruction) is acyclical in Spain. The exclusion of very small firms and new entries might, however, have significantly affected their measurement of gross job flows. Analyses elsewhere have confirmed the importance for the job generation process of new entries in the market vis-à-vis established firms. Boeri and Cramer (1992), for example, find that the entry of establishments is the driving force of trend employment growth whereas employment fluctuations are mainly associated with continuing plants.

Furthermore, most of what we know about employment dynamics in Spain results from the analysis of the manufacturing sector to the exclusion of the much larger and dynamic service sector. Given that the manufacturing and the service sector differ substantially in terms of labour intensity, entry and exit rates, demand shocks or ability to compete externally or to hold inventories, it is not straightforward that what we know from the manufacturing sector could be extrapolated to the whole economy. Indeed, the few existing analyses including the service sector elsewhere confirm that both net and gross job flows are much larger in the service sector, with respect to the manufacturing, as it is the importance of net entry (entry

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<sup>5</sup> There is contradicting evidence in this respect. Carre and ThuriK (1998) for example find that, on average, the employment share of large firms in the 1990 (in 13 European countries) has a negative effect on output growth in subsequent years. The reason is that small firms play an important role as agents of change being the source of entrepreneurial and innovative activity, stimulating industry evolution and creating an important share of new jobs. Hence, countries lagging behind in the industrial restructuring process that has resulted in most developed countries in a shift of employment and production to small firms have suffered a cost in terms of economic growth. On the other hand, Pagano and Schivardi (2001) find that countries with a higher share of small firms lag behind in terms of productivity growth. The reason is that large firms might be able to exploit better the possibilities of a given innovation. Hence, according to them, large firms are important for dynamic efficiency and therefore for growth.

<sup>6</sup> Several institutional and policy factors can affect very differently the performance of small and large firms. For example, any fixed cost has a higher importance for smaller firms, meaning that the reduction in red tape is even more important in an economy with diminishing firm size. Likewise, the design of the collective bargaining procedure or the financial system should react to the reported size reduction.

and exit of firms) versus established firms in the job generation process.<sup>7</sup> The neglect of the service sector could be behind the low contribution of entry and exit to aggregate creation and destruction of jobs found by Ruano (2000).<sup>8</sup>

Using a constructed database that overcomes the problems encountered by other studies in Spain, this paper analyses both the contribution to aggregate employment growth of small firms and whether that contribution is affecting the size distribution of firms. The aim is to shed some light on the real impact of small firms on aggregate employment in Spain. One novelty of the paper is to go beyond the traditional manufacturing-service sector division and explore these issues in industries differing in their technology intensity within each of the main sectors. We find that the analysis at this level of disaggregation uncovers some sector-wide interesting differences.

The database used in this paper, with firm-level information from the provincial firm registries and the National Institute of Statistics (INE), offers at least four advantages with respect to other databases. First, there is little undersampling of small and young firms. Second, it includes all entries and exits. Third, the dataset covers the whole market economy (but the financial sector). Moreover, we have detailed sector information (4-digit) which allows us to go beyond the traditional manufacturing versus service distinction. Fourth and last characteristic of our dataset is the high-frequency of the data which allows us to compute year-to-year employment changes. This is important to be able to compute accurately the contribution of new firms to employment.<sup>9</sup>

The next section describes the dataset and explains some measurement issues. Section 3 shows employment creation rates by firm size and sector and presents some regularities of the Spanish job creation process. Section 4 looks at the employment growth of different cohorts of firms. Section 5 studies the development of the firm size distribution along time and across sectors, and, finally, section 6 concludes.

## 2. Data and measurement

### 2.1. Data

The Bank of Spain Firm Demography Database (BSFDD) contains information on sector of activity (at 4 digits), legal form and employment at firm-level for about 90,000-200,000 Spanish Limited Liability Societies and Corporations operating in all sectors of the market economy (but the financial one) each year between 1996 and 2003. Data come from two sources: the “Directorio Central de Empresas” (DIRCE)<sup>10</sup>,

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<sup>7</sup> See Boeri and Cramer (1992), Armington and Acs (1999), Audretsch, Klomp and Thurik (1998).

<sup>8</sup> Ruano (2000) uses the “Encuesta de Estrategias Empresariales”, a panel of manufacturing firms sponsored by the Spanish Ministry of Industry.

<sup>9</sup> Other studies are only able to compute employment changes from wave to wave of data, like the very influential Dunne, Roberts and Samuelson (1989). In that paper, new firms could be up to five years old when their employment contribution is computed. That information is interesting but different, in our opinion, from the contribution of entries to aggregate employment.

<sup>10</sup> Managed by the National Institute of Statistics (INE).

with information stemming from tax and social security records, and the “Central de Balances del Banco de España” (CB), which processes data from the provincial firm registries.

For a detailed account of the construction of the dataset, please refer to López-García and Puente (2007b). However, three important points of the construction process are worth stressing and repeating here. First of all although all companies (not self-employed) are obliged by law to deposit every year their financial accounts in the provincial firm registries, they often choose not to. Moreover, reporting employment data is not compulsory but voluntary. The result is that amongst the firms that present coherent financial statements and employment figures at least one year, many disappear from the registry to appear year/s later. That means that we are unable to deduct the date of entry and exit of the firms solely from the presence or absence of data in the registry, as it is done in other countries. For that reason we had to resort to a second information source, DIRCE, to get information on all entries and exits within the period of analysis.<sup>11</sup> Information for all the rest of active firms every year comes from the firm registries.

Secondly, the unit of production considered is the firm. We only have data on Limited Liability Companies and Corporations, not on self-employed workers.<sup>12</sup> There are no employment thresholds, that is, we also have firms with no employees (only when they are constituted as Limited Liabilities Companies or Corporations). As it was mentioned before, the number of firms, as well as their employment and sector of activity, that enter or exit the market every year is provided by DIRCE. DIRCE records an entry whenever a new fiscal identification number is given to a firm. An exit is recorded when a fiscal identification number disappears. That means that any restructuring of firms (merges and acquisitions) resulting in a new identification number will be recorded as an entry by DIRCE. Using information from large firms collaborating with the Bank of Spain we have estimated that around 5% of entries of firms with less than 20 employees and most of the entries recorded by DIRCE of firms with more than 100 employees could be the result of some kind of restructuring process or “false” entries. Please bear in mind all these caveats when interpreting the results presented in the paper.

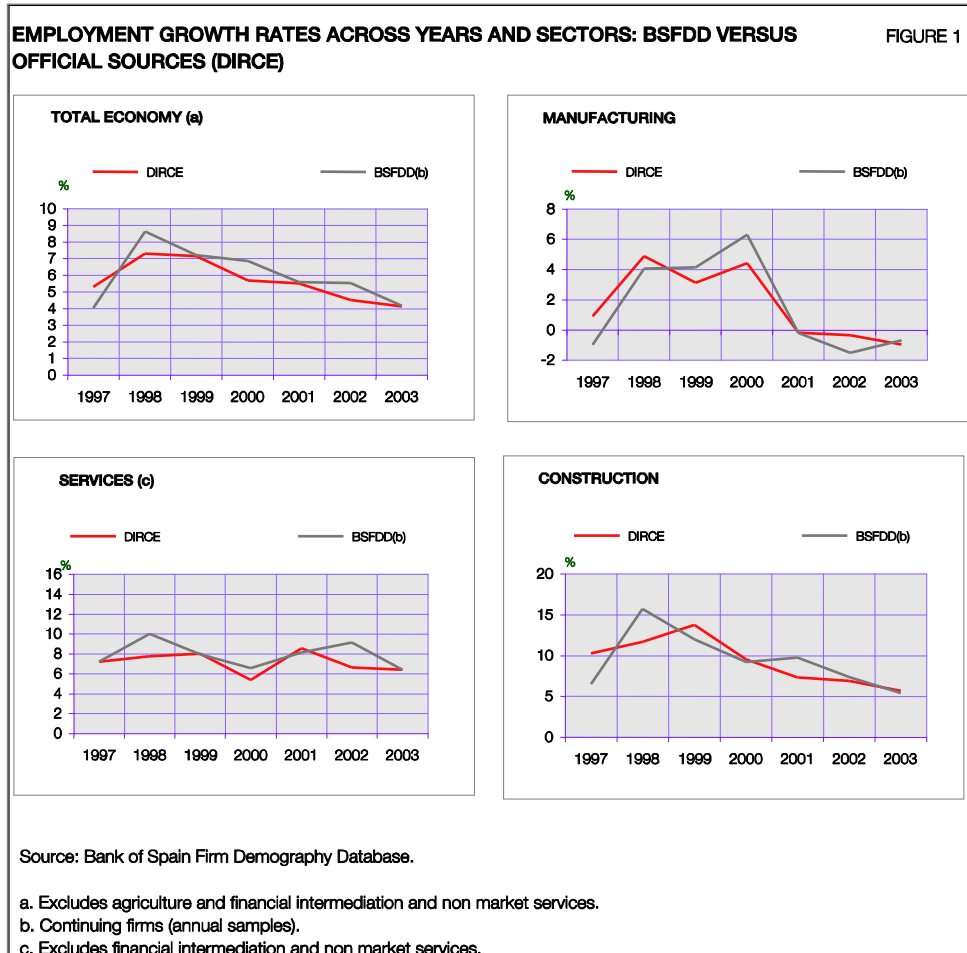
Finally, after cleaning the data we cannot assume that the remaining sample of firms is representative of the population. For that reason we computed annual sampling weights for each firm in the data set according to its 2-digit sector of activity, employment segment and status (continuing firm, entry or exit), using as the population benchmark the aggregate data from DIRCE. The resulting comparison of our database vis-à-vis DIRCE is shown in Figure 1.

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<sup>11</sup> DIRCE has provided as well the employment and the sector of activity at entry or exit.

<sup>12</sup> Which are about 60% of all Spanish firms.





**Figure 1.** Employment growth rates across years and sectors: BSFDD versus official sources (DIRCE)

## 2.2 Measurement issues

We follow closely the definitions in Dunne, Roberts and Samuelson (1989), DRS from now on. Imagine we analyse employment creation between  $t$  and  $t+1$ . Firms in this period can be one of three things: entries, exits or continuing firms: Continuing firms are all firms that were created in  $t$  or before and still continued to be active in  $t+1$ . Entries are firms that did not exist in  $t$  but were active for the first time in  $t+1$ . And lastly, exiting firms are those whose last year of activity is  $t$ , not appearing at all in  $t+1$ . Aggregate employment creation between  $t$  and  $t+1$  is computed as the sum of the employment created by each of these firms.

Let us define:

1.  $B_{t+1}$  = Employment in  $t+1$  in all plants that first appeared in period  $t+1$ .
2.  $C_t, C_{t+1}$  = Employment in period  $t$  and  $t+1$  respectively in all continuing plants.
3.  $D_t$  = Employment in  $t$  in all plants that were in operation in  $t$  but were not active in  $t+1$ .

Hence, the level of employment in each of the two periods,  $L_t$  and  $L_{t+1}$  can be measured as:

$$L_t = C_t + D_t \quad (1)$$

$$L_{t+1} = C_{t+1} + B_{t+1} \quad (2)$$

The net change in employment between the two periods is given by

$$\Delta L_{t+1} = (C_{t+1} - C_t) + B_{t+1} - D_t \quad (3)$$

According to (3), the net change in employment equals the net employment created by continuing firms plus the employment created by entries in the period minus employment lost due to the exit of firms. Recall that we have an unbalanced panel of firms and annual sample weights. These two facts together imply that, for continuing firms, we must first calculate their aggregate employment each year and then calculate the year-to-year variation. The reverse order, that is, to calculate each firms' employment growth and then aggregate over all continuing firm in the period is not feasible given the characteristics of our dataset.<sup>13</sup> The implication is that the net contribution of continuing firms cannot be disentangled into the gross contribution of expanding and contracting firms.

### 3. The contribution to job creation of small firms

In the mid-70s David Birch used for the first time a longitudinal dataset to track establishments along time. He concluded that very small establishments, defined as having less than 20 employees, created 6 out of every 10 new jobs [Birch (1979): *The job creation process*. The main results are also in Birch (1981)]. Birch's claim was challenging at the time: It implied that interclass movements (small firms growing until they are classified as large firms) were a major factor in determining aggregate employment growth. Although Birch's methodology has been contested [Davis, Haltiwanger and Schuh (1996), DHS from now on],<sup>14</sup> it is by now a stylised fact that

<sup>13</sup> This reverse order would require sample weights for firms operating two consecutive periods in order to recover the population equivalent of firm level employment growth rates. This in turn requires knowing the number of firms active two consecutive years in the population. Unfortunately, this piece of information is not published by DIRCE; we have only annual population figures.

<sup>14</sup> Birch classified establishments as small or large on the basis of their base-year size. The main criticism is what is called the "regression-to-the-mean bias" resulting from the fact that many firms' employment changes are transitory, or in other words, the observed gain or loss is reversed in the short-term. Hence at any point in time, the small business sector contains a disproportionate number of business that are less than their equilibrium size, and the large business sector has firms that are greater. Since business that are

gross job creation and destruction of small firms is disproportionately large, although their impact on aggregate employment is still in debate [see Segenberger, Loveman and Piore (1990) and Storey and Johnson (1987) for a summary of OECD studies]. This section investigates whether small producers in Spain are as important for aggregate job creation as it has been reported elsewhere.

How to assign a size class to a given firm has been the subject of a long debate in the literature. In its seminal work Birch (1979) used the size of the initial year of observation as defining variable. However DHS uncovered years later that such classification biased results in favour of small firms due to the so-called regression-to-the-mean problem (see footnote 11). In their paper they proposed instead to use the average size of the firm over the period of analysis. This choice avoided the regression-to-the-mean bias indeed but introduced a bias towards large firms given that small firms that grew fast over the period would be classified as medium or large firms and their growth would be assigned to that size class. Although both size classifications are imperfect, most empirical studies opt to use average size (or both initial and average size to contrast the results) to classify firms as large or small because it is expected to give a better indication of the intended scale of operations of the firm. Given this argument and the specific characteristics of our dataset we also choose to classify firms according to their period average size, although always keeping in mind that this choice might bias the results somehow in favour of medium or large firms.

Figure 2 below shows the percentage contribution of each size class to aggregate employment creation over the whole period of analysis, 1996-2003, as well as the share in total employment.<sup>15</sup>

The smallest size class, firms with less than 20 employees, was responsible for about 50% of all net job creation of the period but employed only a third of all workers. That is, the employment creation of small firms in Spain is much larger than their corresponding share in employment. Larger firms belonging to all the rest of size classes contributed proportionally less than their employment share to job creation.

The large contribution to net employment creation of small firms should not be taken to imply that all small firms create jobs at a uniform rate. On the contrary, there is piling evidence that relatively few firms are responsible for the majority of jobs created in the small firm sector. Storey and Johnson (1987), for example, show for the UK that 88% of firms that had less than 20 employees in 1982 still had less than 20 employees in 1984 and only 2% grew past that threshold. However, that 2% of firms managed to create over half a million jobs. Gallagher and Stewart (1986) do the same

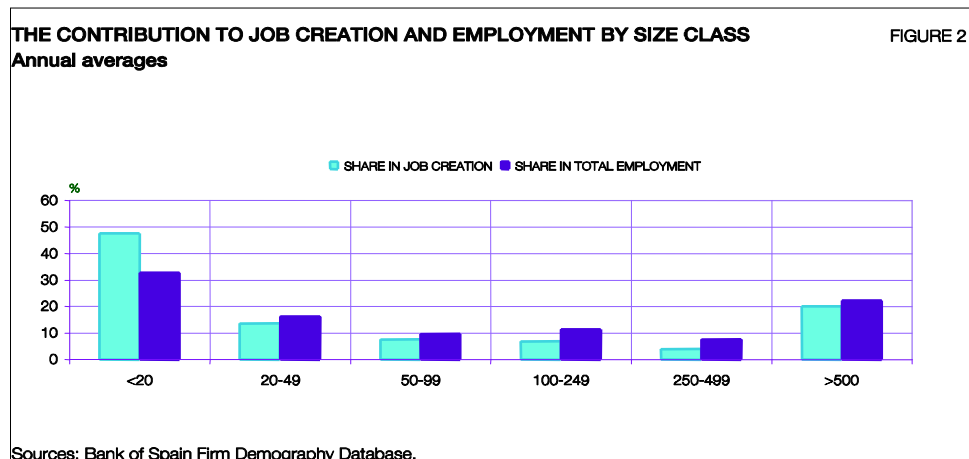
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too small expand over time and businesses that are too large contract over time, we might get the impression that small businesses are creating most of the jobs. What is really happening is that most of these jobs are created by large firms that are temporarily small.

<sup>15</sup> The size thresholds are those used by the OECD. According to the OECD very small firms are those with less than 20 employees, small firms those with less than 100 employees, medium-size firms are those employing between 100 and 500 and large firms are those with more than 500 employees. There is an alternative classification from the European Commission, which defines upper thresholds of 10, 50 and 250 workers for micro, small and medium enterprises, respectively.

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kind of exercise for the UK over a 10-year period to reach a similar conclusion: 2.3% of firms with less than 20 employees in 1971 that survived to 1981 had in 1981 more than 100 employees. The vast majority of survivors remained in the “very small category”. Teitz et al. (1981) show similar results for a sample of Californian firms whereas the Fifth Report of Enterprises of Europe (European Commission) and OECD (1985) confirm the fact that only a small percentage of small firms are truly contributing to overall job creation in other OECD countries. The analysis of the job creation winners, or high growth firms, in Spain is beyond the scope of this paper. However, we have deepened into the topic in a companion paper where the proportion, job creation potential and characteristics of the Spanish high growth firms are analysed. We find among other things that only about 8% of small firms (less than 20 employees) can be classified as high-growth. However, those few firms create between 70 and 100% of all jobs created by the small size class over the period.<sup>16</sup>



**Figure 2.** The contribution to job creation and employment by size class, 1996-2003

The evidence is contradictory, however, as to whether the few small winners come from the pool of young firms, who happen to start-up small and grow fast during their first years of operations, or from the pool of mature small firms, or from both. Birch himself concluded in his seminal paper that “not all small businesses are job creators. The job creators are the relatively few younger ones that start-up and expand rapidly in their youth, outgrowing the “small” designation in the process” [Birch (1981), page 8]. That is, Birch observed that it was not so much the “smallness” of firms what mattered in job creation but their age. This has been confirmed by other empirical studies. In the USA, for example,

<sup>16</sup> See López-García and Puente (2009), forthcoming.

Brown, Hamilton and Medoff (1990) observed that “existing small firms do not grow faster than large ones but by an accident of birth new firms happen to be born small. Since new businesses account for more than 100% of the net increase in employment, and new businesses rarely start out with 100 or more employees, it is almost inevitable that small firms will account for a disproportionate share of new employment” [Brown, Hamilton and Medoff (1990), page 24].<sup>17</sup> In Canada, Picot et al. (1994) found that employment growth between 1981 and 1984 of Canadian firms already existing in 1981 (at least 3 years-old) was of -14% in the group of very small firms, with 20 or less employees, and of -11% in the group of large firms. If the birth of new firms and their contribution to employment growth is added, the employment change among the very small firms is 12% and that among large ones -9%. These results are robust along time. Their conclusion is the same as in Brown et al. (1990): “The results for existing small and large firms are not that dissimilar. It is the fact that new firms tend to be small that makes the difference” [Picot, Baldwin and Dupuy (1994), page 18]. In this same line, Hull (1986) analysed a sample of about 500 small German manufacturers to conclude that “it is more the youth of small firms than their size which makes them grow” [Hull (1986), page 24].

Other studies, however, have found that the superior job generation performance of small firms vis-à-vis their larger counterparts is due both to age and size. Evans (1987) uses USA manufacturing data to estimate the relationship between employment growth, firm size and age. He finds that employment growth decreases with size given age, and with age given size, and this is robust to alternative assumptions and functional forms of the growth relationship. More recently, Gómez et al. (2004) compute gross job flows for 13 European countries in the 1990s using a sample of continuing firms. They find that job reallocation (the sum of job creation and destruction) and also net job creation decreases with the size of existing firms.

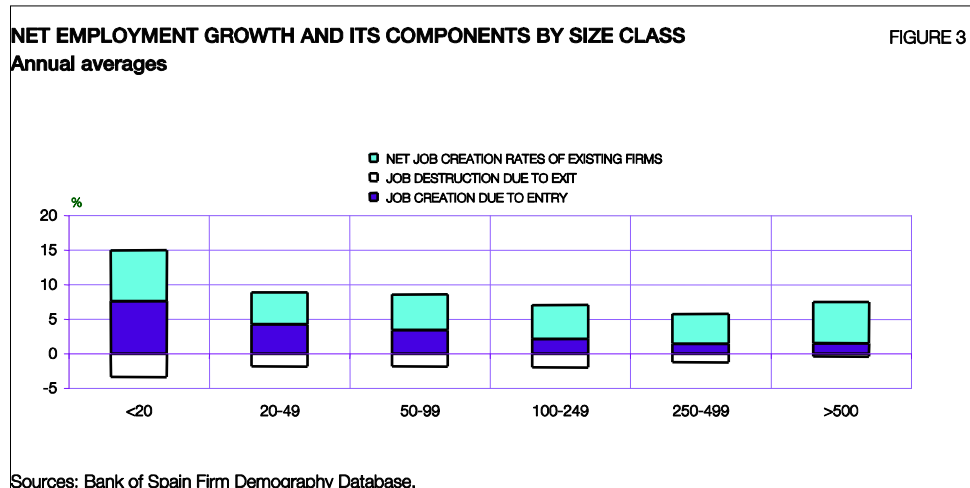
Who are the winners in Spain? We proceed to disentangle annual net employment growth of firms of different size into its three main components: employment creation of new firms, employment destroyed by exiting firms and net job gains of established firms. Figure 3 below shows average annual employment creation rates.<sup>18</sup> Table 1, on the other hand, completes the picture by showing total employment created, in absolute numbers, over the period 1996-2003 by each type of firm (new, exiting or incumbent) and size class.

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<sup>17</sup> Brown et al. (1990) analyse employment growth of manufacturing firms that existed 4 years before and observed that while small firms (defined in their study as firms with less than 500 employees) decreased employment at a rate of 10% large firms remained essentially unchanged.

<sup>18</sup> The employment growth rate of a given size class between  $t$  and  $t+1$  is calculated as the employment created between  $t$  and  $t+1$  by all firms in that size class divided by their total employment in  $t$ .

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**Figure 3.** Net employment growth and its components by size class

**Table 1:**

Total employment created over the period by firm type and size

TOTAL EMPLOYMENT CREATED OVER THE PERIOD BY FIRM TYPE AND SIZE TABLE 1

Thousands

	Total employment creation	Employment creation by entries	Employment destruction by exits	Net job gains by existing firms	Percentage created by firm rotation	Percentage created by existing firms
<20	1,749	1,136	-518	1,131	35.3	64.7
20-49	499	315	-145	329	34.1	65.9
50-99	279	149	-91	220	20.9	79.1
100-249	253	111	-114	256	-1.4	101.4
250-499	146	49	-48	145	0.8	99.2
>500	739	158	-48	628	15.0	85.0
Total	3,664	1,919	-964	2,710	26.1	73.9

Sources: Bank of Spain Firm Demography Database.

Figure 3 and Table 1 together show two important regularities of the Spanish job creation process. First, as Figure 3 shows, small firms create employment at an annual rate which is almost double that of the rest of the size classes. Indeed, average annual *net* employment growth of firms with less than 20 employees was 11.6% whereas that of firms with more than 20 employees was 6.3% (7% for firms with more than 500 employees). The result of the huge annual job creation of very small firms can be seen in Table 1: Over the whole period very small firms created 1,749,000 net jobs out of the total 3 and a half million created in Spain (48%, as shown in Figure 2).

Secondly, the important contribution to aggregate employment growth of the smallest size class is sustained by the outstanding employment performance of new firms *as well as* by the employment creation of small established firms. With respect to the former, whereas small new firms created more than 2 jobs for every job destroyed by small firm exits, new firms with more than 20 employees created 1.8 jobs for every job lost by large firm deaths. On the other hand, established firms with less than 20 employees created about twice as many jobs as established firms with more than 500 employees.<sup>19</sup> The last column of Table 1 shows that the relative contribution of existing firms to the job creation record of each size class increases with firm size. However, even within the small firm sector *two-thirds* of all jobs were created by established firms.

Both regularities above have been established for the aggregate economy. However, OECD (1985) and Picot et al. (1994) among others have proven that part of the disproportionate employment creation of small firms is reflecting an activity shift towards sectors with an above-average share of small firms, like services and construction. Furthermore, it has been reported elsewhere that the employment contribution of firm rotation (established firms) is much more (less) important in the service sector than in the manufacturing one [see Boeri and Cramer (1992), Armington and Acs (1999) and Audretsch et al. (1998)]. To check whether what we observe in the aggregate is robust across sectors, we proceed to compute the contribution to employment creation and share in total employment of small firms within each of the main economic sectors, manufacturing, construction and services. Table 2 presents as well the average contribution to annual employment growth of firm rotation and established firms within each of the sectors and size class. Not to overcrowd this table and the followings, we show results only for the small and large firm size class to stress size differences in job creation patterns. The OECD defines very small firms as those with less than 20 employees and large firms as those with more than 500 employees. Given that the average firm size in Spain is smaller than in other OECD countries<sup>20</sup> we have opted to show instead results for firms with less than 10 employees and for firms with more than 250 employees although results are quite robust to the particular size threshold used to define small firms.<sup>21</sup>

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<sup>19</sup> Even if we assume that all employment created by entries with more than 500 employees is the result of the restructuring of established large firms, very small established firms would be creating about 1.5 times as much employment as established firms with more than 500 employees over the whole period of analysis.

<sup>20</sup> Pagano and Schivardi (2001), for example, show that in the manufacturing sector the firm size in Spain is about 60% of the EU-15 average.

<sup>21</sup> The complete tables are available to request.

**Table 2:**

## Employment creation by size and sector

EMPLOYMENT CREATION RATES OF VERY SMALL AND LARGE FIRMS BY SECTOR							
Annual averages							
%							
	Percentage of total job creation in sector	Percentage of total employment in sector	Job creation rate	Entry contribution	Exit contribution	Continuing firms contribution	Net entry contribution
<b>&lt;10 EMPLOYEES</b>							
Manufacturing	36.2	11.7	7.5	6.3	-3.6	4.8	2.7
Construction	29.3	23.3	16.3	11.5	-4.7	9.5	6.8
Services (a)	35.7	24.5	13.8	8.5	-3.8	9.1	4.7
<b>&gt;250 EMPLOYEES</b>							
Manufacturing	5.9	28.5	0.7	1.0	-0.7	0.4	0.3
Construction	4.8	13.6	5.1	1.3	-0.4	4.3	0.8
Services (a)	36.0	31.1	10.7	1.6	-0.6	9.7	1.0

Sources: Bank of Spain Firm Demography Database.

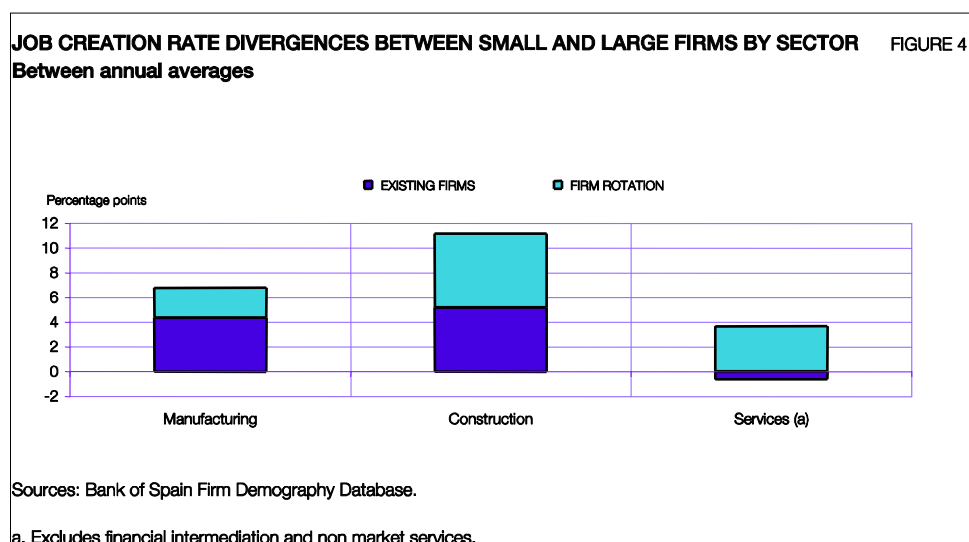
a. Excludes financial intermediation and non market services.

Table 2 shows that very small firms (less than 10 employees) create more net new jobs than their corresponding employment share across all sectors of the economy. The disproportion is largest in the manufacturing sector: Whereas firms with less than 10 employees employ barely 12% of all workers in the manufacturing sector, they create more than one-third of annual manufacturing employment. Very small firms in construction and services employ a larger share of the sector workers and create proportionally more jobs every year but differences are not as striking as in the manufacturing sector.

Very small firms in the service and construction sectors increase employment at an annual rate exceeding 13% over this period of economic boom, about twice the annual job creation rate of small manufacturing firms. Even so, small manufacturing firms create jobs at a rate ten times that of large manufacturing firms. The ratio is not even 1.5 in services. Table 2 shows that more than 2/3 of that large employment creation differential between small and large manufacturing firms is due to the performance of small industrial incumbents. The rest is explained by firm rotation. On the other hand, there are no differences in the employment creation rates of existing small and large firms in the service sector; the whole job creation difference between both firm size classes in services comes from the more dynamic small firm rotation. Figure 4 shows graphically these sector differences. The figure depicts the employment creation rate of small firms minus that of large firms and shows what part of the differential is due to the higher



employment creation rate of small established firms, versus their larger counterparts, and what part to differences in job creation due to firm rotation.<sup>22</sup>



**Figure 4.** Job creation rate divergences between small and large firms by sector

Figure 4 shows clearly that small firm rotation is indeed what explains the superior job creation performance of small firms in the service sector. In fact, very small existing firms perform worse, employment-wise, in the service sector than their very large counterparts. On the other hand, in the manufacturing sector firm rotation is, in average, *less* important than established firms to explain the job creation differential of small firms.

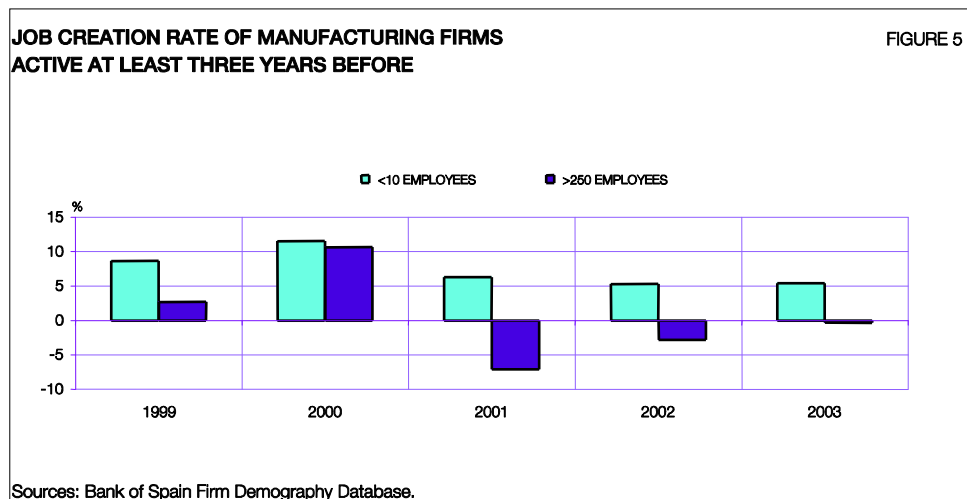
Table 2 and Figure 4 show that the very large employment creation record of small firms in Spain is not responding solely to a sector shift towards more small-firm intensive service sectors because it is a phenomenon taking place within each of the main economic sectors. On the other hand, not all small firms create employment. The winners differ across economic sectors. Whereas small firm rotation is what makes the difference in the service sector, the employment contribution of both new firms and small incumbents are important in the manufacturing one.

These regularities are robust across a number of dimensions. For example, in our dataset established firms are those with one year or more, that is, they can be very young firms. Age could be then the relevant factor to explain the relatively

<sup>22</sup> The total job creation rate of the small firm class is equal to the sum of the net job creation rate of small established firms plus the creation rate of small net entry. The same applies to total job creation rate of the large firms segment. It is true then that the difference in the total job creation rate between small and large firms must be equal to the sum of the differences in the job creation rate of small established firms, versus large established firms, and small net entry, versus large net entry.

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larger employment creation of small manufacturing existing firms. In order to correct for the fact that our established firms are younger than in other studies, we have recalculated employment creation rates and their components using only established firms that already existed 3 years before, that is, that are three years-old or more.<sup>23</sup> Existing manufacturing firms will be then similarly defined as those in Brown et al. (1990) and Picot et al. (1994), two of the studies that found that small established firms did not perform differently than their larger counterparts in the manufacturing sectors of the USA and Canada respectively. Figure 5 shows the annual net job creation rate of existing manufacturing firms by size, conditioned on existing 3 years before.



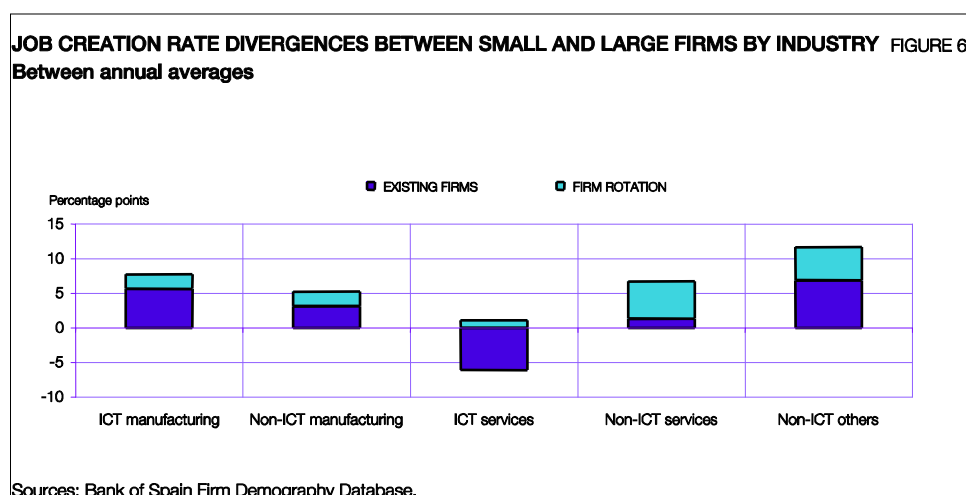
**Figure 5.** Annual job creation rate of manufacturing incumbents with 3 years or more

Even after excluding the very young established firms from our dataset, small established manufacturing firms have a much better employment performance than their larger counterparts, especially over the last part of the period of analysis when the dotcom bubble burst in the USA. Large existing firms had actually net job losses over that period whereas small existing firms in the manufacturing sector continued creating employment.

The distinction between the manufacturing and service sector is useful in many ways: To be able to compare with other similar studies, because they have traditionally corresponded to the traded and non-traded sectors of the economy, and because their technologies of production (capital intensity, minimum efficient scale of operations and

<sup>23</sup> We have included in the computation of annual employment growth only those incumbent firms that already existed three years before. That means that our first year of analysis is not 1996 but 1999. All established firms in the period 1998-1999, for example, were already operating in 1996.

so on) used to divert significantly. However, last decades have brought about important technological changes that have rendered the traditional manufacturing-service distinction less useful. First of all, the information and communications technologies (ICT) have made it possible to delocalise services such as calling centres or IT support. That means that, at least some part, of the service sector can now be traded and is subject to international competition. In Spain, the liberalisation of the telecommunication industries has contributed as well to that process. Secondly, the adoption of ICT in traditional service industries such as retail and wholesale trade during the 90s is dramatically changing the minimum efficient scale of operations and productivity growth patterns of a traditionally labour intensive sector<sup>24</sup>. The result of these tendencies is the coexistence within the manufacturing and service sector of industries of very different technology nature. For this reason it might be of interest to explore whether the regularities observed for each economic sector hold across industries of different technology intensity.<sup>25</sup> This is done in figure 6.



**Figure 6.** Job creation rate divergences between small and large firms by industry

It is striking to note that new and established small firms are creating employment at a larger rate than their larger counterparts across all manufacturing industries, independently on the technology level of the industry. On the other

<sup>24</sup> See van Ark et al. (2003) for an accounting of the impact of the diffusion of ICT in the service sector on European productivity growth vis-à-vis USA.

<sup>25</sup> Following van Ark et al. (2003) we have distinguished between ICT (producing and using) manufacturing and services industries on the one hand, and non-ICT manufacturing and services industries on the other. The 2 and 3-digit industries corresponding to each of these groups can be found in the Annex. Additionally there is a group labelled non-ICT others which gathers construction, mining and production and distribution of utilities.

hand, firm rotation is what makes the difference in non-ICT services. ICT service industries include ICT-producing industries such as telecommunication and computers and ICT-using services such as retail or business professional services. In both cases, although especially in telecommunications, very small established firm perform worse than very large established firms to the extent that total annual job creation rate of very small firms is lower than that of large firms.<sup>26</sup>

Why do small firms have a better employment performance than their larger counterparts? There are two possible answers. The first one is that the greater contribution of small firms is due to some sort of life cycle, whereby fast-growing firms enter small and expand over some years to converge to the average sector size. The second possibility is that the better performance of small firms reflects greater entrepreneurship and hence growth amongst the “small business sector” that typically does not make the transition to the “large business sector”, which is coherent with a reduction in the optimal firm size. The next section explores this question by analysing the growth pattern of different cohorts of firms entering in different sectors of the economy. Our findings suggest that at least part of the latter possibility, a particular small firm dynamism, is present in Spain.

#### **4. Employment growth of new firms in Spain**

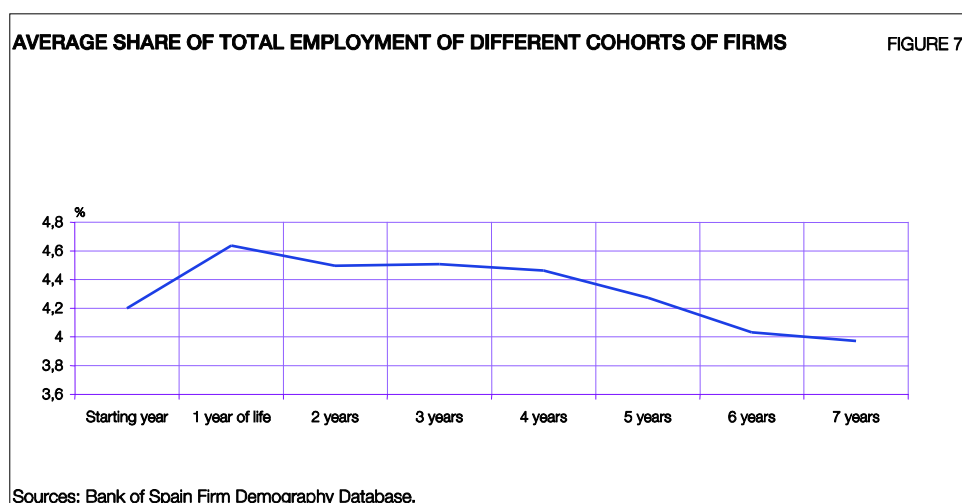
There is mixed evidence on how total employment of new cohorts of firms evolves as their age. The reason is that there are two forces at work: on the one hand, new firms enter small and then grow faster than incumbents in their same sector of activity to converge to the minimum efficient scale of the sector. On the other hand, failure rates of new or young firms are higher than those of established firms [see for example Bartelsman et al. (2003)]. DRS for the USA and Mata, Portugal and Guimaraes (1995) for Portugal find a net fall of employment of different cohort of firms in years subsequent to entry. That is, the destruction of employment due to the exit of young firms outweighed their higher employment growth. On the contrary, Baldwin (1995) found for Canada a net increase of cohorts’ total employment along time whereas Boeri and Cramer (1992) found that German new firms increased their employment during the first or second years of operations to decrease it afterwards.

Figure 7 below shows the average of 7 different cohorts’ share of total employment several years after birth. What we observe is that after an initial push the

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<sup>26</sup> This is the only case in which size thresholds to define small and large firms do make a difference in computed job creation rates. For example, if instead of depicting annual job creation rates of very small firms versus that of very large firms one computes differences between very small firms and the rest (grouping all firms with more than 10 employees), the results concerning ICT services change to a picture very similar to non-ICT service industries: Although small existing firms perform as their larger counterparts employment-wise, the huge employment creation due to small firm rotation brings the annual job creation rate of firms with less than 10 employees above that of larger firms. Hence it seems that very large established firms in the ICT service industries do indeed create employment at very large annual rates but that is not the case for medium-size established firms (very broadly defined), outperformed by very small ones.

cohorts' share of employment decreases as firms grow older. This is consistent with López-García and Puente (2007a) who find that Spanish new firms have an inverted U-shape hazard rate. This type of hazard might respond to the fact that new firms count with an initial stock of resources that help them going through the first years of activity. Only when these resources are exhausted learn new firms about their efficiency and, according to Jovanovic (1982), the least efficient decide to exit the market.



**Figure 7.** Cohort shares of total employment

The decline, after one or two years, in the employment share of new firms is due to the fact that the employment growth of surviving firms is not enough to compensate the employment destruction caused by the exit of young firms. This could be the result of either a very slow employment growth of start-ups or a very high exit rate of young firms or both. Table 3<sup>27</sup> below shows that firms' exit is not the "problem" in Spain: After 7 years of operation, only about 20% of firms of a given cohort have exited the market.<sup>28</sup> This is something happening with each of the cohorts under study. The relatively low exit rates of Spanish firms (please keep in mind that the BSFDD dataset comprises only Limited Liability Societies and Corporations, not self-employed workers) is something already observed in other studies like López-García and Puente (2007a), Núñez (2004) and Ruano (2000).

<sup>27</sup> The table shows the number of firms, as percentage of the initial stock of firms, belonging to each cohort which remains active every subsequent year after entering the market.

<sup>28</sup> This exit rate of firms is quite low. Bartelsman et al. (2003), for example, calculated that after 7 years about 60% of firms have exited the market in Finland, Germany and Canada. The percentage was about 50% in Portugal, Italy and the USA.

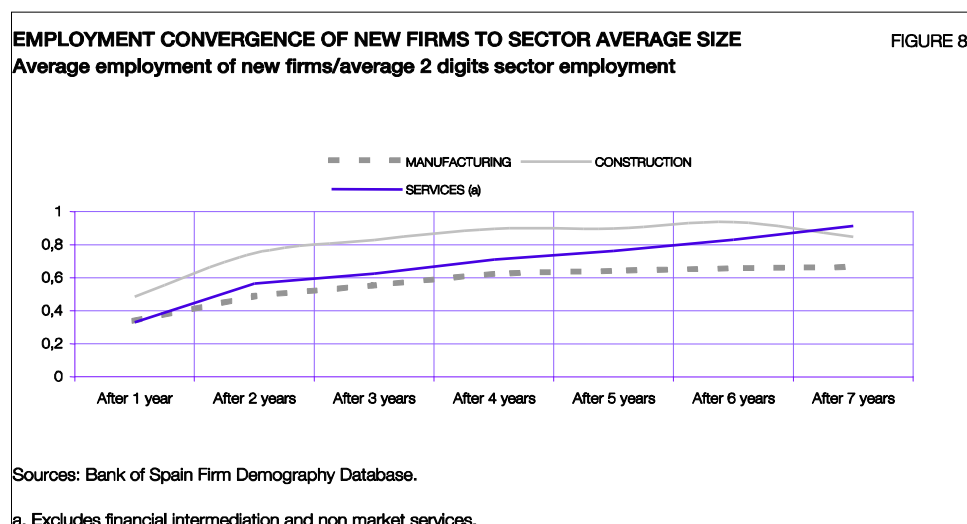
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**Table 3:**  
Firms belonging to different cohorts active every year after entry

FIRMS ACTIVE EVERY YEAR AFTER ENTRY								
TABLE 3								
%	1996	1997	1998	1999	2000	2001	2002	2003
cohort 1996	100	98	96	93	89	86	82	80
cohort 1997		100.0	97.8	95.3	91.5	87.5	84.0	81.2
cohort 1998			100.0	98.0	94.9	91.4	87.9	85.3
cohort 1999				100.0	97.6	94.4	90.9	87.9
cohort 2000					100.0	97.4	94.0	90.9
cohort 2001						100.0	97.4	94.7
cohort 2002							100.0	97.6

Sources: Bank of Spain Firm Demography Database.

If it is not the exit of young firms what explains the decline in new cohorts' share of employment, it must be that new firms grow quite slowly. Figure 8 below shows that this is the case, above all in the manufacturing sector. Given that employment growth of new firms depends crucially on their market of reference, Figure 8 shows the ratio of employment of each firm to its 2-digit sector of activity average size along time. We show those ratios for all firms belonging to each of the main economic sectors.

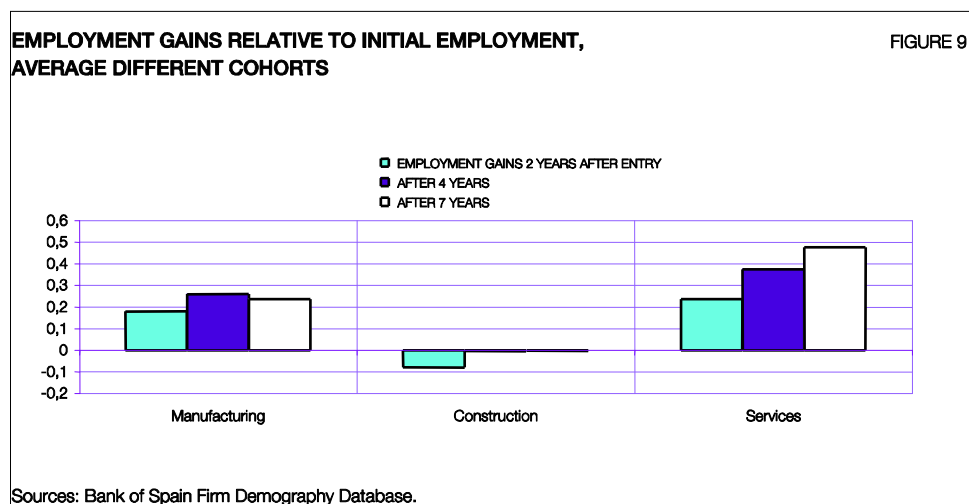


**Figure 8.** Employment convergence of new firms to the sector average size

First of all, entrants are about a third of the average size of the incumbents in their reference sector within the manufacturing and the service sector. Second, first year employment growth of firms is larger than that of subsequent years, which is

consistent with the growth path of new cohorts' employment share shown in Figure 7. Third, after 7 years of activity Spanish firms have not reached yet the average size of established firms in their market of reference. Growth of new cohorts of firms is relatively slower in the manufacturing sector vis-à-vis the service sector.

To get a feeling of whether Spanish new cohorts of firms grow slower than in other countries, Figure 9 shows the employment gains of surviving firms belonging to different cohorts at 2, 4 and 7 years after entry relative to its initial employment for the three main sectors of the market economy.



**Figure 9.** Employment gains of a new cohort of firm relative to initial employment

In average, new manufacturing firms increase by 20% their initial employment seven years after entry whereas new service firms manage to increase their employment by 50% in the same time period. According to Bartelsman et al. (2003) these computed employment gains of new cohorts are in line with other European countries and clearly below those in the USA, where new firms double their initial employment in 7 years. However, the analysis of Bartelsman et al. (2003) refers to firms entering the market in the late 1980s or early 1990s, a period of economic slowdown due to the dotcom crisis of early 1990s. On the other hand, the oldest cohort of firms in our analysis entered the market in 1996, when a long period of economic growth had just started. Given the different moments of the business cycle in which new firms entered the market in both analyses we would have expected higher relative employment gains in the Spanish case. The fact that it is not the case suggests that Spanish new firms grow slower than in other European countries.

What could explain the slow post-entry growth of Spanish firms? Bartelsman et al. (2003) give some hints. As it was mentioned before, in their paper they find that surviving European new firms enter larger but grow much slower than their American

counterparts. They conclude that the observed differences in post-entry behaviour seem to indicate a greater degree of experimentation amongst entering firms in the United States and obey to a given number of factors that could apply to the specific case of Spain. Among those the fact that certain administrative costs at entry are fixed and very large in Spain could be a disincentive for firm experimentation. Likewise, post entry adjustments in employment may be hindered by rigidities arising from labour regulations, like hiring and firing restrictions. Finally, higher risk aversion in project financing might result in lower financing possibilities for entrepreneurs with small or innovative projects, often characterised by limited cash flows and lack of collateral. Gómez, Messina and Vallanti (2004) also find that labour market institutions such as employment protection and unemployment benefits reduce job reallocation rates in a panel of European countries.

We do not explore further in this paper which or what group of these possible reasons can explain the slow growth of Spanish new firms, leaving it for further research.<sup>29</sup> What we do now is to focus on the fact that it is not so much “age”, or a life-cycle story, what explains the huge share of jobs created by small firms in Spain. Our results suggest rather that the “smallness” of the firms matters for their employment creation record. This small firms’ dynamism is coherent with the increasing importance that small firms are having in terms of aggregate employment and activity in other developed countries. The next section explores this issue by analysing the evolution of the firm size distribution over time and across sectors in Spain.

### **5. Is the size distribution of firms in Spain changing?**

As Baldwin and Picot (1995) suggest, the net employment creation rates for different size classes are only partial measures that describe the dynamic path of adjustment of producers in an industry. Imagine, for example, that a technology shock or a shift in demand prompts the entry of a wave of small new firms. In the short-run we will observe high small firms’ job creation rates. Whether this shock has an impact in the short-run on the firm size distribution depends on whether the new entries displace other existing small firms, in which case the total share in employment of small plants might not change, or whether they displace other large firms or no firms at all. In the latter two cases we might observe a temporary surge in small firms’ employment share. In the long-run the new firms might move along the learning curve and grow to produce at a larger scale. In this case after the initial surge, small firms’ employment share might decline and that of medium or large firms start increasing. If, on the other hand, the learning process was not so important and new technologies were exploited better at a smaller scale the explosive employment growth of small firms would be maintained along time. The

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<sup>29</sup> López-García and Puente will explore in a companion paper which are the factors that increase the probability that a firm grows fast.



consequence would be a shift in the size distribution towards the small size class along time. Hence, the analysis of the firm size distribution over time, and across sectors, is the second piece of information required to understand what might be causing the job creation differentials across firm size classes and whether those differentials are having any impact at all on aggregate employment.

There is piling evidence in other developed countries that there has been indeed a shift in the firm size distribution towards small production units since the 1970s after decades of dominance of the economies of scale in production. The most impressive and cited proof is the drop in the share of the 500 largest American firms (Fortune 500) in employment: from 20% in 1970 to 8.5% in 1996. Loveman and Sengenberger (1991), on the other hand, review the existent data for the six largest OECD countries<sup>30</sup>. They write: “The most important empirical result to emerge from the country reports is that there has been a recent increase in the share of total employment in small enterprises and establishments. While the magnitude of the increase varies considerably from country to country and across sectors, its significance rests primarily on the fact that it signifies the reversal of a substantial downward trend in the employment shares of small units that has prevail for many decades (...). What is remarkable about this finding is that (...) the pattern of decline and then growth is so robust over such a wide sample of countries, sectors, size distributions and institutions” (pages 6 and 7).

Moreover, this increasing importance of small production units in employment is robust independently on whether one uses firms or establishments as production units and it remains after controlling for the effect of the business cycle. Moreover, no more than 50% of the economy-wide employment shift to small production units can be explained by a sectoral recomposition of employment from goods to services production given that average enterprise and establishment size is smaller in the service sector [OECD (1985), Davis and Haltiwanger (1989), and Picot et al. (1994)]. Therefore, while composition effects are clearly important, there remains a significant within-sector shift to smaller units.

What is not so clear is why this shift has taken place. The most probable answer is that a complex set of factors, with different weight depending on the country or sector of reference, is to be blamed. Early works like Carlsson (1992) or Acs (1992) explain it as the result of three major changes in the world economy since the early 1970s. The first one is the intensified global competition, mainly from low-cost Eastern Europe and Asian countries, resulting from the development in transportation, information and communication technologies. Some firms have responded to this increase in competition shifting production out of high-cost locations to low-cost ones, which can explain the wave of corporate downsizing of the last two decades. Moreover, technological changes, such as those that have decreased computer costs, have reduced optimal firm size and the minimum scale of entry.

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<sup>30</sup> United States, Japan, France, Germany, United Kingdom and Italy.

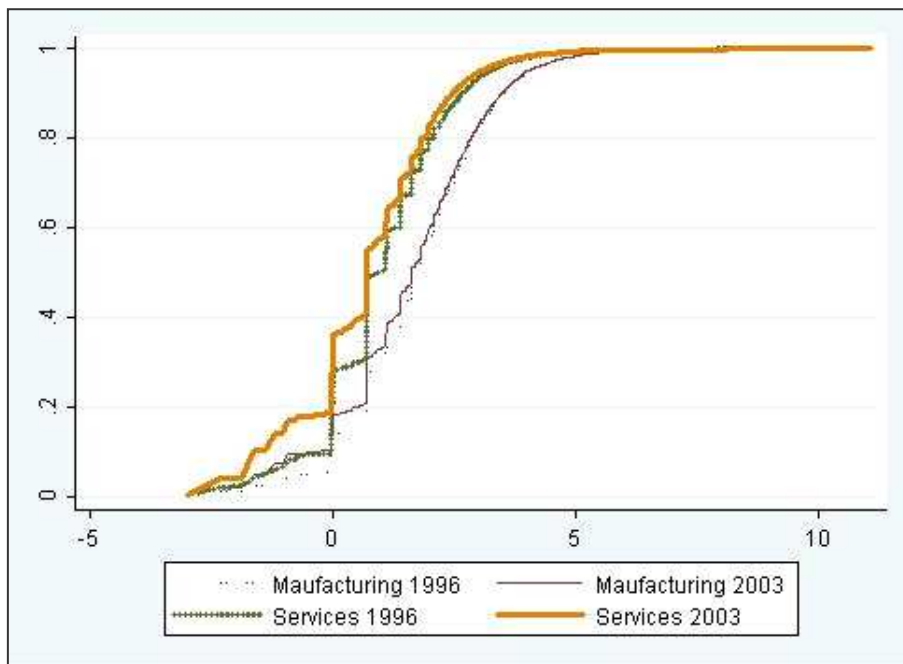
The second major change has been the increase in the degree of uncertainty, reflected in a significant growth slowdown in all industrial countries triggered by the oil price shocks of the 1970s and exacerbated by the volatility of exchange rates. Piore and Sable (1984) and Brock and Evans (1990) claim that the instability of markets has resulted in the demise of mass production and has promoted flexible production, a comparative advantage of small firms over their large counterparts. Other recent episodes of instability could have triggered similar effects. Flexible production has also been a crucial advantage of small firms given the third major economic change, namely, the intensified market fragmentation due to growing consumer demand for differentiated products.

More recently, Audretsch (1995), Audretsch and Thurik (2001) and Acs and Audretsch (2001) have suggested that increased globalization and the technological revolution have shifted the comparative advantage towards a knowledge-based economic activity. In such economy, the focus is on the individual as possessor of knowledge rather than on the firm. It is argued that asymmetric information and uncertainty about the future value of the knowledge result in its different valuation by firm and individual. This situation can lead to the departure of the individual from the incumbent firm in order to launch a new firm where his knowledge can be commercialized. That is, entrepreneurship is taking a new importance because it serves as a key mechanism by which knowledge created in one organization (such as a university or an incumbent firm) becomes commercialized in a new firm.

From a theoretical viewpoint, there is not a single theory of the firm that can embrace all these factors to explain the change in optimal firm size. Instead, diverse theories of firm size and firm size distribution, not necessarily exclusive, incorporate one or several of the explanations put forward to account for the observed shift in size distribution [You (1995)]. The traditional firm theory [Viner (1932)], for example, is a technological theory where scale economies determine firm size. According to this theory, the expansion of the service sector, generally characterised by lower scale economies, and the drop of the costs of computers, which have reduced the minimum efficient scale of operations, might be behind the increasing importance of small firms. Traditional industrial organization models [Williamson (1985), for example], on the other hand, focus on product and cost differentiation to explain firms' market shares. According to these theories, a change in the market environment favouring flexible production or increased demand for specialised and customised products or a reduction in the cost of factors of production for small firms - due to better access to finance or to the introduction of new financing possibilities for small firms like venture capital funds or business angel networks - could all result in an increasing share of small firms.

Transaction cost theories [Piore and Sabel (1984)], which explain cross - industry differences in the extent of vertical integration, are usually invoked to explain the success of Northern-Italy clusters or industrial districts of small firms to face increasing competition from emerging economies. Lastly, according to evolutionary models based on innovation and Schumpeterian competition [Acs and Audretsch (1987)] small firms have a comparative advantage in young industries where the main source of innovation is information outside the industry whereas large firms are dominant in routinised technological regimes. In this context small firms would be the main actors in the new knowledge economy.

Has the firm size distribution also changed in Spain? Our data is unfortunately only available from 1996, meaning that there are no years in the sample with aggregate employment destruction or even stagnation. For this expansionary period, the whole firm size distribution has indeed shifted to the smallest size classes both in the service and in the manufacturing sector. Figure 10 shows the cumulative distribution function of firm size<sup>31</sup> the first and last year of observation (1996 and 2003) in the manufacturing and the service sector.



**Figure 10.** The cumulative distribution function of firm size, 1996 and 2003

<sup>31</sup> Size is expressed as the log of the employment of the firm.

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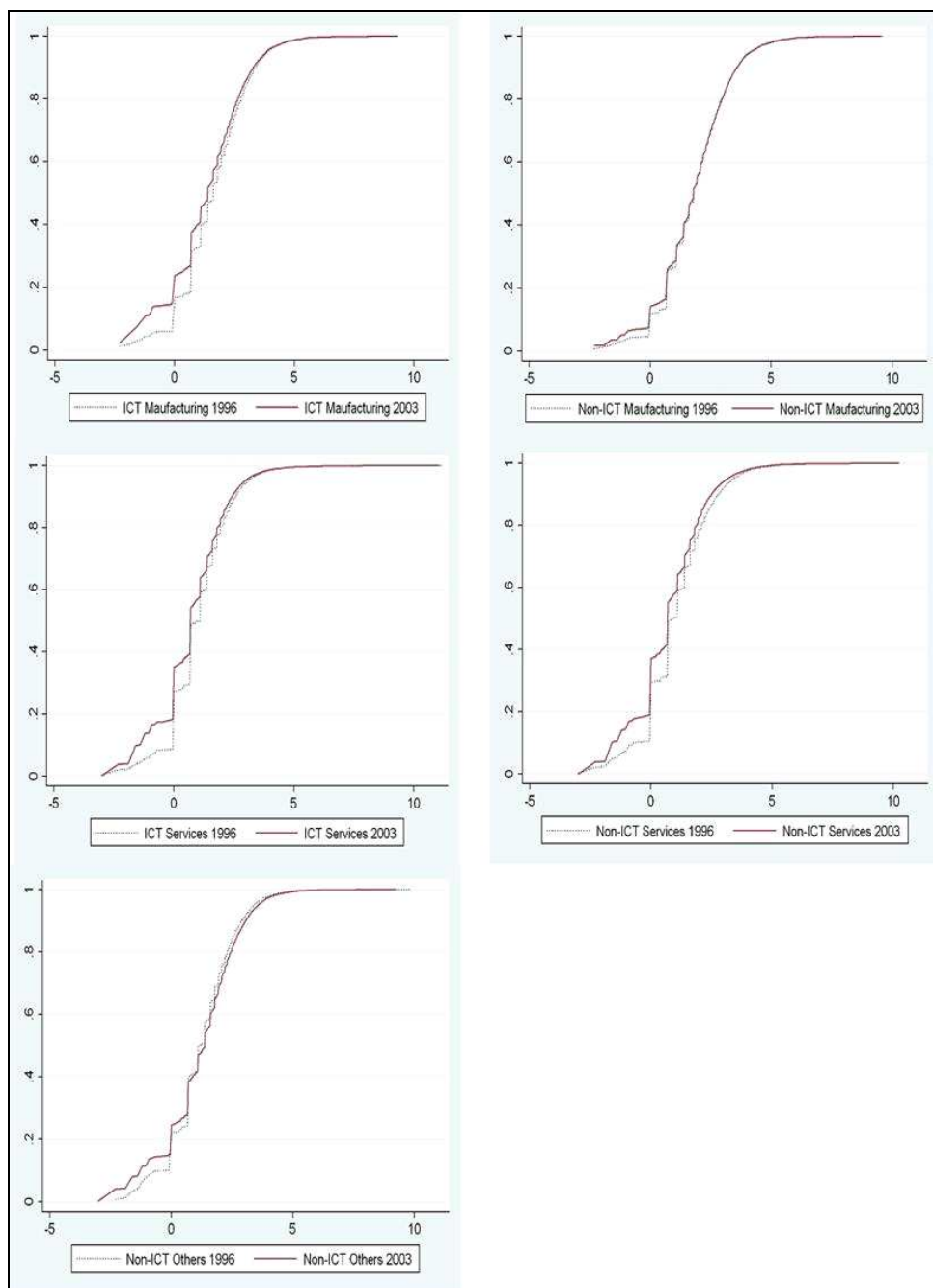


Figure 11. Firm size distribution across sectors with different technology intensity

To our knowledge there is no other analysis of the development of the firm size distribution in Spain. For that reason we do not know whether the shift towards the small size classes has just started or, like in other developed economies, it started before.

We saw in section 3 that the superior employment performance of small firms in the manufacturing sector was due to the job creation of small new and existing firms. In the service sector it was the employment created by small net entry what made the difference between small and large firms. In both sectors the large employment creation of very small firms has had an impact on the size distribution of firms. Although we only show the size distribution in the first and last year of analysis, the shift towards the smallest size classes has been continuous along time. The last piece of the puzzle required is the analysis of the changes in the firm size distribution across industries of different technology intensity.

Figure 11 shows that the firm size distribution has changed uniformly across all service industries, independently on whether they are technology intensive or not. On the other hand, only in technology intensive manufacturing industries has the activity and employment shifted towards smaller production units over time. The optimal firm size seems not to have changed in non-ICT manufacturing industries like textiles, food and beverages or the production of cars neither in other non-ICT industries like construction or the production and distribution of gas, electricity and water.

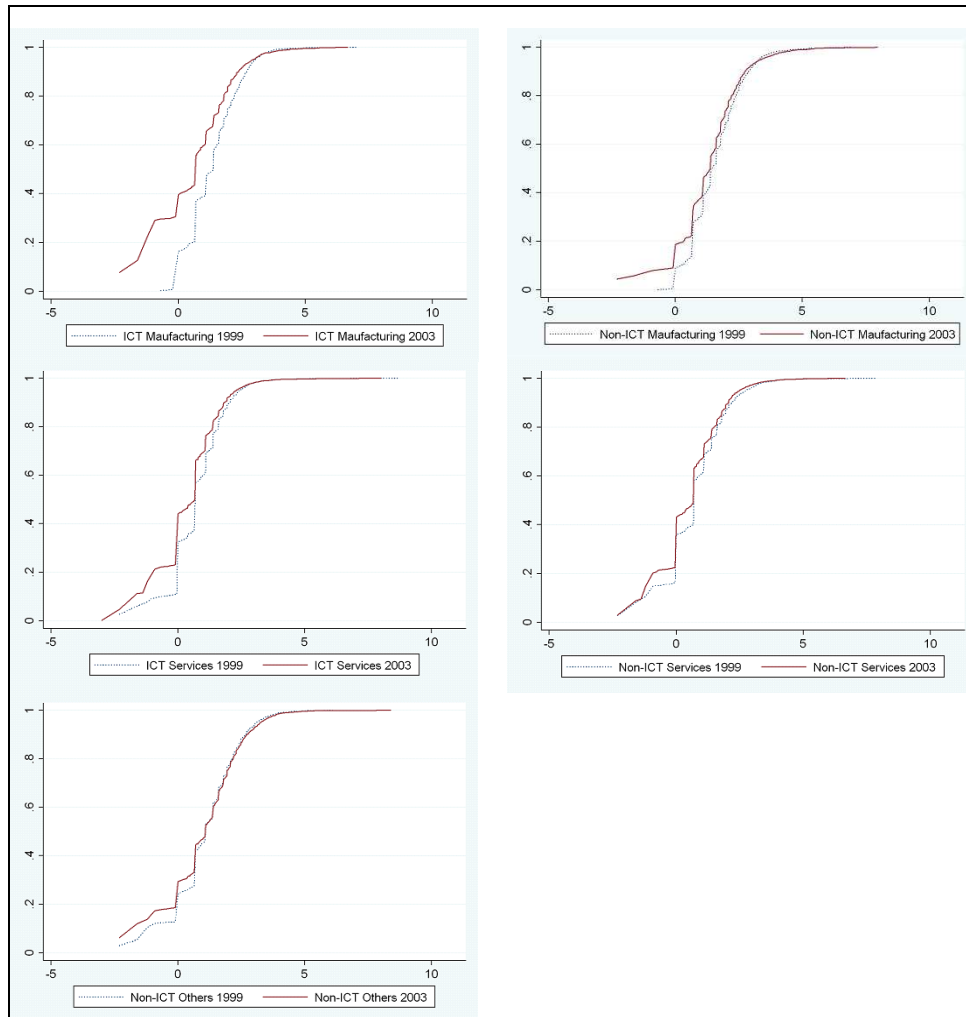
During this period of economic boom in Spain an enormous amount of small new firms entered the markets. This, possibly temporal, phenomenon could explain the observed displacement of the firm size distribution. For that reason we present below the cumulative distribution function of the size of firms with exactly three years of existence, the first and the last year of observation.<sup>32</sup> Comparing only this sub-sample of firms we have relative confidence that any displacement observed in the distribution function is reflecting an actual decrease in optimal firm size and not a circumstantial wave of new small firms.

The size distribution of firms in non-manufacturing does not change if we only look at a sub-sample of existing firms or at the whole population of firms. The observed difference between Figure 11 and 12 in the manufacturing sector could be due to the fact that the percentage of firms with exactly three years of activity (relatively young) is much lower every year in manufacturing than in services. In any case, Figure 12 shows that firms with three years of activity in 2003 are smaller than firms with three years of activity in 1999 across all sectors where a displacement of the size distribution was observed for the whole population of firms. Hence the shift in the size distribution is a robust fact to the age composition of the sample of firms compared.

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<sup>32</sup> The first year of observation for this exercise is 1999. The reason is that we only know the age of firms that entered between 1996 and 2003. Hence all firms that entered the market in 1996 have 3 years of activity in 1999.

EMPLOYMENT GENERATION BY SMALL PRODUCERS IN SPAIN



**Figure 12.** Size distribution of firms with three years of existence across sectors with different technology intensity

Now we have all the pieces of information we need to start understanding the importance of very small firms for the employment creation process in Spain. We begin with the manufacturing sector. We know that both new and mature small firms are creating employment at a much higher rate than their larger counterparts in the sector. This is so across all manufacturing industries. The result has been a shift in the size distribution of firms in technology intensive manufacturing industries, at least over the last seven years. It is then clear that firm optimal size has been reduced in those industries, and this is true for new firms entering the

market and for already existing firms. The fact that it is happening in technology intensive industries suggests that small entrepreneurial high technology firms are gaining comparative advantages due, for example, to new ways of financing their operations (risk capital), opening of new markets where knowledge and not scales of production are important, increasing subcontracting of the technology intensive lines of production by large firms etc.

On the other hand, it seems that the firm size distribution of less-ICT intensive manufacturing industries has not changed along time. This is only true for the car industry, with a very important employment weight in the sector, but not for the rest of non-ICT manufacturing industries, such as textiles and shoes, where the firm size distribution has indeed shifted to the smallest size classes. The reduction in the optimal size in those non-ICT industries has already been highlighted by some case studies of the shoe industry in the region of Valencia (with 2/3 of the Spanish production of shoes).<sup>33</sup> The reason is the increasing outsourcing (to other Spanish firms and abroad) of many activities to reduce fixed costs and be able to face increasing competition from other low-cost countries.<sup>34</sup>

The fact that small existing service firms perform worse in terms of employment, or not very differently, than their larger counterparts, above all in some ICT industries such as telecommunications and computers, suggests that the shift to the smallest size classes in all service industries responds to the huge push of new firms who are entering very small relative to the size of the firms that exit the market. Maybe this could be explained by the opening of new service markets (those related with business to business services, for example) and the possibility to outsource some of the service activities. It is not clear whether this push will continue in the future, once the markets have matured.

With respect to the other non-ICT industries —construction, mining and the production and distribution of water and electricity—, Figure 11 shows that the size distribution has not shifted but increased its dispersion (the 1996 distribution is steeper than the 2003). That means that the weight of the very small and large firms have increased over time, to the detriment of the medium-sized firms which is consistent with a very dynamic sector such as the construction one over the years of analysis.

## 6. Conclusion and some policy implications

Much has been written about the Spanish productive structure, dominated by very small firms. But we have not a clear idea as to whether that firm size distribution has changed along time and why. This paper uses a database that

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<sup>33</sup> See Martinez Mora, forthcoming in the *Revista de Estudios Regionales*.

<sup>34</sup> The competition has sharply increased due to the reduction of transport costs and trade barriers, especially since 1995, when import quotas started to be dismantled in the EU (the process culminated in 2005).

overcomes the problems encountered by other firm-level studies in Spain, to try to shed some light on the employment contribution of small firms in Spain.

We first study the contribution to annual employment growth of new firms, exits and continuing firms of different sizes over the period 1996 to 2003. We find that, as it has been reported elsewhere, Spanish small firms create a disproportionate share of new jobs. This is so across all economic sectors but the disproportion between the contribution to total job creation and actual share in employment is largest within the manufacturing sector, where firms with less than 20 employees are responsible for more than 60% of annual manufacturing net employment creation but employ solely about 20% of all workers in the sector. Moreover, new small firms are responsible for most of the job creation differential between small and large production units in the service sector while both new and existing small firms create jobs at a much higher rate than their larger counterparts in the manufacturing sector. These regularities are also true across industries of different technology intensity within each of the main economic sectors.

We proceed then to study whether the observed better performance of small firms is just reflecting the fact that new firms are normally small and, as reported elsewhere, create jobs at a higher rate than incumbent firms. Age and not size could also be behind the job creation record of the small existing manufacturing firms given that, in this study, continuing firms can be quite young. However, the analysis of the convergence patterns to the average sector size of different cohorts of firms across sectors show that new firms grow as slowly as in other European countries, if not more, compared with the USA, especially in the manufacturing sector. Why is this so? Bartelsman et al. (2003) offer some tentative explanations like the existence of higher entry and adjustment costs in Europe as well as the higher risk-aversion of the bank-based European financial system. In any case, our results suggest that not only the age but also the "smallness" of firms matter for their employment creation record. The small firms' dynamism is coherent with the increasing importance that small firms are having in terms of aggregate employment and activity in other developed countries.

To explore further this issue as well as to understand whether the large job creation record of small firms is a transitory phenomenon or a permanent one and to evaluate its real impact on the employment generation process in Spain we proceed to study whether the firm size distribution has changed over the period of analysis. We find that it has indeed been the case although not uniformly across all sectors of the economy. The optimal firm size in ICT manufacturing industries seems to be decreasing, and this is true for new and mature firms, which suggests that small technology manufacturing firms are gaining comparative advantages over larger ones and that it is a development which is here to stay. Non - ICT manufacturing industries such as textile and shoes are also reducing their optimal size due to increasing outsourcing of lines of production to face competition from low-cost countries. In all service sectors, independently on their technology level,



the firm size distribution is also shifting to the smallest sizes. However that is due to the employment impact of new firms, entering very small in comparison to the size of the firms that exit. The firm size distribution of the construction sector has not shifted but become more disperse, with very small and large firms gaining employment share to the detriment of medium-size firm classes.

The fact that employment and activity is concentrating more and more in the very small firm sector might have important policy implications, given the particular problems small firms face. It has been proven, for example, that administrative burdens inflict a higher relative cost to small firms than to their larger counterparts<sup>35</sup>. In this regard, the fact that average firm size is getting yet smaller should be a call for a careful revision of the administrative regulation imposed on the small firm sector. As there would be the need to improve the policy instruments aimed at facilitating the access to finance for small firms, given the fact that they face higher difficulties to finance their operations, above all if they are new - with no track record or collateral - and/or innovative.<sup>36</sup> Other institutions or regulations, including those of the labour market, with a disproportionate effect on small firms would accordingly need to be revised.

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<sup>35</sup> See for example Nijsen and Vellinga (2002).

<sup>36</sup> Klapper et al. (2004) show using an international database that countries that introduce regulation aimed at enlarging the financial instruments available to firms enjoy higher firm entry rates, especially in R&D intensive industries.

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**THE SUPPORT OF TECHNOLOGY DEVELOPMENT IN  
IMPERFECT COMPETITION  
(SELECTED ASPECTS FOCUSED ON SMES  
IN THE CZECH REPUBLIC)**

**IVANA KRAFTOVÁ<sup>1</sup>, JIŘÍ KRAFT<sup>2</sup>**

**ABSTRACT.** The phenomenon of globalization affects a lot the reality of imperfect competition and it influences its forms. The imperfect competition includes two extreme forms and each from them is connected with specific problems. An enterprise generally disposes of reasonable resources for an implementation of technology development in the monopoly position but practically it does not have any motivation to implement it. The monopolistic competition, represented by SMEs, is motivated to implement technology development. However, financial resources are usually missing. In this situation, the role of state or “supra-state” (the EU) support can be considered as irreplaceable.

The support of SMEs in the Czech Republic reflects the EU-framework. In the period 2007-2013, the most of the finances from public resources, affecting SME competitiveness, flow into the Czech Republic from the EU structural funds, namely through relevant published operational programmes.

The platform of “technology centres” was made in the previous period and it was allocated in separate regions. Their significant role is the support of technology development and innovation focused on SMEs. Research results show that these technology centres differentiate by founder, as well as by their capital power and operational performance. As a result, it presents a different rate of the fulfillment of their main role: to support innovation trends of SMEs effectively. Simultaneously, the research presents – in the framework of the analysed problem – a connection between the support of technology development and indicators of wealth in regional context.

**Key words:** Technology development, imperfect competition, SMEs, technology centres

**JEL classification:** D43; M13; O32; R11

## **1. Introduction**

The world economy changes by the influence of technology development. However, there are not changes only in the way of production and changes of final products. In consequence of technical and technology progress, there are changes

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in production, distribution and sales processes. There might be even changes in market structures, sector and branch structures of economies.

*“Markets have become much more opened and competition has intensified significantly over recent years. The value chain is increasingly disaggregated with activities distributed to locations that make the most economic or strategic sense. Advances in technology enable communication and management to take place on a global scale, and underpin new business models and innovative products, services and solutions.”* [1]

The perception of technology development (as the crucial factor of economic growth) also brings its institutional support in the Czech Republic (by the way, like in all EU member states) on three levels: EU, the Czech Republic and separate regions NUTS II, respectively NUTS III.

In June 2001, the European Commission issued the European Union Strategy for Sustainable Development, which became a base for Strategy for Building of Knowledge Society [2]. Conclusions from the evaluation of the first cycle achievement of Lisbon Strategy in 2005-2007 state – among others – weaknesses in the environment enabling entrepreneurial growths and strengthening innovation, research and development. The main motto of the second cycle of Lisbon Strategy for years 2008-2010 is growth and employability [3]. An important element is the 7<sup>th</sup> Framework for years 2007-2013, which disposes with 70 milliards EUR, and whose projects are focused on selected research activities, support of innovation activities of small and medium enterprises (*in the next text only “SMEs”*), cooperative enterprises and research institutions.

The Czech Republic has created likewise many strategic documents, which concern the already mentioned problems; for example [4]:

- The National Research and Development Policy of the Czech Republic for years 2004-2008, (nowadays the version for years 2009-2015 is available);
- The National Innovation Policy of the Czech Republic for years 2005-2010, (innovations are understood as the main outcomes of research and development);
- The Framework Programme for Support of Technology Centres and Centres of Strategic Services published in 2004.

In the shortened programming period 2004-2006, the development of innovation business and technology was supported in the Czech Republic in the framework of the operational programme “Industry and Business”, and partially also in the framework of the operational programme “Human Resources Development”. The most important programme was “Prosperity” which was focused on the support and development of the infrastructure of industry research and development, namely enterprise incubators, scientific and technical parks, and centres of technology transfer.

The National Strategic Reference Framework for planning period 2007-2013 announced as one of priorities the capacity support of research, development

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and innovation, which is connected with the following two operational programmes: “Research and Development for Innovations” and “Business and Innovations”. They are complemented with the operational programme “Education for Competitiveness”.

The amount of paid funds for operational programmes in the period 2004-2006 gives evidence of the extent of this support. Financial resources are ready to be used for the current planning period from EU funds,

Table 1 presents both absolute amounts, and their relation to incomes of state budget and to GDP of the Czech Republic.

**Table 1:**  
Support of operational programmes from EU funds in the Czech Republic  
(milliards of Czech Crowns, current prices)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Incomes of state budget	769	866	923	1 026	.	.	.	.	.	.
GDP	2 815	2 984	3 216	3 530	3 706	.	.	.	.	.
ERDF, ESF, CF	18	21	27	83	87	91	95	99	104	108
% of state budget incomes	2,34	2,42	2,93	8,09	.	.	.	.	.	.
% of GDP	0,64	0,70	0,84	2,35	2,35	.	.	.	.	.
Source: own elaboration according to [15]; [16] and [17]										
Notice 1: The exchange rate 25 CZK/EUR is used for easy comparison.										
Notice 2: The total amount for years 2007-2013 is presented in planned distribution, although the CR is delayed in finance utilization from EU funds markedly.										

Analogical accent, which is given to innovation processes in terms of institutional support, is put – and again both on the EU level, and the Czech level – to SMEs, because they are considered to be an important stabilizer of economy in aspect of their flexibility. [5]

Therefore, the EU pays significant attention to them. Apparently, one of the last issued documents is „Think Small First“, i.e. „Small Business Act for Europe“ from June 2008. It is stated there that in general SMEs in the EU still have lower productivity and grow more slowly than their counterparts in the USA. In the USA, surviving firms increase on average their employment by 60 % by their seventh year, while employment gains among surviving firms in Europe are in the order of 10% to 20%. [6] Moreover, the need to focus on enterprises outcomes in terms of their financial management should be emphasized. [7] SMEs still wrestle with market failure, which disturbs conditions, in which SMEs operate, and

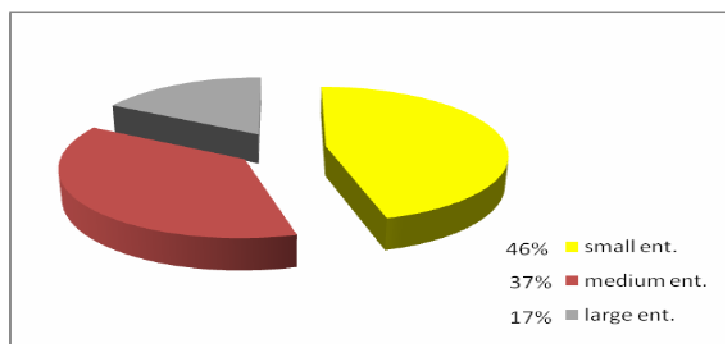
compete to other subjects in scopes such as finance (namely risk capital), research, innovation and living environment. Therefore, one of the 10 principles for policy preparation and implementation on the EU level, as well as on the level of particular countries in the mentioned document is: „Promote the upgrading skills in SMEs and all forms of innovation“. [6] The member states are invited to „promote the development of SMEs’ competences in the research and innovation field by means of, e.g. simplified access to public research infrastructure, use of research and development services, recruitment of skilled employees and training, as allowed in the new Community Framework for state aid for research, development and innovation.“ [6]

The law on SMEs support from 2002, the Conception of SMEs development launched in 2005-2006, and the following Conception of SMEs development for period 2007-2013 with the guarantee of Ministry of Industry and Trade, as well as the financial support from public resources in the previous planning period, give evidence how attention was paid to this question in the Czech Republic in the past. The following two tables and graphs show counts and rates of using the support by SMEs in comparison with large enterprises.

**Table 2:**  
Financial support of innovation activities from public resources in 2004–2006

2 a) Number of enterprises according to their size

	Enterprises received financial support from		
	regional authorities	central government	EU (incl. 5th or 6th EU Framework Programme )
Small enterprises (10-49 empl.)	174	422	437
Medium enterprises (50-249 empl.)	91	363	393
Large enterprises (above 250 empl.)	29	210	146

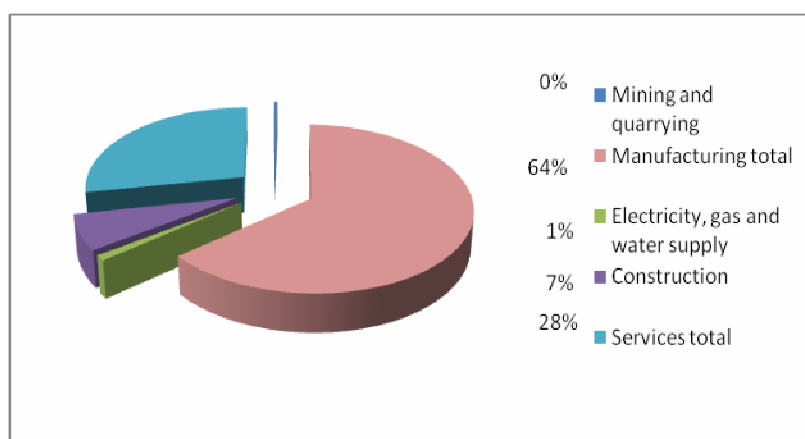


**Graph 1.** Relation among supported types of enterprises

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2 b) Number of enterprises according to industry branches

	Enterprises received financial support from		
	regional authorities	central government	EU (incl. 5th or 6th EU Framework Programme)
Mining and quarrying	2	3	3
Manufacturing total	166	634	643
Electricity, gas and water supply	4	10	9
Construction	45	52	60
Services total	78	297	260

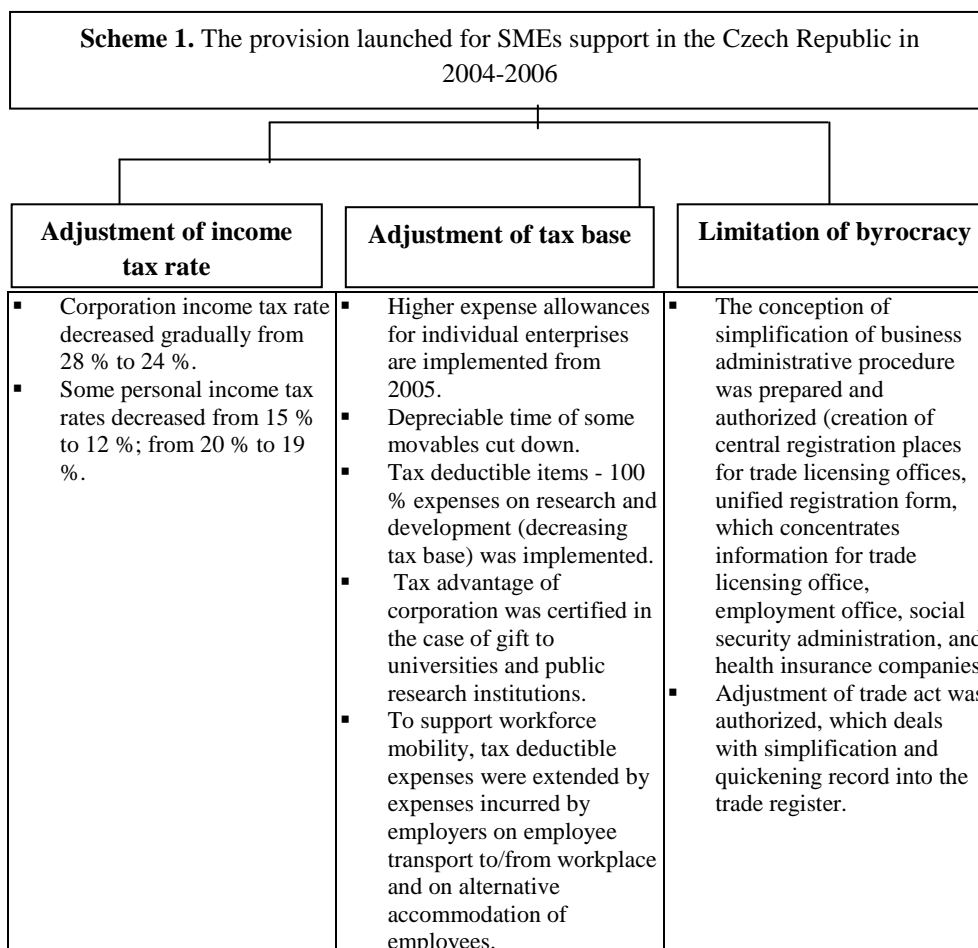


**Graph 2.** Relation among supported enterprises according to industry branch

Source of tables 2a), 2b) and graphs 1 and 2: own elaboration on the base of CZSO data [15]

Particular provisions are mentioned in the Conception of SMEs support, which were launched for SMEs support in the past – see scheme 1:



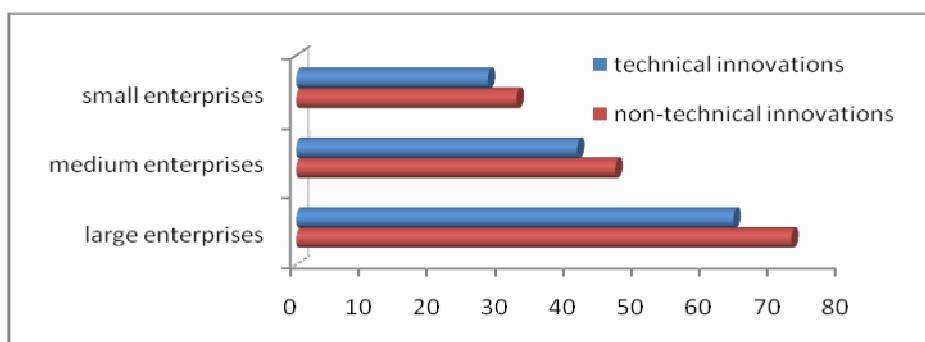


Source: own elaboration according to [8]

A significant shift just in accent on the research, innovation, technology development as important factors of competitiveness increase of SMEs is seen at the comparison of the conceptions of SMEs support for period 2004-2006 and for period 2007-2013.

The study, which analyses the situation in the capital city Prague, touches the rate of innovation enterprise environment too. [9] In aspect of industry branches, dominant innovative Prague enterprises (excl. research and development branch) are IT industry, chemistry industry, production of transport means and metal products. Graph 3 records the rate of technical and non-technical innovations in Prague enterprises according to their size.

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**Graph 3.** Implementation of innovations depending on enterprises size in Prague in 2003-2005 (%)

Source: own elaboration on the base [9]

It is evident that the innovation rate decreases with decreasing enterprises size, and it is possible to say that the majority of non-technical innovations (organization and marketing) over technical (innovations of products and procedures) are roughly the same. Beside this, it is very interesting to see different attention on innovations depending on size of enterprises. Table 3 presents the survey of this aspect.

**Table 3:**  
Kinds of innovation activities according to size of Prague enterprises in 2003-2005 (%)

Enterprises	Extension of assortment of products or services	Quality improvement of products or services	Improvement of production flexibility	Gain of new market	Extension of market	Decrease of energy and material intensity of use	Organization innovations	Marketing innovations (methods of sale and distribution)
small	36	37	.	.	18	18	20	12
medium	44	37	.	.	28	28	37	14
large	49	44	44	36	.	.	60	30

Source: own elaboration on the base [9]

The Framework Programme for Support of Technology Centres and Centres of Strategic Services [10] is an obligatory document in the Czech

Republic. Its purpose is to support economic development in the Czech Republic by the support of investment projects focused on advanced technology and activities with high value added and great export potential. It should increase international competitiveness of the Czech Republic in the scope of innovations, IT and strategic services, as well as support creation of new job opportunities, namely in less developed Czech regions.

The Ireland case, referred to as a European tiger due to its abnormal dynamic growth at the beginning of this century, proves the justness of choice to support advanced technology and activities with high value added. Ireland achieved the second highest value of GDP per capita (after Luxembourg) in 2008 while it took even the 10<sup>th</sup> place in 1999. [14] J. Harford speaks about six elements, on which enterprises hankering after success must focus: markets, customers, intensive capital, intensive knowledge, intensive skills, and strong participative culture. He just mentions to the factor of “intensive knowledge”: *„Innovation, including non-technological innovation, across all elements of the business functions is essentials in order to gain a competitive edge through differentiation. Even more mature manufacturing areas can benefit from the application of new knowledge to continuous improvement and the use of technologies.”* [1]

## 2. Material and methods

The situation described above points that a considerable institutional support is given to problem of technology development (innovations are considered to be the main expression), as well as to stabilization element of economy in the form of SMEs in the Czech Republic in connection with the EU policy. It is comprehensible, if the technology development is considered as immanent part – *condicio sine qua non* – of competitiveness increasing and achievement of sustainable growth.

The aim of this article is to show three fundamental connections:

- a) The institutional support of technology development in aspect of market structures, namely in the reality of globalized world, in context with basic postulates of economic theory.
- b) Financial health, respectively effectiveness of technology centres as one of institutionally strongly supported elements in the Czech Republic in aspect of their function fulfillment, i.e. support innovation trends of SMEs.
- c) Regional distribution of technology centres in the Czech Republic and focus attention on question, if its current state can be evaluated as synergy positively affecting element on creation of regional wealth.

There are used following methods for fulfillment of the mentioned aims:

- a) graphic-analytic method;
- b) on the base of elaboration and analysis of received data, comparison of the three selected technology centres which is launched in the form of a case

study, regarding submissions, this comparison goes out from vertical (structure) financial analysis, which is completed with cause analysis of top indicator of effectiveness;

- c) regional aspect of the problem is evaluated with space analysis method combined with classification and comparison method of quantitative development of technology centres and development of regional GDP, respectively rate of particular regions (NUTS III) on total Czech GDP in the analysed period.

### **3. Results and discussions**

#### **3.1 The theoretic assessment of relation of technology development and market structure**

The development of technical-economic level of enterprises leads to monopolization, but spreading territory of enterprises operation, namely in connection with globalization, has just the opposite effect, i.e. it leads to demonopolization. In the next consideration, it is assumed that demonopolization does not go through a fragmentation of monopoly, thereby decrease of current technical-economic level. On the contrary, it is supposed that it will reach demand increasing through expanded market by globalization at unchanged technical-economic level of enterprises, i.e. at adequate costs level.

Ask the question, if the support of SMEs is reasonable also from theoretical point of view. It is no worth to glorify perfect competition, it is necessary to make up the reality of imperfect competition.

However, imperfect competition does not need necessarily the form of monopoly; it can express as oligopoly or as monopolistic competition based on SMEs functioning. Which forms of imperfect competition will be reality depends on technical-economic level of enterprises, but also on area of territory, where the given firm can offer its products, respectively on number of people that are its customers.

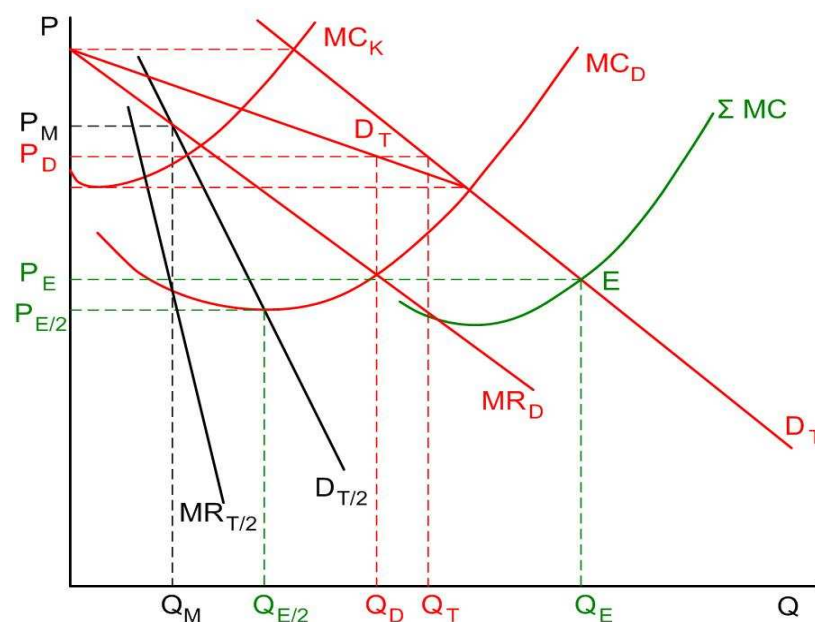
The monopoly, a typical representative of imperfect competition, keeps down its production quantity below the level, which would be optimized by market, and increases its monopoly prices above market price adequately in the interest of maximum profit achievement. A monopoly would not react on the market extension with change of technology, because it would not be motivated to do this. On the contrary, an increasing market demand extended by globalization could lead to product price rise. By contrast in the framework of oligopoly, which sells at a lower price and produces higher quantities of products in comparison with monopoly, there exists a competitive environment, in which the competitive fringe is interested in change of technology, and thus in decreasing product costs leading to following decrease of price and increase of production quantity.

An oligopoly can exist in form of cooperative oligopoly, but it would not solve the situation. A cartel is considered to be an illegal subject in most of economies, but first of all, it does not contain the element of dynamic competition, which - as only one - can lead to technical-economic progress, in which the monopoly is not interested. This element is contained in oligopoly with a dominant firm. Competitive fringe of firms has an area to a positive change of their technologies. This is the situation when a priori a lower oligopoly price and a higher production quantity are affected henceforward positively by escalation of competitiveness of the firms in competitive fringe in comparison with a monopoly, i.e. the price is decreasing and the production quantity is increasing not only by firms of competition fringe, but by whole oligopoly. Chart 1 illustrates a rationality of this theoretical consideration.

Legend:

P – price; MC – marginal costs; AC – average costs; D – demand; AR – average revenue; MR – marginal revenue; Q – quantity; E – equilibrium.

The indexes mean:  $M$  – magnitude relevant to monopoly;  $A$  – magnitude relevant to firm A;  $B$  – magnitude relevant to firm B;  $K$  – magnitude relevant to competition fringe;  $E$  – magnitude relevant to equilibrium;  $T$  – magnitude relevant to total;  $D$  – magnitude relevant to dominant firm.



**Chart 1.** The comparison of price and production quantity of monopoly and oligopoly with a dominant firm

Source: own elaboration

The extended market by globalization could be saturated with one monopoly firm or with an oligopoly with a dominant firm presenting co-existence of prior monopoly firm and firms of competition fringe. This case concerns about a non cooperative oligopoly, because SMEs supported by states rise next to dominant firms. A substitution of monopoly with cartels – i.e. cooperative oligopolies - is not an interest of economies, because their practices are illegal in most of national and supranational entities.

Chart 1 reflects conclusively that the price demanded by oligopoly is lower than that one, which would be demanded by monopoly; the production quantity is higher too.

The globalization process, which leads to market extension, can lead – from theoretical point of view with its influence on demonopolization by creation of a competition environment – to positive economic affects through oligopolization. Of course, a necessary condition is the maintenance of domestic competition on the newly globalized market, which would be interested in a technical-economic development, in contrast to monopoly.

The problem is not that firms of competition fringe have a higher costs level (i.e. SMEs in principle) than a dominant firm. Small and medium entrepreneurs present a stabilizing element namely in aspect of employment. In this respect, the SMEs maintain a permanent rate close above 60 % of total employment with moderate trend to growth in the Czech Republic. These entrepreneurs – surely in consequence of the support, which is given them - have been able to keep in step with effectiveness and performance development in large enterprises. It is argued with the maintenance of their share of GDP (round 35 %) and export (between 30 and 40 %), as well as in produced value added (above 50 %). Effectiveness of their activities measured with labour productivity and costs profitability is lower than large enterprises, which is given - among others - their higher rate in industry branches, where an achievement of above-average effectiveness is more difficult. [11]

### **3.2 Technology centers in the Czech Republic and their financial health**

Technology centers<sup>3</sup> (*in the next text only “TCs”*) are one of the platforms of the technology support development in the Czech Republic and their objective is to support development of innovative environment, namely in relation to SMEs, and so simultaneously, to influence regional development positively.

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<sup>3</sup> It is to remark this term includes different name of the subjects. In the Czech Republic, 12 different terms are used, e.g. technology park, scientific-technical park, business and innovation centre, business incubator, which have analogical mission. The scientific-technical park is historically the first name, which has been used since 1990 when the Society of Scientific-Technical Park was established.

TCs provide their consultant, technical and finance services internally or externally. Since 1990, when the first scientific-technical park was arisen, number of TCs has reached value of 44 in 2008, and it gives evidence of dynamic development of these subjects. [12] In 2004 the support programme of TCs was declared by the Czech government. However, TCs are not a homogenous entity; more over in connection with the thesis about a priori inefficiency of public sector, and thus disputableness of all public support, it is necessary to pay attention to economy, efficiency and effectiveness of their operation. *“The government support.....disturbs economic competition.... Disposal of the government support must be suggested circumspectly with the aim to restrict scope of this distortion. Otherwise, the government support will become counterproductive and will decrease total level of research, development and innovation, as well as economic growth.”* [13]

The most of the TCs (56 %) are private profit societies (39 % limited company, 24 % stock company, 3 % limited partnership); public institutions present less rate (16 % - 13 % universities, 3 % public research institutions); and private non-profit organizations (13 %); the rest is presented by associations of corporations (5 %).

In aspect of settler, we can distinguish three basic types of TCs in the Czech Republic:

- a) TCs found by public corporations (32 %) = “public TC”;
- b) TCs found by private corporations (32 %) = “private TC”;
- c) TCs found by both types of corporations (36 %) = “joint TC”.

A case study was launched for assessment of harmony or difference in TCs financial health, which compares some features of financial health by three TCs [12] different according to their type of settler incl. their state in the years 2006 and 2007. The most important results are selected from this case study: structure of capital, development of revenues, costs, profit & loss (net income), and regarding specific feature of these subjects in aspect of assumed qualification structure of employees – financial wages productivity measured as relation between revenues and personal costs.

From the case study follows:

#### **Public TC**

- Debts present c. 98 % of total capital, there predominate commerce short term liabilities (c. 87 %), short term bank loans create c. 13 %; equity is made up more than 91 % by legal capital;
- Revenues increased between 2006 and 2007 to 161 % (i.e. c. 7 million CZK), expenses increased to 165 % at the same time; loss amounted 0,013 million CZK);

- Progress in wages increased in inter-annual development from value of 1.99 to value of 2.24; but it is the lowest value in the analysed sample of subjects.

#### Private TC

- Equity creates early 82 % of total capital; absolute predominance has profit of last and current years (practically 99 %); short-term liabilities predominate in debts (91 %), but private TC also uses long term liabilities from business relations (9 %);
- Revenues decreased to 87 % between 2006 and 2007 (i.e. 134 million CZK); costs reduction was at the same level, which led to profit decrease to 94 % (i.e. 7.7 million CZK);
- Progress in wages decreased the most markedly (from value of 4.08 to value of 3.64); however, it still presents the highest level in the analysed sample.

#### Joint TC

- Equity (c. 93 %) also predominates over (c. 93 %) debts (c. 7 %); the basic capital is the largest part of equity (57 %), but profit (26 %) and capital funds (16 %) also present an important share; debts present only short-term liabilities from business relations;
- Revenues decreased to 89 % between 2006 and 2007 (i.e. c. 15 million CZK); there was higher cost reduction (to 88 %) and its profit increased to 104 % (i.e. 1.5 million CZK) as the only one from the analysed subjects;
- Progress in wages decreased moderately (from value of 2.61 to value of 2.41), and presents middle level in the analysed subjects.

If we use indicator ROE (return of equity) for assessment of effectiveness of the analyzed TCs, rather different results follow – in terms of level of this indicator, as well as in terms of its inter-annual development. The following decomposition can be applied for determination causes of these changes:

$$\frac{EAT}{E} = \frac{EAT}{S} \times \frac{S}{A} \times \frac{A}{E}$$

Legend: EAT = earnings after taxes; E = equity; S = sales; A = assets

Table 4 presents the values of ROA and its components of the compared TCs.



**Table 4:**

Values of ROE decomposition of analyzed subjects

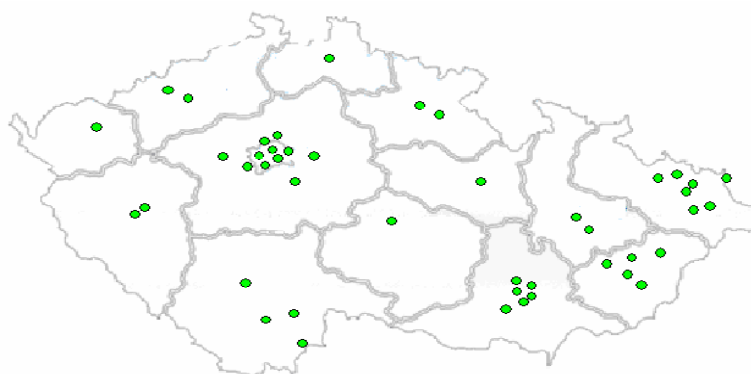
	ROE	EAT/S	S/A	A/E
private TC 2006	0,10	0,05	1,58	1,32
private TC 2007	0,11	0,06	1,46	1,23
public TC 2006	0,45	0,02	0,57	39,00
public TC 2007	0,07	0,00	0,57	58,96
joint TC 2006	0,03	0,09	0,27	1,10
joint TC 2007	0,02	0,10	0,23	1,08

Source: own elaboration according to [12]

As indicated, profit margin is the highest in the joint TC, it developed negatively only in the public TC. Assets turnover in the private TC reached higher values markedly, although this indicator of activity decreased, analogically like in the joint TC, which in contrast features the lowest activity in this point of view. Financial leverage reflects above described capital structure of the compared subjects. It affected the ROE development in the private TC, as well as in the joint TC negatively, on the contrary, it put behind ROE decrease in the public TC, which, however, decreased markedly as a result of influence of decreasing already very low profit margin.

### 3.3 Regional distribution of TCs in the Czech Republic

An evident inequality is seen in regional distribution of TCs in the Czech Republic. We can say the regions with higher number of universities and research institutions are characterized by higher number of TC. Chart 2 shows the strongest region is Prague and Stredocesky region (viewed together), the both regions are followed by regions Moravskoslezsky, Jihomoravsky and Zlinsky.

**Chart 2.** Regional distribution of TCs in the Czech Republic

Source: [12]

The regional GDP is chosen as indicator of regional economic wealth creation. Particular regions are judged by index of regional GDP growth between years 2002 and 2007, their share in the total Czech GDP, and a number of TCs in both monitored years.

**Table 5:**  
Comparison of GDP and number of TCs in separate NUTS III in the Czech Republic

regions in the Czech Rep.	Index of regional GDP growth 2007/2002	Share on the Czech GDP (%)		Number of TCs	
		2002	2007	2002	2007
Praha	1,37	25,7	24	4	5
Stredocesky	1,76	9	10,8	1	6
Jihocesky	1,44	5,5	5,4	1	4
Plzensky	1,50	4,9	5,1	1	1
Karlovarsky	1,30	2,3	2,1	1	1
Ustecky	1,47	6,4	6,5	1	2
Liberecky	1,46	3,4	3,4	1	1
Kralovehradecky	1,43	4,7	4,5	1	2
Pardubicky	1,49	4,1	4,2	0	1
Vysocina	1,56	3,9	4,2	1	1
Jihomoravsky	1,46	10,3	10,3	4	6
Olomoucky	1,43	4,8	4,7	2	2
Zlinsky	1,51	4,6	4,7	1	5
Moravskoslezsky	1,43	10,3	10,1	4	7

Source: own elaboration according to [12]

We can deduce from data in the table 5 that the increase of number of TCs is not the same like the index of regional GDP growth. Actually it could be said about Stredocesky or Zlinsky region, but other situation is in Zlinsky region. It is obvious that the starting level of GDP plays an important role there, i.e. the base for GDP growth index calculation. If we judge the share development of particular regions in total Czech GDP, we can see that the increase of TCs number does not lead always to the increase of share in total wealth creation. A simple explanation might be the fact that the objective of TCs existence is to support innovation environment of SMEs, whose share of total GDP presents only about 1/3. However, an unanswered question is how the structure of shares of regional GDP

would develop, if the mentioned support of innovation entrepreneurship would not be launched, and SMEs as a stabilizing element of economy would be weakened.

#### **4. Conclusions**

Regarding the role of SMEs in the national economy, their institutional support focused on support of technology development and innovation entrepreneurship (in condition of globalization and in aspect of market structure) can be evaluated as desirable. Oligopolization – namely conditions for functioning SMEs in the framework of competition fringe in the oligopoly with a dominant firm – leads in condition of globalized economy to development of competition though in the framework of imperfect competition.

Tools of institutional support still must be applied circumspectly so they do not have a negative effect on economic competitiveness and do not become roots of economic inefficiency.

This danger is evidently expressed on a case on one of “institutions”, whose base objective is to support innovative trends of SMEs, i.e. TCs. On the base of results of the case study, it can be deduced that financial health, performance and effectiveness are different among analysed subjects according to their belonging to public or private sector. The thesis about inefficiency of public sector is confirmed in this connection. The separate number of TCs in region does not enable to assume higher regional GDP growth rate. It is caused by starting level of regional GDP and purpose of TCs existence (the support of SMEs, which does not present crucial share of GDP.)

However, regarding the role of SMEs – a stabilizing element of employment rate, maintenance of competition environment, and interest in technology development – it is obvious that their institutional support (provided initially and circumspectly) is desirable. (Regarding impossibility of launching economic experiments – only modeling is possible – we will not be able to prove that economic consequences would be different without this institutional support.)

#### **Acknowledgement**

This article was prepared with the support of the Grant Agency of the Czech Republic in connection with solving the research project No. 402/09/0592 „Development of economic theory in the context of economic integration and globalization“, and research project No. 402/08/0849 “Model of management of sustainable region growth.”

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## **ALLIANCE DECISION-MAKING OF SME: PHASES AND INFLUENCE FACTORS**

**KARLA DIAZ<sup>1</sup>**

**ABSTRACT.** Experience of some countries shows how alliances have helped SME (small and medium enterprises) to be successful; however, this strategy is still not very popular in many other countries. Managing alliances is no more difficult than deciding to enter into such a cooperative relationship. Many researchers, particularly in the advanced countries have studied strategic alliances with special emphasis on large enterprises and focused as a way of internationalization but there is still a gap of references to understand how this decision is taken from the SME: what makes SME to be engaged in alliances? which factors are playing an important role into this decision?

The innovation of this research is to provide a framework of alliance decision-making process based on five phases as well as the identification of key factors that make SME to be engaged on alliances. The proposal is based on different perspectives from the social capital, mainly social exchange, and economic development into the alliances decision making particularly in SME. This research could be especially attractive to the different actors involved in SMEs: government; large enterprises, universities and Non-government organization in order to focus their effort on those weak phases or factors that may be potentially developed in a new way of joint working.

The empirical data comes from a sample of Mexican SME. The preliminary results show that the perception of the enterprise competence and the identification of potential partners are critical phases into the alliance decision-making process. Although most of the entrepreneurs desire to be involved in alliance, the lacks of possession of information about alliances issues as well as the lack of trust are key factors that limit this decision.

**Key words:** Alliances, decision-making, phases, influence factors.

**JEL Classification:** D01

### **1. Introduction**

Many sectors from developing countries are succumbing to new competitive pressures, and many firms, especially the small and medium size enterprises are finding the global marketplace a very hostile territory. These firms, as well as the social actors that are affected by their performance, are clamouring for assistance. To solve this dilemma, the search for new way of working is

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required, in which government; enterprises, universities and nongovernmental organization could take the decision to work together. Only few firms have all of the resources needed to be competitive. Experience of countries such as: Japan, Italia and Korea, for example, shows how alliances have helped SME to be successful in today's fast changing environment; however there are many examples, particularly in developing countries like Latin America, in which this strategy is still not very popular; how can these economies promote this strategy that has enjoyed great success in other countries?, what makes SME to be engaged in alliances?, which factors are playing an important role into this decision?. This paper provides a framework of alliance decision-making of SMEs, and proposes different phases and key influence factors which SME may experiences before deciding to be engaged.

Alliances are defined, in this paper, as a co-operative agreement between independent firms based on business contracts to enhance medium or long term benefits, involving exchange, sharing or co-development of products, technologies or services.

Managing alliances is no more difficult than deciding to enter into such a cooperative relationship. There has been much discussion of the reality that state-led strategies have enjoyed great success in some developing countries in East Asia, but few scholars have suggested new alternatives for the post liberalization stage in those countries that failed in their original attempts at state-led development, like most of Latin America countries (Casaburi, 1999). Many researchers, particularly in the advanced counties have studied strategic alliances with special emphasis on large enterprises and focused as a way of internationalization but there is still a gap of references to understand how this decision is taken from the point of view of SMEs as well as the factors that influence on them in undeveloped economies.

In order to be able to find answers to help understanding the current alliance decision-making that are facing SME mainly in non advanced economies, this research bases its proposal on the social capital literature, particularly in the field of economic development and social exchange because of three main reasons:

1.- The literature on social capital and economic development, mostly associated with Ronald Burt (1992, 1997, 1998), Alejandro Portes (Portes and Sensenbrenner 1993; Portes 1995, 1997, 1998), Douglas Massey (Massey and Espinosa 1997, Massey 1998) and Marcel Fafchamps (Fafchamps and Minten 1999), identify in perspectives the role of groups and organizations, it is recognize two key propositions. First, social capital is a double-edged sword. On the one hand, it can provide a range of valuable services for community members, ranging grooms baby-sitting and houses-minding to job referrals and emergency cash; but, on the other hand there are also costs, in that those same ties can place considerable non-economic consequences. Second, the sources of social capital need to be distinguished from the consequences derived from them. Imputing only outcomes may

be attained at another groups expenses, that five outcomes may be sub-optimal or that desirable outcomes attained today come at the price of significant cost tomorrow.

2.-The theories of economic development and social exchange incorporate on one hand, economic variables such as profit, growth, and development, and on the other hand, social variables such as interaction, cooperation, and cultural. Both variables are always presented in alliances strategies and the combinations of them impacted strongly on alliances decision.

3.- The social capital argues that the vitality of community networks and civil society is largely the product of the political, legal and institutional environment. This view argues that the very capacity of social groups to act in their collective interest depends crucially on the quality of the forma institutions under which they reside (North 1990), and that emergent qualities such as high levels of generalized trust” in turn correspond to superior rates of economic growth. It also stresses that the performance of states and firms themselves depends on their own internal coherence, credibility and competence and their external accountability to civil society.

This proposal is also based on successful experience of alliances from some countries in Europe and Asia which provide interesting elements to be analysed; for example: in Baden-Wurtemberg, a region located in Germany, is characterized by successful engagements. The Co-operation among SME in Italy follows three models: High technology focus to exportation in the north of Italy, traditional industry of micro and small enterprises (south) and the called “the third Italy” in central and northeast of the country. The governmental programs to promote long-term co-operation among SME in Norway has reduced cost between 20% and 30% and they have increased their knowledge. These programs have been successfully reproduced in Australia, New Zealand and Canada. (Secretaría de Economía, 2008).

Since 1936 the government of Japan promotes alliance engagement between SME and LE (large enterprises). The electronic and car industries, characterized by subcontracting, are a good example of this way of engagement. Korea and Taiwan provide also good examples of co-operation and inter-relationship among SME. (Secretaría de Economía, 2008)

### **The Experience in México.**

In Mexico, there has been during the last twenty years, different ways of promotion focusing on the micro, small and medium enterprises. Many of them have had poor results. Since ten years ago, the government had begun to promote different ways of inter-organization such as cooperatives, agriculture unions, credits unions, most of these ways of associations were characterized by associations of one activity sector (mainly agricultural) and even some of them were very success at that time , they are now decreasing.

As results of the different trade treatments among Mexico and EUA, Chile, Venezuela, Colombia and other countries in Latin America and Europe, the Mexican government has had to develop different programs to promote the micro, small and medium enterprise in order to take advantage of the opportunities of these treatments but without losing their structure, they could continue being small but they must be enough competitive and highly efficiency to be able to participate in this new challenge.

This challenger is producing now a new paradigm “Joining to be competitive” consequently in 1993, a new legal society was introduced in Mexico under the name of “Empresa Integradora” (Integrated Enterprise).

This way of inter-cooperation is defined as enterprises of specialized services that integrate in a business unit, individual entrepreneurs or groups of SME in order to be more competitive. (Secretaría de Economía, 2008).

### **The proposed Model**

Alliance decision-makers are no longer assumed as completely rational — rather, they are believed to have limitations in reasoning capacity. As Anderson and Paine (1975) note, “strategy formulation is subject to many subjective (behavioural, political, emotional) forces which influence its ultimate form”.

A fair number of scholars have studied strategic decision-making in alliances, typically aiming at understanding the perception and decision context that form the basis of the partner’s decision. However the decision to be engagement of SMEs goes beyond to choose a “good partner”. The current literature does not provide a clear scheme of the whole decision-making process and the key factors into this process.

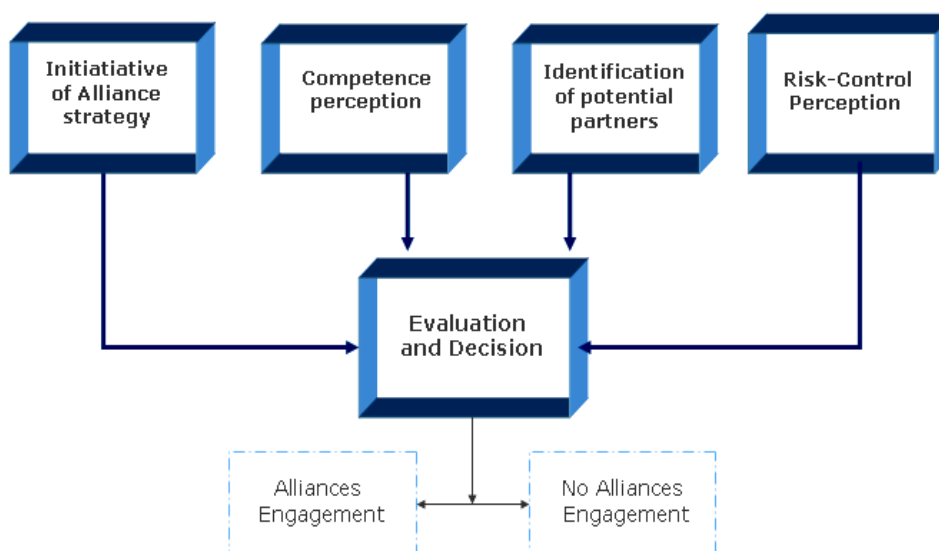
The essence of this approach lies in the prominent role assigned to identify different phases and factors that have influence on the alliances decision-making of SMEs.

This study propose a scheme integrated by five phases: the initiative of alliance’s strategy phase, the competence perception phase, the identification of potential partners phase, the risk-control perception phase and finally the evaluation and decision phase.

One entrepreneur, before being in roll in a new strategy will take into consideration all the benefits his company could get from this strategy. The growing interest in strategic alliances has begun to provide us with significant research insights. Most major perspectives attempt to answer the question “Why strategic alliances?”



## ALLIANCE DECISION-MAKING OF SME: PHASES AND INFLUENCE FACTORS



### Phase 1. The Initiative alliance's strategy

Many theories provide enough information trying to answer this question:

- a) The transaction costs theory argues that an organization should organize its boundary-spanning activities in order to minimize the sum of its production and transactions cost (Beamish & Bank (1987), Dyer (1997), Faulkner (1995); Hennart (1988), Hill (1990), Madhok & Tallman (1998), Parkhe (1993), Thorelli (1986), Williamson (1975)).
- b) The resource dependence theory is represented by Das & Teng (1998); Das, Sen & Sengupta (1998); Deeds & Hill (1996), Mitchell & Singh (1996), Pfeffer & Salancik (1978); Sinha & Cusumano (1991).
- c) The Learning theory suggests that the main benefit through inter-organizations is focused to absorb as much knowledge as possible from partners, thus increasing organisational competencies and ultimately adding value to the organizations (Doz (1996), Gulati (1999), Hamel (1991), Inkpen & Crossan (1995), Lane & Lubatkin (1998); Larsson, Bengtsson, Henriksson & Sparks (1998), Mowery, Oxley & Silverman (1996), Kumar & Nti (1998), Simonin (1997), Powell, Koput & Smith-Doerr (1996)).

The identification of economical benefits is, therefore, a factor strongly engagement to the initiative of any strategy. According to the Irish economist Richard Cantillon, in 1732, entrepreneurship is identified as the willingness of individuals to carry out forms of arbitrage involving the financial risk of a new

venture. Since then, economist such as Mill (1870), Say (1857), Knight (1921), Schumpeter (1934), and Kirzner (1973, 1997) have been among the most influential contributors to our understanding of entrepreneurial behaviour and its related processes.

A clear example to help to illustrate the importance of leadership into the alliances strategy could be found in the experiences which came from the fast growth of SMEs in Italy, mainly in Prato, Toscana; the existence of a leader enterprise to be in charge of promoting and coordination with other enterprises has become one of the most important force to develop these enterprises (Secretaría de Economía, 2008)

### **Phase 2: Competence perception**

SME are always full of contrast; on one hand the simple structure that many SMEs have, provide a vast pool of creative energy distributed in small way of production that are more inclined to innovate and more able to implement changes than is likely in large but on the other hand, they, particularly in Mexico, face structural problems; many of enterprises are family-business in which the conventional methods have been used generation by generation, many entrepreneurs argument: This way of operation has worked in the past, why should we change our way of working?"

The global markets provide competitive pressure, and individual entrepreneurs provide the creativity and energy necessary to face adjustment challenges, each individual SME alone lacks capacity, resources an scale to compete successfully. In the industrial district or dynamic sectors, SMEs overcome individual limitation through collective efficiency (verschoor, 1994) achieved in three different ways: interfirm co-operation, public –private collaboration and supportive public policies. These three forms provide the organizational forms under which the small firms can combine its advantages of flexibility and the support that came from larges networks (Pyke and Sengerberger, 1990, p. 4).

The entrepreneur, as protagonist of the decision-making, could have different perceptions of the company's competence. Knowledge is a factor that has influence on the entrepreneur's decision making.

Knowing the different association available and how to engage on them can be difficult and time consuming. (Roos, J. 1997) argued that employee generate Intellectual Capital through their competence, attitude, motivation and intellectual agility. Relational capital represents the knowledge embedded in the relationships with the outside environment. It's the potential an organization has du to ex-firm intangibles. Many researchers content that Intellectual Capital greatly assists enterprises in promotion competitive advances.

The capacity to manage alliances and absorb knowledge on alliances is a distinct management capability: the alliance capability. Possession of information

regarding to different issues makes people to be more confident and to have more possibilities to decide their business strategies.

### **Phase 3: Identification of Potential Partners**

The relative size, resources, and market power of the partners affect the decision of being engagement in an alliance. Alliances between equally strong, equally weak or unequal partners can be dramatically different in their alliance motives and structuring process. Oliver (1990) observes that partner asymmetry – which allows one partner to exercise power and control over another partner, is one of the key alliance motives. Bleeke and Ernst (1995) suggest that many stronger partners enter into an alliance with the hidden agenda of “capturing” the weaker one. They also contend that alliances between unequal partners are unlikely to be successful. In line with Oborn and Baughnüs (1990) argument that small firms are more vulnerable to their partners’ opportunistic behaviour, we reason that a small partner firm will be even more vulnerable to a larger firm.

Partners’ trustworthiness influences the conduct of the partners in all stages of alliance development. Ngowi suggests that there are some factors that are considered in selecting a partner: complementarily, resources relative to their value, status similarity, direct prior alliance experiences, indirect prior alliance experiences and prestige. This Study suggests especial attention to be engage in an alliance, the expected characteristic that an entrepreneur wanted to find in a partner and the trust of being engagement. This last one plays a key role, particularly in developing countries whose economics are fragile and highly vulnerable.

Trust is influence by cultural background. Various studies point out the role of cultural beliefs in the performance of work organizes, evaluate and carry out their work (Hofstede, 1980; Trompenaars, 1994). The construction of stereotypes related to the culture of a country affect the way of doing business. Octavio Paz, the Mexican who was awarded the Nobel Prize of Literature in 1991 contributes to the current national and international debate about Mexican culture in the work place.

### **Phase 4: Risk-Control Perception**

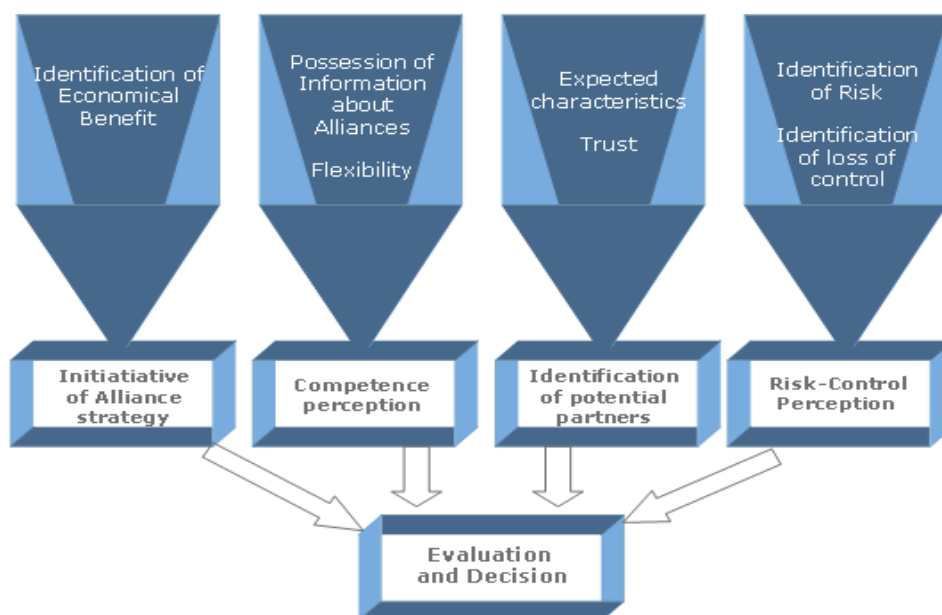
Scholars suggest that, we need to give special attention to uncertainty and risk perception (March and Shapiro, 1987). Anderson and Paine (1975) argue that there are two key sets of managerial perceptions: the perception of environmental uncertainty and the perception of the need for strategic action.

A risk perception is a term to refer to those ambiguities, as perceived by prospective alliance partners, about the future events that may negatively impact on the performance of the alliance. Ring and Van de Ven (1992, pp 92-93) identify two distinct sets of uncertainty in strategic alliances: “uncertainty regarding future stares of nature” and “uncertainty whether the parties will be able to real on trust”.

Proceeding along similar lines, it can be differentiated between relational risk and performance risk in strategic alliances (Das and Teng, 1996, 2001 in press a). According to the literature reviewed, this study aware the importance of control and risk as a pre-conditions to be engaged on alliance strategies.

Alliance researches have emphasized the importance of both output and process controls in determining the success cooperative agreements (Geringer and Hebert, 1989). The literature suggests that control is a key source of confidence in partner cooperation (Gulati, 1995, Parkhe 1993). While strategic alliances present new opportunities with risks that can be shared, they often limit the discretion, control, and profit potential of partners, while demanding managerial attention and other resources that might be directed toward the firm's mainstream activities (Hitt et al., 1996). Howarth, Gillin, and Bailey (1995) argue that strategic alliances also present costs and risks to partner organisations because of their organisational form, and they associate these with organisation's loss of autonomy and flexibility accompanied with possible relegation to an inferior position in the alliance.

The following figure illustrates the phases of the decision-making process as well as shows the key factors that influence in each phase the final decision.



## 2. Method

Most developing countries are facing economic policy dilemmas; they have experienced several variations of state-led development strategies in the past, with disappointing results. Imperfect markets, poor infrastructure, deficient

educational systems and weak governments are making the transition to open and competitive economies very painful. One of the most vulnerable sectors is the small and medium sized enterprises (SMEs). (Casaburi, 1999). Mexico is a good example of these countries. There are more than 3 million units of micro, small and medium enterprises operating in Mexico. They provide more than 16 million employments and contribute with 52% of the GDP (INEGI, 2008).

Particularly in Mexico, enterprises have on one hand structural and cultural limitations to let them to decide to be engage but on the other hand it is an important number of successful experiences of inter-organizations. These two paradoxes provide relevant data to try to answer the question of this study: What makes SME to be engaged in alliances? which factors are playing an important role into this process?

### **Sample**

One of the reasons than motives this research is the gab of information regarding to alliance of SME with other sectors: Universities, Government, Non governmental organizations, etc. There is not official information of the total number of enterprises who are now working under this scheme in Mexico (not even in Latin America). There is an estimation by UNAM (Universidad Nacional Autonoma de Mexico), who is the most important Public University not only in Mexico but also in Latin America, that mention that there are between 2000 and 2500 project per year in which UNAM is working together with enterprises of different sectors in order to develop products, improve services, etc. but there is no information available regarding, particularly to SME.

In order to be able to collect important data to analyze the framework of the alliance decision-making of SME it was defined the following two criteria:

- a) One group of SMEs who have, now, or have been experienced the alliance decision-making
- b) One group of SMEs who have never experienced this decision of engagement.

Veracruz represents, in accordance with these criteria, the most important state of Mexico. According to the data from the SHCP 2009, 70% of the enterprises under the concept of “empresa integradora” are located in Veracruz. It also represents the first state of the south-east zone of Mexico with more business units classified as micro, small and medium enterprises. (Contacto PyME, 2007).

This research is now leading to the empirical data collection of a sample 150 enterprises, 50% with alliances experiences and 50% without.

In order to access to information of these two groups. Three important research partners provide different facilities to be able to interview and apply questionnaires to these SMEs. One of this partner concentrate more than 80% of the total enterprises under the concept of “Empresas integradoras” the other two partners provide us access to enterprises which haven not experienced any alliance so far.

The sample of this study has the following characteristics:

- ❖ They are located mainly in the State of Veracruz
- ❖ They are small, and medium enterprises
- ❖ They belong to different sectors: agricultural, manufacture and services.

### **Measurement**

The empirical data collection of the phases and key factor of alliance engagement of SMEs is measured using 11 variables under one to two dimensions; existence of alliance proposal, identification of economical benefits, enterprise competence perception, possession of information regarding to alliance, flexibility, identification of partners, expected partners characteristics, trust, risk and control perception, identification of risk and identification of control. For quantitative measurement between the variable and the alliance decision-making of SMEs is measured using the liker scale of 3 and 5 options.

An especially questionnaire to this study was designed with two sections:

Section A: This questionnaire has 47 items and it is conducted to those enterprises who had been involved in alliance decisions and

Section B: This questionnaire has 35 items and it is conducted to those enterprises who hadn't been involved in alliance decisions at all.

The answers of this questionnaire are being collected through three means: personal interviews, phone interviews and by e-mail.

### **3. Results and Discussion**

The empirical data comes from a sample of Mexican SME. It is still too early to present the final results, there are interesting findings so far. The preliminary results show that the perception of the enterprise competence and the identification of potential partners are critical phases into the alliance decision-making process.

There is a high tender of the successful alliance-decisions to spend enough time evaluating their enterprises potentialities as well as weakness in order to evaluate the potential partners.

Especially interesting is the fact that the economic benefit seems to be no one of the most important factor to take the decision to be involved in alliances decision making.

Because of the current status of the study in which is now the collection of empirical data, it is not yet possible to present many detail of the key factors, most of the entrepreneurs desire to be involved in alliance but the lack of possession of information about alliances issues as well as the lack of trust are key factors that are limiting this decision.

### **4. Conclusions**

Many sectors from developing countries are succumbing to new competitive pressures, and many firms, especially the small and medium sized enterprises are

finding the global marketplace a very hostile territory. To solve this dilemma, it is required the search for new ways of working, in which government; enterprises, universities and non governmental organization decide to work together. This paper provides a framework of alliance decision-making of SMEs, and proposes different phases and key influence factors which SME may experiences before deciding to be engaged.

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## **RECRUITMENT AND SELECTION SERVICES OFFER FOR SMES: THE CASE OF ROMANIA**

**MARIANA DRAGUSIN<sup>1</sup>, RALUCA MARIANA PETRESCU<sup>2</sup>**

**ABSTRACT.** Considered to be the engine of the economy, the SMEs sector has a well defined identity in the configuration of any modern economy, helping to renew its structure and to increase its competitiveness. In Romania, the small business sector had to be practically recreated after decades of centralized economy. The statistical figures confirm once again that this sector can be one of the main sources of growth that Romania should rely on as a new member of EU family.

SMEs are usually displaying an increased responsiveness to market needs in a dynamic and complex working environment. Thus, SMEs have relied on human resources as a source of competitive advantage. More and more entrepreneurs are becoming aware that quality of the hired human resources is one of the main success variables' and that recruitment and selection processes require professional approaches. In that sense, SMEs' demand for these services has increased significantly. As a consequence, SMEs sector, as the most important new job generator, highly stimulated such services providers' development.

This paper is aiming to point out the specificity of the recruitment and selection services offered to SMEs on the Romanian market, based on a complex and comprehensive research. Data on 129 identified services' providers (in 2008) were grouped and analyzed in order to highlight their main characteristics according to several variables: firms' size and age; their targeted markets and clients; the types of services offered; their specific working methods and techniques; price strategies. The results revealed diversity and flexibility as essential attributes of the recruitment and selection services' offer for SMEs, along with a growth trend. Further research is required in order to explore economic crisis' impact on this market.

**Key words:** SMEs, recruitment and selection, services, offer

**JEL Classification:** D00, M12

### **Introduction**

The fact that personnel are the most valuable resource of an organization is largely recognised. An adequate human resource management ensures the success of an enterprise, regardless of its size. An efficient human resource management starts with efficient recruitment and selection processes. These processes can be

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considered the most important stages of the human resource management because the success of an enterprise directly depends on its staff's quality. This paper was written because of a vast interest in human resource management in SMEs. Based on a complex and comprehensive research conducted in 2008, the paper aims to present the specificity of the recruitment and selection services offered to SMEs on the Romanian market by providers, visible on the Internet. The research was based on secondary data obtained from external sources (specialized web pages) and internal sources (the web pages of the identified suppliers). The paper is structured into two main parts, besides the introduction and the conclusions. The first part of the paper points out the main steps of the research methodology and the second one focuses on the main findings of the research.

Further on, in the introduction we considered useful to explain the *main concepts* used in this paper.

*The supply of services:* In the generic sense, the supply of services is the production of services for marketing on the market. Unlike the supply of goods, the supply of services does not take the form of stocks existing on the market and of quantities of goods that can be brought to market, therefore of the supply of goods in the contractual relations between suppliers and customers.

*Small and medium enterprises:* According to Law no. 346/2004 on stimulating the creation and development of small and medium enterprises with the subsequent modifications and additions, legal definition for SMEs in Romania established that SMEs are classified into 3 classes of enterprises: micro, small and medium enterprises. Micro enterprises are those enterprises that have up to 9 employees and create an annual net turnover or total assets of up to 2 million Euros, equivalent in Lei<sup>3</sup>. Small enterprises are those which have between 10 and 49 employees and achieved an annual net turnover or total assets of up to 10 million Euros, equivalent in Lei. Medium-sized enterprises are enterprises that have between 50 and 249 employees and achieved an annual net turnover up to 50 million Euros, equivalent in Lei, or which have total assets of up to 43 million Euros, equivalent in Lei.

*Recruitment:* "Recruiting is the work of human resource management, which identifies sources of qualified candidates to fill a post and it determines the candidates to apply for employment of new or vacant positions within an organization"<sup>4</sup>. Recruitment can be done inside the organization and/or outside it. Recruiting from internal sources is possible especially if the organization was engaged in a sustained recruitment process in a previous period of time. Usually, internal recruitment is known as a form of promotion or transfer within the organization. The most frequently used method for the internal recruitment is the employment ad. External recruitment is common especially for fast developing enterprises and for those hunted by higher educated and qualified candidates.

<sup>3</sup> Leu (plural – Lei) is the Romania's currency.

<sup>4</sup> Alexandrina Deaconu, Lavinia Rasca, Simona Podgoreanu, Iulia Chivu, Andreea Nita, Doru Curtenau, Ion Popa, „Organizational behavior and human resource management”, Publishing house: A.S.E., Bucharest, 2002, p. 209.

There are different methods used in external recruitment such as advertising ads, recruitment agencies, online recruitment agencies, recruitment in educational institutions or search in applications for employment published in press.

*Selection:* “Selection is the activity of human resource management which consists in choosing, according to certain criteria, the candidate whose psycho-socio-professional profile best matches the characteristics of a particular job”<sup>5</sup>. Selection refers to the final stage of the decision in the recruitment process. Selection must provide two essential features: to identify, from a lot of employees, the adequate person for the free job and to be effective (the resources used for designing and conducting the selection process have to be justified by the quality of new employees)<sup>6</sup>. The selection’s purpose is to provide candidates who will have the best results in the job for which selection takes place. During the selection process different criteria are used, such as the study of background information provided by the curriculum vitae and letter of motivation.

### **Personnel recruitment and selection services offer for SMEs - Research methodology**

The study on the supply of recruitment and selection services for SMEs was based on *five consecutive stages*, whose best performance was vital to obtain the final results.

*The first stage* refers to establishing the research *purpose*: characterizing the providers of recruitment and selection services for Romanian SMEs, with visibility on the Internet.

*The second stage* is represented by *information collection*. Data was collected from external sources (specialized web pages) and internal sources (the web pages of the identified suppliers). The specialized web pages contain lists of enterprises active in different fields of activity. From those lists, only the information about the suppliers of different services in human resources field, including recruitment and selection services was chosen. The web pages used for the research were the following: [www.afacerist.ro](http://www.afacerist.ro), [www.bizoo.ro](http://www.bizoo.ro), [www.clubafaceri.ro](http://www.clubafaceri.ro), [www.dmoz.org](http://www.dmoz.org), [www.ghidafaceri.ro](http://www.ghidafaceri.ro), [www.ghidul.ro](http://www.ghidul.ro), [www.hrmarket.ro](http://www.hrmarket.ro), [www.infocompanies.com](http://www.infocompanies.com), [www.prestariservicii.ro](http://www.prestariservicii.ro), [www.woow.ro](http://www.woow.ro). Along with the above mentioned web pages, web pages of the identified bidders have also been consulted, in order to verify the veracity of the collected information and also to obtain a larger volume of information. Since neither on the specialized websites nor on those of the companies providing recruitment and selection services there was not sufficient information on the tariffs, we have sent an email to all the suppliers that had specified their contact data, in order to obtain the necessary information for the research.

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<sup>5</sup>Alexandrina Deaconu, Lavinia Rasca, Simona Podgoreanu, Iulia Chivu, Andreea Nita, Doru Curtenau, Ion Popa, „Organizational behavior and human resource management”, Publishing house: A.S.E., Bucharest, 2002, p. 220.

<sup>6</sup> Radu Emilian, Gabriela Tigu, Olimpia State, Claudia Tuclea, Catalina Brindusoiu, „Human resource management”, Publishing house: A.S.E, Bucharest, 2003, p.253.

After obtaining all the necessary data, *the third stage* of the research (*information processing*) could be initiated. All data obtained were selected, keeping only the data about the bidders of recruitment and selection service that have as customers both large companies and SMEs or only SMEs. Those major providers having only big companies in their portfolio were not considered as bidders for SMEs and they have not been taken into consideration for this research. The information obtained after filtration was grouped in a table in Microsoft Excel on the following 13 *criteria*: the type of suppliers; the geographical area in which they operate; the year when they were established; the size of the team of experts in the human resources domain; their target market; their target customers; the offered services; the field of activity for which they provide recruitment and selection services; the approach regarding job characteristics' design; the way of CVs' transmission and receipt; sources and methods used for recruitment; selection methods used; rates. After clustering, information was processed (measured) in relation to the criteria listed above.

*The fourth stage - analysis and interpretation of the results* was based on the information obtained in the previous stage.

*The fifth stage* of the research - *the conclusions* provides information on the recruitment and selection services offered to SMEs by providers visible on the Internet.

### Data analysis and results interpretation

Following the documentation, 129 providers working in the service of recruitment and selection for SMEs were identified, as indicated in the following table.

**Table 1:**

Types of providers

<i>The type of the supplier:</i>	<i>Frequency</i>	<i>%</i>
Company	125	97
Psychological Offices	4	3
Total	129	100

Source: data processing

Following the centralization of information related to the criterion group "the type of suppliers" is observed that most bidders (125 – representing 97%) are companies, and the remaining 4 (3%) are psychological cabinets. Of the 125 companies providing recruitment and selection services, 9 (7%) are multinational. Relatively high number of providers of recruitment and selection services reveals the extent of an application for such services.

Depending on the geographical area in which they operate, the bidders of recruitment and selection services for SMEs have been grouped as shown in the following table.

**Table 2:**

Bidders grouped by the geographic area in which they operate

<i>Geographic area</i>	<i>Frequency</i>	<i>%</i>
Bucharest	56	43
Province	73	57
Total	129	100

Source: data processing

As outlined in the table above, almost half of applicants (56 – representing 43%) are in Bucharest and the remaining 73 (57%) is in the province. Since more than half of suppliers of recruitment and selection service for SMEs are present in the province, we considered that grouping them according to the counties, in which they are active, is recommended. Results obtained after the grouping are presented in the following table.

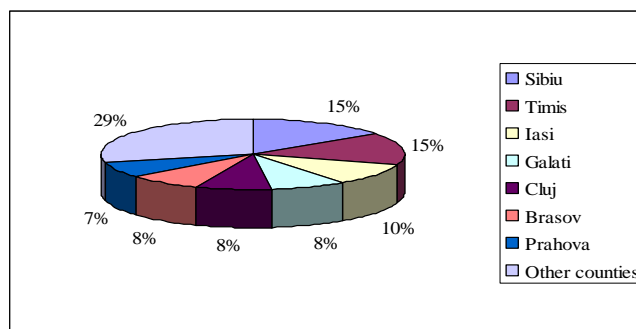
**Table 3:**

Grouping suppliers depending on the county where they act

<i>County</i>	<i>Frequency</i>	<i>%</i>
Sibiu	11	15
Timis	11	15
Iasi	7	10
Galati	6	8
Cluj	6	8
Brasov	6	8
Prahova	5	7
Other counties	21	29
Total	73	100

Source: data processing

Thus, a high concentration of providers of recruitment and selection services for SMEs in Sibiu and Timis counties can be observed.



**Figure 1:** County distribution of the suppliers from province

Source: data processing

According to the 8 Romanian regions, the distribution of the recruitment and selection services' suppliers is relatively heterogeneous: Centre (Brasov and Sibiu – 23%), West (Timis - 15%), North-East (Iasi – 10%), Southeast (Galati – 8%), Northwest (Cluj – 8%) and South (Prahova – 7%). Thus, not only in Bucharest, but also in the province it can be identified an increased demand for recruitment and selection services, but also a higher concern of some managers to attract suitable candidates. The concentration of the suppliers of recruitment and selection services for SMEs in the above mentioned areas are most probably correlated with the territorial distribution of SMEs too. Thus, in 2007, 11% of SMEs active in industry, construction, trade and other services were in the Northeast, 12% in Southeast, 10% in South, 9% in West, 14% in North-West and 12% in the centre<sup>7</sup>.

Of all 129 suppliers, 98 did not specify the year of their establishment, and the remaining 31 are grouped as shown in the following table.

**Table 4:**

Grouping suppliers by their establishment year

<i>Year</i>	<i>Frequency</i>	<i>%</i>
1993	1	3
1996	3	10
1997	2	6
1999	3	10
2000	4	13
2001	5	16
2002	3	10
2004	2	6
2005	3	10
2006	4	13
2007	1	3
Total	31	100

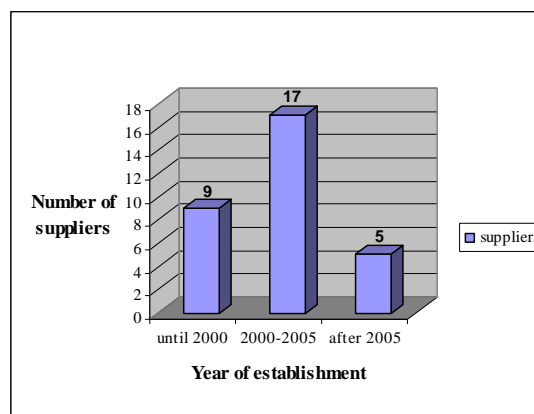
Source: data processing

For easier analysis reasons we have grouped the suppliers of recruitment and selection services for SMEs as follows: established before 2000, established between 2000 and 2005, respectively established after 2005. Results obtained in this group are presented in the following figure.

It is noted that 9 (29%) of the providers have been established before 2000, 17 (55%) between 2000 and 2005 and the remaining 5 (16%) after 2005. There is a substantial increase in the number of bidders of recruitment and selection services between 2000 and 2005. This increase could be explained by the fact that between 2000 and 2005 the number of SMEs active in industry, construction, trade and other

<sup>7</sup> National Institute of Statistics, „Statistical Yearbook of Romania” edition 2008, p. 700-704.

services had a high increase rate: from 306.073 to 431.135<sup>8</sup>. Furthermore, according to the Romanian Centre of Economic Modelling in 2001, in our country, 29 multinational companies were active, while in 2005 their number rose to 49. Thus, there is an increase in multinational companies present in our country during 2001-2005.



**Figure 2.** Allocation of tenders according to the year of establishment

Source: data processing

Very few suppliers of recruitment and selection services for SMEs, only 9 (7%) out of 129, have specified the size of their human resource department, but all of them have outlined that most of their staff are psychologists, with extensive experience in the field. Since the size of the teams vary between 3 and 21 permanent members (one bidder had a team of 3 members, one bidder had a team of 5 members, one bidder had a team of 9 members, two suppliers had teams of 10 members, two suppliers had teams of 14 members, one bidder had a team of 15 members and a bidder had a team of 21 members), we considered useful to group them as shown in the table below.

**Table 5:**

Grouping suppliers by the size of their team of experts in the human resources field

<i>Team size</i>	<i>Frequency</i>	<i>%</i>
Less than 10 members	3	33
Between 10 and 15 members	5	56
More than 15 members	1	11
Total	9	100

Source: data processing

<sup>8</sup> National Institute of Statistics, „Statistical Yearbook of Romania” editions 2001 (p. 345) and 2006 (p. 576).

As showed in the table, most of the suppliers of recruitment and selection services for SMEs (5 – representing 56%) have teams with 10 to 15 permanent members, suggesting the existence of a preferred size, in this field. It is useful to outline that in certain situations, requiring a greater workload (eg: situations when customers need many employees in a very short period of time), temporary members join the permanent team.

By grouping the providers according to their market’s target, the orientation toward internal market became obvious.

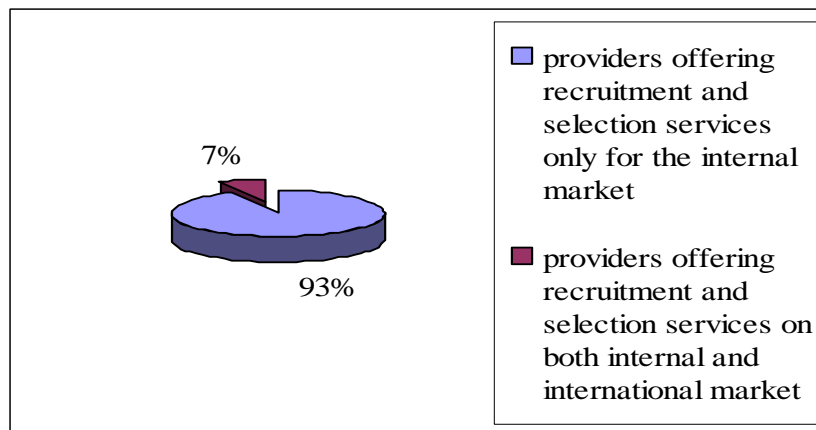
**Table 6:**

Suppliers grouping by their target market

<i>Market type</i>	<i>Frequency</i>	<i>%</i>
Only internal market	120	93
Both internal and international market	9	7
Total	129	100

Source: data processing

As showed in the table, the majority of bidders - 120 (93%) are aiming only the national market, by recruiting and selecting local personnel for local companies, including SMEs. The 9 companies (7%) offering recruitment and selection services for both internal and international market are involved in bidirectional flows, attracting Romanian workforce for the internal and international market and vice versa. The increased migration trend of both qualified and unqualified labour force between countries offered higher opportunities for recruitment and selection services’ suppliers.



**Figure 3.** - Suppliers typology according to their target market

Source: data processing



From their target customers' point of view, recruitment and selection services providers are mainly oriented toward companies.

**Table 7:**

Supplier grouping by target customers

<i>Customer type</i>	<i>Frequency</i>	<i>%</i>
Only companies	111	86
Both companies and individuals	18	14
Total	129	100

Source: data processing

Only 14% of the studied suppliers provide recruitment and selection services for individuals too, especially in career guidance and professional orientation.

Bidders who provide services for companies (all 129 applicants) were grouped according to the size of the firms they address. Not all suppliers clearly specified the targeted companies - SMEs or to both SMEs and large companies, but they offered some information on their web-sites about clients' feedback, or portfolio of customers, that helped us to determine the nature of their orientation.

**Table 8:**

Suppliers grouping by targeted companies

<i>Type of client company</i>	<i>Frequency</i>	<i>%</i>
Only SMEs	13	10
Both SMEs and large companies	116	90
Total	129	100

Source: data processing

Only a low weight of recruitment and selection services' suppliers – 13 (10%) are directly addressing only to SMEs, the remaining 90% are aiming both SMEs and large companies. Of the mentioned 13 providers, 4 are the psychological offices.

The bidders of recruitment and selection services for SMEs have been also grouped by the type of services they provide (Table no. 9).

Simple services providers are considered those who only offer recruitment and selection services, regardless of their channel of distribution ("face to face" or via Internet) and their purpose (recruitment and selection for any position, recruitment and selection for management positions or head hunting).

Complex services providers are considered to be those who offer both simple services and other services in the human resources field, such as payroll, training or staff administration (drafting contracts of employment, operating in the books of work).

**Table 9:**

Suppliers grouping by type of services

<i>Suppliers of:</i>	<i>Frequency</i>	<i>%</i>
Full services in human resources field	3	2
Complex services in human resources field	54	42
Complex services in human resources field and personal development services	12	9
Complex services in human resources field and psychological testing for different activities	4	3
Complex services in human resources field and different types of services in other domains	11	9
Simple services in human resources field	25	19
Simple services in human resources field and personal development services	6	5
Simple services in human resources field and psychological testing for different activities	2	2
Simple services in human resources field and different types of services in other domains	4	3
Only on-line recruitment services	8	6
Total	129	100

Source: data processing

Were considered full-service providers those who offer full services in the human resources field.

As underlined in the above table, almost half (54 – representing 42%) of providers offer complex services in the human resources domain, 25 (19%) of them provide only simple services, and 3 (2%) offer full service in the human resources field. It is important to note that 83% of suppliers provide services only in the human resources domain and 17% in the human resources, including other areas such as: management, marketing or sales. Of the 83%, 6% (8 companies) provide only on-line recruitment services and 14% of them are oriented toward personal development services, along with simple or complex services. Personal development services address to individuals and refer to different types of services like vocational and professional counselling or guidance on drafting a CV and/or letter of intent.

The next table (table no. 10) reveals that out of the total considered providers, the vast majority (97%) recruits and selects personnel for various fields of activity. This situation reflects the low specialisation of the “actors” playing on a still emerging market.

Only 4 companies (3%) are specialized in recruitment and selection for a particular domain: 1 recruits and selects personnel only in IT, 1 recruits and selects staff solely on the IT & C, 1 recruits and selects personnel only in IT and engineering fields and 1 recruits and selects staff solely on sales.

**Table 10:**  
Suppliers grouping by the field for which they provide recruitment and selection services

<i>Domain</i>	<i>Frequency</i>	<i>%</i>
Different domains	125	97
Only one domain	4	3
Total	129	100

Source: data processing

Only 14 companies out of the suppliers of recruitment and selection services for SMEs accepted to reveal their approach regarding job characteristics' design. Their options were grouped in 4 categories, as pointed out in the table below.

**Table 11:**  
Suppliers grouping by the approach regarding job characteristics' design

<i>Approach regarding job characteristics' design</i>	<i>Frequency</i>	<i>%</i>
Job and candidate profiles are established with the employer	8	57
Job profile is established with the employer	1	7
Candidate profile is established with the employer	4	29
Employer specifies the profile of the job and the profile of the candidate	1	7
Total	14	100

Source: data processing

Most of the companies – 8 (representing 57%) are closely cooperating with their clients in the both job and candidate profiles establishment process. According to their strategies, 4 providers of recruitment and selection services for SMEs (29%) establish only the candidate's profile with the employer. A single company gets the necessary indications on the available and desirable candidate directly from the employer, without a prior debate.

According to the way of CVs' transmission and receipt, the 45 suppliers that published it, were classified as presented in the following table.

**Table 12:**  
Suppliers grouping by the way of CV transmission and receipt

<i>Manner of transmission and receipt of CV's</i>	<i>Frequency</i>	<i>%</i>
E-mail	10	22
Web page	21	47
Both methods (e-mail and website)	14	31
Total	45	100

Source: data processing

Most of the suppliers who published the way of CVs' transmission and receipt (21 – representing 47%) displayed preferences towards receiving CV's on their websites. The percentage of those oriented towards both methods is also high (31%). Receiving CVs help the providers of recruitment and selection services for SMEs to form a database, later used in the recruitment process.

Out of the 129 providers of recruitment and selection services for SMEs, only 59 (46%) specified the sources and methods of recruitment they are using. According to our data, all 59 providers use their database carefully built up. In situations when the desired candidate can not be found in the database, suppliers appeal to different methods of attracting other candidates, as shown in the following table:

**Table 13:**

Suppliers grouping by the recruitment methods they use

<i>Recruitment methods</i>	<i>Frequency</i>	<i>%</i>
Only on-line recruitment	41	69
On-line recruitment and other methods	17	29
Other methods	1	2
Total	59	100

Source: data processing

Almost all providers (58 out of 59) are using the modern method of on-line recruitment. Only one company stated the use of traditional methods like publishing recruitment ads in the media. Of the 58 providers who use the on-line recruitment, 83% publish ads for available jobs on their website and only 17% have their own recruitment portal (eg: eJobs).

Regarding the used selection methods, only 16 (13%) providers of recruitment and selection services for SMEs, of the all 129, specified them on their web sites. According to our data, the 16 bidders use the following selection methods: selection of applications (CVs/letters of motivation), applications verification, pre-interview, psychological tests and professional knowledge tests and interview with the employer.

There are also some exceptions to the above methods, which are presented in the following table.

**Table 14:**

Exceptions to the selection methods used by the suppliers of recruitment and selection services

<i>Exceptions</i>	<i>Frequency</i>	<i>%</i>
The absence of the employer to the interview	1	8
The absence of the pre-interview	11	84
The absence of tests	1	8
Total	13	100

Source: data processing

Only 3 (19%) providers of recruitment and selection services for SMEs have specified on their web sites that they use all the methods mentioned above. It is interesting to note that, 11 companies out of 16 do not pre-interview the candidates before their interview with the employer.

Because recruitment and selection services prices are a major market regulator, this criterion was intensely observed on providers' web sites. Since neither the specialized websites nor the suppliers' web pages published sufficient information on charges applied for the recruitment and selection of staff, we have sent an e-mail each, in order to obtain the necessary information from all suppliers who had the contact details specified, namely 90 providers. Of those 90, only 12 (13%) answered our e-mail, out of which, 3 from the province and 9 from Bucharest. Only half of those 12 have provided concrete information on tariffs in their answers, the other half indicating that they are confidential.

Following the received responses we observed that, as expected, both in the province and capital, fees vary depending on certain criteria like the position for which they recruit or the experience and level of training required for the job. The fees mentioned by the 6 respondents are percentages between 30 and 50% of gross annual salary of the employee, or 85% of net salary per month of a medium education employee and 95% of net salary per month of a higher education employee. There are also companies that develop complex recruitment and selection projects (some projects may begin with consultancy in the human resources domain and analysis of the team in which will enter the new employee and complete with head-hunting). These companies usually charge fees starting from 700 Euros up to several thousand Euros.

Out of the 8 on-line recruitment companies, 3 did not provide information on tariffs on their recruitment portal. Of the remaining 5, 2 provide free recruitment ads, and 3 companies offer only a certain number of free recruitment ads (usually 3) and offer customers different packages, priced between 29 Lei and 1179 Lei, depending on certain criteria such as number of ads, ad placement, ad validity or customizing ads.

### **Conclusions**

The identified recruitment and selection services for SMEs offer is composed of 129 suppliers having their offer visible on the Internet. There are both companies and psychological offices. The relative high number of providers of recruitment and selection services for SMEs reveals an increasing corresponding demand, reflecting entrepreneurs' concern to attract suitable candidates.

The main suppliers are unequally distributed among almost all the 8 Romanian regions: Bucharest, Centre (Brasov and Sibiu), West (Timis), North-East (Iasi), Southeast (Galati), Northwest (Cluj), and South (Prahova). The increasing number of new ventures and the accordingly raising need for personnel in the analyzed period created an auspicious environment for the emergence of suppliers of recruitment and selection services for SMEs.

A large part of the providers were established between 2000 and 2005, especially in 2001.

In general, the size of the team of experts in the human resource field varies from 10 to 15 permanent members. In situations that require a workload higher, implicit a larger number of experts in human resources domain, temporary members join the permanent team.

Most bidders are only acting on the local market. The increased migration trend of both qualified and unqualified labour force between countries determined the Romanian providers of recruitment and selection services to adapt their supply to market requirements, offering their services also on the international market.

SMEs that have proved to be the most important job generator became an attractive segment for the suppliers of recruitment and selection services. Most bidders have only corporate customers (both SMEs and large companies) but are also suppliers that address to individuals. This shows the increasing companies' interest in professional human resources services. Of all bidders, only a small part provides recruitment and selection services only for SMEs, among them being the psychological offices.

A relatively small part of total bidders provides only recruitment and selection services whatever their channel of distribution and purpose, most offering various services (full and complex) in the human resources domain and in other areas such as management, marketing or sales.

Most bidders recruit and select personnel for various fields. Very few of them are specialized in recruitment and selection for a particular domain.

Considering the approach regarding job characteristics' design, according to our data, providers of recruitment and selection services for SMEs are closely cooperating with their clients in the both job and candidate profiles establishment process.

In order to form a database used afterwards in the recruitment process, most bidders preferred as a way to receive CV's their web page.

As source of recruitment, all bidders of recruitment and selection services for SMEs prefer to use databases. Regarding the recruitment methods, most suppliers prefer the modern method of on-line recruitment. Only a small part of providers use traditional methods of recruitment like publishing ads in the media (newspapers, magazines and others), this being considered by many specialists in the field an out of date method for present days.

The most frequently used methods of selection are: the selection of applications (CVs/letters of motivation), applications verification, pre-interview, psychological tests and professional knowledge tests and interview with the employer.

The prices of recruitment and selection services for SMEs vary depending on different elements such as the position for which the recruitment process takes place or the experience and the level of training required by the job. In regard to on-line recruitment, there are agencies that allow free publication of all recruitment ads and agencies that offer free publishing of only a certain number of ads (usually

3) and offer to customers, different packages priced according to certain criteria such as number of ads, ad placement or validity.

Based on a complex and comprehensive research conducted in 2008, this paper outlined the specificity of the recruitment and selection services offered to SMEs on the Romanian market by providers, visible on the Internet. The results of the research revealed diversity and flexibility as essential attributes of the recruitment and selection services' offer for SMEs, along with a growth trend. But, in order to explore economic crisis' impact on this market, further research is required.

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## THE ROLE OF KNOWLEDGE IN THE INTERNATIONALIZATION PROCESS OF SMALL AND MEDIUM ENTERPRISES

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**ABSTRACT.** The article analyses the role knowledge plays in the internationalization process of small and medium enterprises. Small and medium enterprises are considered from a knowledge-based view, an extension of the resource-based view of the firm, with knowledge as the most strategically significant resource of a firm and the basis for building and sustaining competitive advantage in nowadays complex, dynamic environment. Knowledge may be thus viewed as an essential determinant of small and medium enterprises internationalization processes. The assigned models of small and medium enterprises internationalization refer to this role, and an examination of the different approaches allows for an integrated view of the ways in which knowledge may determine, influence and support small and medium enterprises internationalization.

Small and medium enterprises internationalization strategy development implies several specific phases which are analyzed in order to identify the knowledge necessities for internationalizing small and medium enterprises. Knowledge is then object of certain knowledge processes which include knowledge acquirement, through creation or acquisition, use, handling and development, and revaluation, that are further analyzed according to their specificity related to small and medium enterprises internationalization. A special focus is placed on the process of knowledge acquirement, as the main premise of the internationalization process. These considerations are applied in the case of Romanian small and medium enterprises, providing proposals regarding possible ways of integrating knowledge in the process of internationalization and facilitating their access to knowledge.

**Key words:** Internationalization, Knowledge, Knowledge-Based View, Small and Medium Enterprises

**JEL Classification:** F23

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## **1. Introduction**

Traditional approaches to internationalization have had as center of interest the large multinational companies, while entrepreneurship has targeted business development and management in the local context. Recent developments, especially since the 1990's, which have marked the new, magnified role of small and medium enterprises in the contemporary economy and have opened new opportunities for an increased international involvement, have gnawed the demarcation between international business and entrepreneurship, implying the need for a reassessment of the traditional approaches regarding their applicability to small and medium enterprises.

The knowledge approach to internationalization is not a recent trend, but the understanding of how internationalization knowledge is acquired, retained, transformed and revalued has developed significantly over the past decades. The knowledge approach has been assigned as a useful framework for the analysis of internationalization, and linkages to knowledge can even be found in most traditional internationalization theories. Such a framework can also be applied in the case of small and medium enterprises.

## **2. Small and medium enterprises internationalization from a knowledge-based view**

The knowledge-based view on the firm has emerged from the resource-based view, both also having been applied in the case of internationalization small and medium enterprises. *The resource-based view of the firm* has become significantly influent since the beginning of the 1990's. In this view, organizations are considered as being made up of a unique set of tangible and non-tangible resources: assets, capabilities, processes, managerial attributes, information and knowledge. Such resources create organizational capabilities, referring to an organization's capacity to perform a particular function or value activity. They should be valuable, rare, inimitable and non-substitutable - the so-called VRIN attributes - and, therefore, hard to copy or transfer. Those capabilities that make a significant contribution to ultimate customer value, or to the efficiency with which the value is delivered, providing a basis for entering new markets, are referred to as core capabilities. Firms acquire sustainable competitive advantage if having a set of unique resources that create value in the marketplace, which is, superior core capabilities over the competitors'.

*The knowledge-based view* focuses on intangible resources, rather than on physical assets. While resource-based models recognize the importance of intangible knowledge-based resources in providing a competitive advantage, in the knowledge-based view, knowledge is the most important resource of a firm, and the basis for building and sustaining competitive advantage, as heterogeneous knowledge bases across firms are the main determinants of performance differences.

Knowledge has been dichotomised into two types: explicit and tacit<sup>5</sup>. *Explicit knowledge* is objective, sequential, and digital, and can be acquired from books, lectures, and other formalised means. Explicit knowledge may take form of studies, patents, licenses, analyses, standards, computer programs, etc. Conversely, *tacit knowledge* is embedded in its possessor, of which he is either unaware or simply cannot articulate, as it is not codifiable, unable to be transferred through formal language. Tacit knowledge can only be acquired through experience or imitation. It may take form of know-how of different types: technical, informatical, managerial, etc.

The knowledge-based view of the firm is actually a response to the criticisms received by the resource-based view, which for example has been called conceptually vague and tautological and not applicable to dynamic markets as the sustainable competitive advantage is hard to achieve in such an environment. Resource-based models have thus been extended in order to address not only the ownership of resources, but also the dynamic ability for organizational learning required to develop new resources. This has led to a dynamic process view, which is actually the knowledge-based view of the firm.

Past research offers few examples of resource-based or capabilities-based studies of small and medium enterprises internationalization. It has been argued that small and medium enterprises are dependent on the development potential of key internal and external resources, which can be adjusted or developed within the firm and between firms and their environments. Thus, small and medium enterprises may pursue different internationalization development strategies, with different international activities over time. They can be either firm- or network-oriented resource development strategies or a combination utilizing internal and external resources<sup>6</sup>.

Nevertheless, the knowledge-based view has been largely discussed in the literature related to small and medium enterprises internationalization, as this has become an amplifying phenomenon, and especially related to the Born Global model of internationalization - enterprises which internationalize their activities right from their establishment or shortly after<sup>7</sup>. Especially in the case of small and medium enterprises, competitive advantage is merely explained by knowledge as a primary firm resource. Thus, if small and medium enterprises can generate competitive advantage from their knowledge, they should be able to internationalize just like large firms. By their experience-based learning in non-domestic environments, small and medium enterprises can develop experimental, tacit, knowledge that can be transferred across foreign markets.

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<sup>5</sup> Nicolescu Ovidiu, Nicolescu Luminița (2005) *Economia, firma și managementul bazate pe cunoștințe*, Editura Economică, București, p. 121.

<sup>6</sup> Ruzzier Mitja, Hisrich Robert D., Antoncic Boštjan (2006) *SME internationalization research: past, present, and future*, in *Journal of Small Business and Enterprise Development*, vol. 13, nr. 4, p. 486.

<sup>7</sup> Celalalt articol

## 2. Knowledge linkages in internationalization theories

There are two main categories of approaches to internationalization in the literature: economic and behavioral approaches<sup>8</sup>. Within them several streams, theories and models integrate; most studies adopt perspectives based on both approaches, since they are rather complementary and not contradictory, offering different perspectives on internationalization mechanism, namely:

- *Economic approaches*, which view internationalization as a result of internal and external contingencies, as the firm seeks for an appropriate degree of control over its international activities, bearing on its own risk exposure and flexibility (market imperfections theory or monopolistic advantage theory, internalization theory or transaction cost theory, oligopolist reaction theory, eclectic paradigm, etc.);

- *Behavioral approaches*, which emphasize the evolutionary nature of internationalization, focusing on the influence of decision factors, how they actually base the decision of internationalization, and the learning processes that underpin it (network theory, stage models of internationalization, product life cycle theory, etc.).

An examination of the assigned models of internationalization, which can also be applied in the case of small and medium enterprises, based on both economic and behavioral approaches, allows us to state that most of them recognize the role of knowledge in the internationalization process, explicitly or implicitly. Knowledge is not only a necessity for internationalization, but also an inherent component of various internationalization approaches.

*Market imperfections theory*, or *monopolistic advantage theory*, which was proposed by Hymer (1960) and has been subsequently tested and developed through various contributions, among which: Kindleberger (1969), Gruber, Mehta, Vernon (1967), Horst (1972). According to this theory, the existence of multinational companies shows imperfections of competition, since the firm, in order to become multinational, should have a monopolist advantage to compensate the initial handicap on the foreign markets in the competition with local firms, especially in the case of investments abroad. Such an advantage is based on capabilities, processes, and technologies, which actually derive from the specific knowledge that the firm has acquired. These assets allow the firm to obtain differential advantage in foreign markets.

*Internalization theory* or *transaction cost theory*, proposed in the 1970's and subsequently developed and enriched by contributions such as those of: Teece (1986), Williamson (1979, 1985), Buckley, Cason (1976), Hennart (1982), McManus (1972), Rugman (1986), focuses on transactional market imperfections, considering that the internationalization of the firm pursues subordination or internalization of market

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<sup>8</sup> Lawrence S. Welch, Gabriel R. G. Benito, Bent Petersen (2007) *Foreign Operation Methods: Theory, Analysis, Strategy*, Edward Elgar Publishing, Cheltenham, p. 20.

mechanisms that determine trading costs. Such market imperfections may be transportation costs, trade barriers, risks of know-how dissemination, significant differences of information between buyers and sellers, etc. In order to proceed to market internalization, firms pursue a process of knowledge gathering and assessment, through which management determines the best foreign expansion approach.

*Stages approach to internationalization*, understood as a gradual process, with the completion of several stages, remains the explanatory basis for the internationalization mechanism. This approach originates from the so-called Uppsala model of internationalization, proposed by the Swedish school of business internationalization (Johanson and Wiedersheim-Paul, 1975, Johanson and Vahlne, 1977, 1990, 2003, 2006) from a study on Swedish firms internationalization. Under this model, there are four stages of the process of internationalization: no permanent export, then, typically, firms begin to export to another country through an intermediary, then they establish a branch of trade and finally, in certain cases, begin production in the host country<sup>9</sup>.

Regarding the market selection, firms will begin to internationalize on the markets perceived as close in terms of psychological distance, and browsing through the stages of internationalization, will target more and more distant markets. The concept of psychological distance, introduced in the literature with the Uppsala model of internationalization, was defined as all factors that impede the flow of information from and into the market. Examples are differences in language, education, business practices, culture and level of industrial development<sup>10</sup>. A basic assumption of the model is that the lack of knowledge about foreign markets is an important obstacle to the development of international operations and that the necessary knowledge can be acquired mainly through operations abroad - through experiential market knowledge. The model is a dynamic one in which there are state and change aspects of internationalization variables. The state aspects are market commitment - resources committed to foreign markets, and market knowledge, and the change aspects are the decisions to commit resources and the performance of activities. By distinguishing between objective and experiential knowledge, the latter one is highlighted as critical in the international process, as the driving force behind the process.

Numerous stage models have developed over time, which approach internationalization as a gradual process. According to an assigned study of the 1990's, there has been made a distinction between the U-models - Uppsala model and subsequent developments, and the I-models - based on innovation, respectively, stage models which emphasize the importance of innovation in the

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<sup>9</sup> Jan Johanson, Paul Finn Wiedersheim (1975) *The internationalization of the firm - four Swedish cases*, in *Journal of Management Studies*, vol. 12, nr. 3, p. 305 - 322.

<sup>10</sup> Jan Johanson, Jan-Erik Vahlne (1977) *The internationalization process of the firm - A model of knowledge development and increasing foreign market commitments*, in *Journal of International Business Studies*, vol. 8, nr. 1, p. 24.

internationalization of the firm, among which can be mentioned contributions like: Bilkey and Tesar (1977), Cavusgil (1980), Czinkota (1982), Reid (1981, 1983), etc. In the I-models the role of knowledge is even more obvious, as internationalization is presented as an innovation of the firm, a learning approach.

A summary of the key characteristics of knowledge in the U-Models, which may also be applied to the I-Models is presented below<sup>11</sup>:

- The knowledge of critical importance to firms is market-specific.
- Knowledge is experience-based and is acquired in a learning-by-doing process.
- Knowledge is embedded in individuals and is not easily disseminated throughout the organization.
- Market commitment increases proportionally with acquisition of market knowledge.

*Network theory* - contrary to the traditional idea of the existence of clear demarcations between the firm and its environment, which underpins the traditional approaches to firm internationalization, both economic and behavioral – is the perspective contoured in the 1990's of the company's interaction with its environment. This approach has been developed through many contributions, beginning from Johanson and Mattson (1988). In this approach, the process of internationalization depends on the relationships and networks that the company owns or builds on foreign markets, the emphasis being moved from an economic and organizational to a social plan. Such relationships can be with customers, suppliers, competitors, public authorities, their branches, etc. Therefore, the degree of involvement on international market will depend not only on formal relations, but also on informal, personalised relations. It is obvious, and has also been stated that the acquisition of knowledge on external assets and target markets is fundamental to the network approach.

### **3. Knowledge processes in small and medium enterprises internationalization**

*The strategy of internationalization* is a business strategy, and in its development, enterprises, regardless of their size, follow the overall well-known methodology for strategy development, taking into account the nature and specificity of the international activities. There are three broad stages for strategy development: fundamentation, elaboration and implementation<sup>12</sup>.

- *Internationalization strategy fundamentation* involves an analysis of the context (external and internal environment), which takes into account general external factors, competitive market factors and enterprise factors. Such factors influence the

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<sup>11</sup> Petersen Bent, Welch Lawrence S., (2003) *International Business Development and the Internet – Post-hype*, in *Management International Review*, vol. 43, nr. 1, p. 7-29.

<sup>12</sup> Nicolescu Ovidiu, Verboncu Ion (2008) *Metodologia de realizare a strategiei*, in *Metodologii manageriale*, Editura Universitară, București, p. 59 – 98.

strategic options of the company on a long-term, stimulating, or, on the contrary, discouraging international involvement. The analysis of external factors is reflected in identifying opportunities and threats associated with internationalization, and the analysis of enterprise factors allows for the identification of the company's strengths and weaknesses, accordingly, the resources and restrictions for internationalization. Viewed together, the two approaches (strengths / weaknesses on the one hand, opportunities / threats, on the other hand) are components of a SWOT analysis (strengths, weaknesses, opportunities, threats).

- *Internationalization strategy elaboration* is based on the SWOT analysis, as identified in the previous stage, according to which the key elements of the internationalization strategy are identified, which should consider the inclusion in the overall strategy of the company, internationalization decision, market selection, location and facilities, marketing mix elements - product / service, promotion, distribution, price, etc.. Of these, essential for the internationalization strategy are considered to be the foreign markets selection and operation methods establishing.

- *Internationalization strategy implementation* - it is the proper implementation of the strategy, according to how it was previously founded and elaborated.

During each of these stages, there are certain knowledge necessities which have to be considered according to small and medium enterprises specificity. Such knowledge is actually object of some specific processes, which include knowledge acquirement, through creation or acquisition, use, handling and development, and reevaluation.

Internationalization triggering is essentially determined by the existence of relevant knowledge, obtained by processing information related to internationalization and foreign markets. The role of knowledge in the development of internationalization strategy is essential for establishing the operation methods and external markets concentration or diversification, especially related to uncertainty, asset specificity, knowledge appropriability through tacit or explicit means, economies of scale and scope<sup>13</sup>.

Knowledge processes in the case of small and medium enterprises internationalization can be analyzed as a specific case of the general knowledge processes which develop within an organization, as presented in the figure below<sup>14</sup>. These processes thus imply the following phases:

- *Available and accessible knowledge evaluation* – for both internal, organizational and individual knowledge, and external, stakeholders' and potential partners' knowledge;

- *Knowledge necessities and sources forecasting* – according to the existing knowledge and the internationalization strategy; a special focus must be put on the identification of knowledge sources and ways of acquirement;

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<sup>13</sup> Sami Saarenketo, Kaisu Puumalainen, Kalevi Kylaheiko, Olli Kuivalainen (2008) *Linking knowledge and internationalization in small and medium-sized enterprises in the ICT sector*, in *Technovation*, vol. 28, nr. 9, p. 591 – 601.

<sup>14</sup> Nicolescu Ovidiu, Nicolescu Luminița (2005), *op. cit.*, p. 217.

- *Knowledge acquirement* – from both inside the firm and outside, also including knowledge creation if the existing knowledge is not sufficient and its acquisition is not possible;

- *Knowledge use, handling and development* – makes the most of the knowledge processes in a firm, and is a laborious, complex phase which implies several technical, economic and human aspects. Several operations can be included in this phase, in order to develop superior, innovative products and services;

- *Knowledge revaluation* – is the phase in which the organization economically benefits from the previous processes, and the core purpose of knowledge processes.

The knowledge necessities for small and medium enterprises internationalization are various and complex. Specific for the internationalization process is knowledge related to *foreign markets selection* - which includes an examination of political, economic, social, cultural, technological, legal, environmental factors, as well as competitive market factors related to competitors, customers, suppliers, etc. – and *operation methods* – the path whereby the firm is to be internationalized, which implies a choice between different alternatives, the most appropriate for small and medium enterprises being considered: the Internet, export, intermediaries, counter trade, licensing, franchising, joint-ventures, foreign direct investment<sup>15</sup>. The need for knowledge increases as small and medium enterprises shift from simple to more complex internationalization paths.

Moreover, internationalization implies *changes and developments in the internal and external functions* to support the chosen strategy, especially referring to those functions most closely influenced by a particular choice. Such functions may be sales, logistics, production, research and development, commercial intermediaries or strategy consultants.

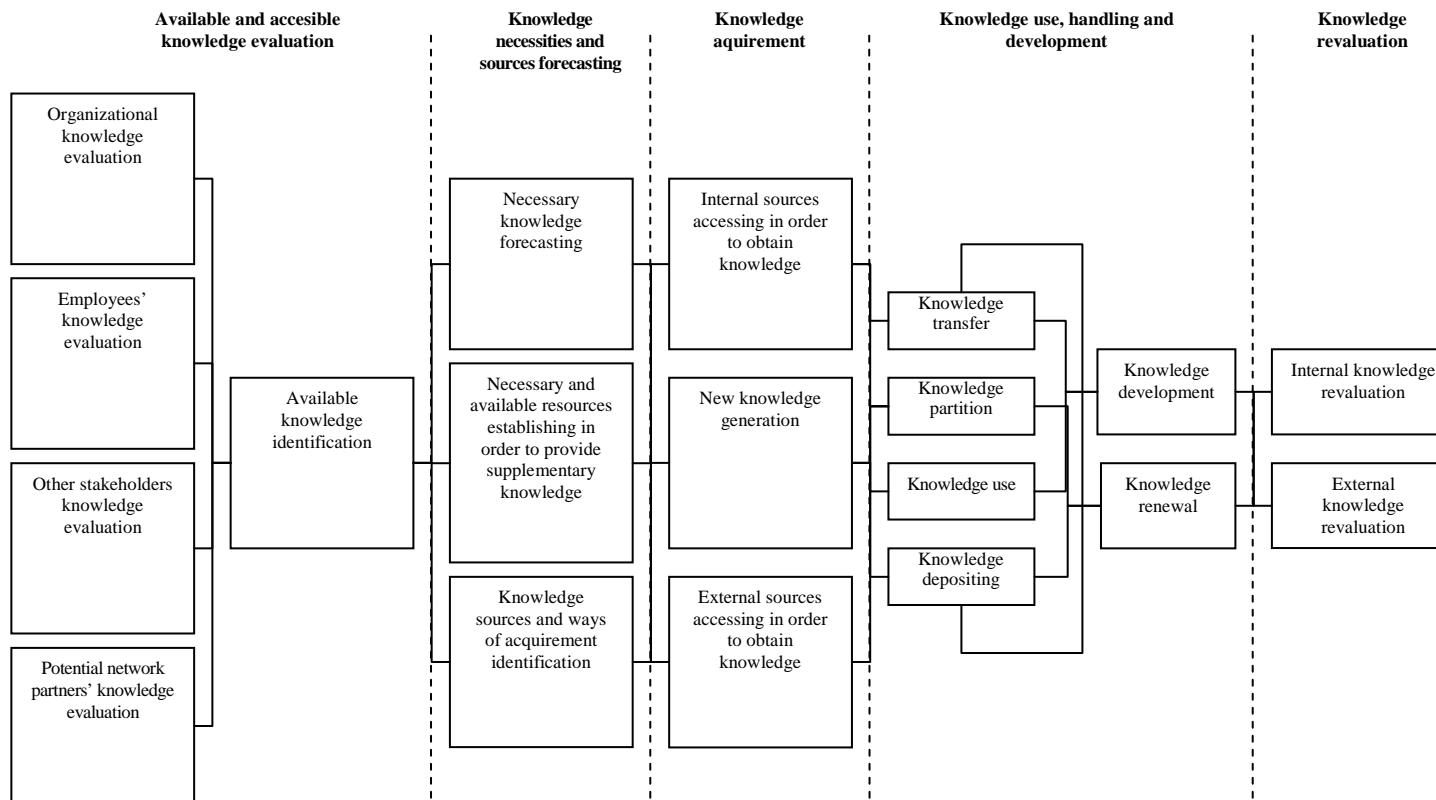
The necessary knowledge may be acquired from a number of *sources* such as written works, government agencies, trade associations, personal contacts, or the Internet, relevant to the intended internationalization strategy. This may imply both desk research and field research. Due to the advances in information and communication technology, small and medium enterprises access to knowledge is practically equal to that of large firms.

If the role of knowledge as a key determinant of competitive advantage in internationalization is widely recognized, the approach to knowledge in the small and medium enterprises does not constitute an integrated, systematic process, but rather independent and randomly, with a restricted use of the specific knowledge management methods and techniques, and of the specific applications, such as the production chain management or customer relations management. The knowledge based approach to small and medium enterprises internationalization is actually more related to the entrepreneur and his characteristics, including on the expense of the available resources<sup>16</sup>.

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<sup>15</sup> Norman M. Scarborough, Thomas Zimmerer (2006) *Effective small business management: an entrepreneurial approach*, 8<sup>th</sup> Edition, Pearson/Prentice Hall, Upper Saddle River, New Jersey, p. 371 – 372.

<sup>16</sup> Sami Basly (2007) *The internationalization of family SME. An organizational learning and knowledge development perspective*, in *Baltic Journal of Management*, vol. 2, nr. 2, p. 154 – 180.





#### **4. Knowledge acquirement for Romanian small and medium enterprises internationalization**

Romanian small and medium enterprises internationalization issues are currently only tangentially approached, both in the literature and as a reality of the business environment. Until present there are no studies regarding the internationalization status of Romanian small and medium enterprises, though its knowledge and analysis are a necessity where the development of this sector, which includes fostering internationalization, is currently a priority for Romania. Small and medium enterprises internationalization stimulation is a current concern in the European Union and will be also emphasized in Romania in the near future. In this regards, a first step would be the ensuring of appropriate access to internationalization knowledge.

Small and medium enterprises are not to be considered a single class or typology of economic organization, and, moreover, the effective demand concerning internationalization knowledge by small and medium sized firms is probably very little compared to the unexpressed or hidden one, as small and medium enterprises may specifically have a partially clear and largely unconscious perception of their needs. Thus, providing access to appropriate internationalization knowledge is a complex task, especially since currently such an access is very limited, and requires special efforts for Romanian small and medium enterprises.

This should include several ways of access to internationalization knowledge, taking into account the heterogeneity of the sector and its needs. As a first step, *standardized access to internationalization knowledge* should be provided, respectively, largely independent of the demand by a specific category or enterprise, like the organization of international exhibitions, supply of statistics on foreign trade, access to online databanks providing news on international markets.

Furthermore, *flexible access to internationalization knowledge* should be designed to meet the requirements of differential groups of small and medium enterprises. This may include legal or international marketing advice provided by consultants, technology related services extensively using telecommunication instruments, access to online databases using specialized software, etc. Flexible access to knowledge requires professionals' contributions, which should intervene when it would be too costly for the small and medium enterprises to produce and manage such services by themselves. It should be oriented especially to those industries and products and services that have better chances of succeeding abroad, taking into account for example that Romania's current comparative advantage as compared to the European Union is in the production of clothing. Though, one may notice a decreasing trend of the comparative advantage for clothing, but there is an increasing trend of the comparative advantage for textiles<sup>17</sup>.

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<sup>17</sup> Gagea Andreea Mihaela, Grigore Liliana, Stănculescu Anca Maria, Georgescu Bogdan (2009) *The comparative advantage in Romania's intra-communitary commercial relation*", 5<sup>th</sup> International Economic Conference "European Integration - New Challenges for the Romanian Economy", Oradea.

Last but not least, *appropriate access to internationalization knowledge* should be provided, especially for small and medium enterprises operating in rapidly evolving industries, with highly specific knowledge needs. The need for such knowledge is expected to grow in Romania in the near future, and is not limited to technology related knowledge necessities. It should be mentioned that Romania holds an appreciable number of registered patents, in various sectors, but their owners' possibilities of commercializing them abroad are limited.

## 5. Conclusions

The knowledge-based view on the firm, emerging from the resource-based view, has become an assigned framework for analyzing small and medium enterprises internationalization, due to its explanatory value. It may also be viewed as an integrated framework which relates to traditional assigned theories, both economic and behavioural approaches, most of them recognizing the role of knowledge in the internationalization process, explicitly or implicitly. Knowledge determines, influences and supports small and medium enterprises internationalization in various ways, and is an essential necessity for internationalization.

Having considered the specific stages of the internationalization strategy development, we can conclude that specific knowledge necessities arise at each stage. Such knowledge is actually object of some specific processes, which can be structured according to the model for the general knowledge processes which develop within an organization. In the internationalization process, knowledge is object of certain knowledge processes which include knowledge evaluation, knowledge necessities and sources forecasting, knowledge acquirement, knowledge use, handling and development, and knowledge revaluation. Knowledge necessities specific to small and medium enterprises internationalization include knowledge related to foreign markets selection, operation methods, changes and developments in the internal and external functions, and it may be acquired from a number of sources that should theoretically be equally accessible to both small and large firms.

We have put a special focus on the process of knowledge acquirement, as a main premise of the internationalization process, providing an analysis for the case of Romanian small and medium enterprises. Romanian small and medium enterprises internationalization issues are currently only tangentially approached, and a first step for their stimulation would be the ensuring of appropriate access to internationalization knowledge. In this regards, several ways of access have been proposed: standardized, flexible and appropriate access to internationalization knowledge - by taking into account the heterogeneity and complexity of the sector's necessities.

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**THE QUANTIFICATION OF THE FISCAL IMPACT OF THE  
SOCIAL TAXES AND CONTRIBUTIONS LEVIED ON EMPLOYED  
LABOR ON SMALL AND MEDIUM SIZED ENTERPRISES. IT'S  
ROLE AS A TOOL OF ECONOMIC COMPETITIVENESS**

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**ABSTRACT.** In the actual world economic framework, in which the financial crisis is running at full steam, and is being felt, not in the least, by the small and medium enterprises, the fiscal impact of the social taxes and contributions levied on employed labour (*id est*, on employed labour income) is of the outmost importance, for the management of such firms.

In this paper we intend both to quantify the amplitude of this particular impact, through the use of the index known as Implicit Tax Rate on Labour, and to highlight the main measures needed to be adopted, if the management of small and medium enterprises is to diminish the possible or probable negative effects of this type of fiscal impact, impact which is punctuated by the Implicit Tax Rate on Labour index.

For the emphasizing of the main features of the managerial strategy needed to be adopted in this case, we use the strategy of pointing up this particular type of fiscal impact on the small and medium enterprises of Romania, given its quality of being part of the European Union.

**Key words:** fiscal impact, implicit tax, small and medium enterprises

**JEL classification:** E24, E62, H32

The role of small and medium enterprises (SME) is extremely important in the economy of every state; this is due to the fact these companies are the engine of the innovative activities carried out, in a system of modern market economy, anyway, in the *real* economy – to be more exact, the small (and medium sized) businesses are, in such a system, the forefront of technical and economic innovation. It is not, in this sense, without use mentioning a market economy is not characterized, if we have in mind the *sphere* of producers, that is all the producers, only by large market ratios, but, in the era of globalization and virtually free of

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charge telecommunications, by – if not in the most part by – small market ratios, or by residual ‘niches’ of the demand for goods and services.

In this context, it is impossible to ignore the importance of small and medium enterprises’ productivity, in the present economic *status-quo*, and, consequently, the importance the ‘comparative advantage’ the fiscal system can give, automatically or through the conscious action of the management of those enterprises, to the small and medium enterprises, ‘comparative advantage’ that enhances, or can augment, the efforts made by those small and medium enterprises in their competition struggle.

It is well known the fact excessive fiscal policy represented – and still typifies one of the causes of slowdown of the expansion of this kind of producers, this situation imposing, along the diminishing of the fiscal pressure, a differentiation of taxation using the criteria of economic branch, practice in use, as a matter of fact, in some industrialized states of the European Union, like Belgium<sup>5</sup>.

We can, in this way, express a reasonable opinion about the influence of fiscal pressure on the competitiveness of small and medium enterprises, only if we use a mathematical index – an instrument used for our economic goals, with which we can quantify the quantitative characteristics of fiscal pressure.

Given the fact ITR is the index which embodies the quantification of the tax rate on labour, tax levied on both producer (employer) and consumer (employee), we, though the use of this tool, measure, in fact, the (total) tax on labour put up with, in the *real* economy, by the above mentioned taxpayers, tax that, moreover, comprises the fiscal influence of the mix of direct taxes and contributions levied on (employed) labour incomes.

The taxes levied on employed labour incomes, that is those levied on the employers of the producers – in our case, of the small and medium enterprises – *and* those levied on the producers themselves (i.e., small and medium enterprises) encompass all taxes directly linked to salaries, many of those being withheld at source, paid by employers and employees, including, here, the social security contributions. Those taxes, for more precision, comprise the compulsory social contributions paid by employers and the payroll taxes, the compulsory social contributions paid by employees and the (personal) taxes levied on the earned income. The implicit tax rate on labour reflect the taxes and contributions paid/supported by employers and employees in relation to the work taxpayers – we mean here the consumers, not the producers – bring forth for the producers in their quality of employees.

The ITR on labour is a macroeconomic index, derived, structurally, from the data comprised in the national accounts. In some member states of the E.U. the recent fiscal reforms had powerful effects on the taxpayers whose salaries are as large, so to speak, as the minimum wage in the real economy, on the low-qualified workers and on the taxpayers with – among others – the quality of parents, fact which seems to prove

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<sup>5</sup> In Belgium, the companies that fulfill their operations making good – and daily – use of technological innovation benefit from fiscal measures, or from innovation premiums.

that these changes only partially reflect the discretionary measures of fiscal policy. According to the ESA95 rules for national accounts, the taxes will be, in normal circumstances, recorded by the fiscal authorities in the very moment of realizing the economic activities – that is, the carrying out of employed labour – for which those taxes are calculated and levied on, rather than according to the moment when the actual payment of taxes takes place. For example, the personal income tax is levied on the incomes accumulated one year before the payment of the due tax is realized.

If we keep in mind the fact fiscal pressure, in general, is quantified through the intermediation of an index itself computed using, among other components, the tax on labour, and the impact of fiscal pressure on SME competitiveness is a considerable one, it becomes clear taxing labour influences, directly, the power of such a firm of sustaining the competition struggle.

Given the importance of income taxation for SME competitiveness, our paper relies on the study of the effects of labour taxation on the financial and economic performances of those companies.

In order to understand better the global implications of the concept of fiscal pressure, we can use order taxes, according to the ‘object’ the taxes are levied on, into three main categories: consumption taxes, taxes on labour and taxes on capital.

The aggregate taxable bases corresponding to the quantification of the fiscal pressure *tolerated* by SME are constructed starting from the data comprised in the national accounts, in order, to be (more) explicit, to determine ITR on consumption, labour and capital. ITR is, thus, an index that measures the average of the effective fiscal pressure levied on different categories of incomes or economic activities; it, however, does *not* measure the final incidence of taxes, given the economic reality taxes can be displaced from one activity to another due to (microeconomic) producers’ psychology.

Previous approaches, relying exclusively on aggregate data from the national accounts, estimated the total personal income tax, in what labour or capital incomes were concerned, using the ratio of (aggregate) labour or capital income to the (aggregate) total income of the taxpayer. These approaches inferred the effective average ratios of personal income tax were of the same value, considering different sources of taxable income and different types of taxpayers, statement unsoundly enough for us to say more about it here.

In order to have a realistic image of the fiscal pressure generated by labour incomes taxation, including the SME case, we consider it is necessary to use the ITR index. This is the fact, as we will demonstrate, and for more than one reason.

One of the reasons is the characteristic of ITR to facilitate the building up of a study of the dynamics of the levels fiscal pressure reaches in time – and, by this, the identification of the production factor, or of the income source mainly taxed, in a given period of time –, and in a given group of states, so that it will be feasible, and reasonably accurate, to make an inter-state fiscal comparison.

Another reason for which we, and not only we chose to put this mathematical tool to good use – we, in this very paper –, in order to reach the goals mentioned above, is the possibility it gives us to obtain a near complete picture of the phenomena we are analyzing therein: with the help of ITR index it becomes visible the entire field of financial and economic influences which leave their mark on taxation (on labour taxation, in this case).

It must be underlined that, for sure, a taxation *trend* cannot be fully explained just by using ITR. But, for the goals of this paper we need a little less than that, and, precisely, the piece of knowledge the ITR index is, more surely, able to supply us with; this is the clarification of the *shape* of such a trend, clarification that no longer seems improbable to occur once we state the formula with which ITR on labour is computed, which is what can be seen below:

$$\text{ITR on labour} = \frac{\begin{array}{l} \text{direct taxes (if any, indirect taxes too) and compulsory} \\ \text{actual social contributions paid by employers} \\ \text{and employees, on employed labour income} \end{array}}{\text{Compensation of employees} + \text{Wage bill and payroll taxes}}$$

The main methodological difficulty which must be confronted in order to calculate the ITR on labour is the fact the personal income tax is levied on multiple sources of incomes (employed labour, self-employed labour, and income in the form of pensions received and in the form of social benefits payments). Dividing the tax according to the personal income tax (PIT) concept, into different types of taxable (personal) income has the aim of realistically calculate the average personal tax rates (in the sense they cannot be conceived as being equal to one another, given the different sources from which taxable incomes are obtained and the different types of taxpayers that are not producers); therefore, the tax is quantified as a weighted average of the taxable incomes obtained from different sources (wages, copyright, etc.).

The quantified ITR can be seen as a synthetic measure that approximates the average level of the effective fiscal pressure levied on the labour incomes generated in the real economy. In this sense, it must be underlined the calculus of ITR may, can be said, hide important variations of the effective tax rates – concerning different activities of the company, or different families, or different wage levels. For example, cuts in social contributions on the part of taxpayers whose salaries are around the level of the minimum wage, or on the part of low-qualified workers may have a small impact on the global ITR and yet be effective in raising take-home pay for the taxpayers involved.

Most of the member states of E.U. compute the labour income tax by multiplying, basically, every payment accounted for an income tax with the ratio of every selected income source to the global income of the taxpayer (e.g. Belgium, Denmark, Germany, France, the Netherlands, Ireland, Luxembourg, Finland and Sweden).



This is done both through macroeconomic simulation models, which are based on samples of all taxpayers, and by using extensive data regarding the return of personal incomes of exhaustive tax return data-sets (e.g. Belgium and Ireland). Estimates obtained at taxpayer level are aggregated in order to obtain estimates on the personal income tax levied on personal labour income. Personal income tax (labour) can be estimated as follows:

$$PIT(\text{labour}) = \sum_j \left( \frac{W_j}{Y_j} \right) \times PIT_j = \sum_j w_j \times PIT_j$$

Where:

$W_j$  quantifies the labour income of taxpayer  $j$  in a sample of individuals ( $j=1,..,n$ ) and  $PIT_j$  measures the personal income tax payment of taxpayer  $j$  (on his total taxable income  $Y_j$ ).

The equation above illustrates the total personal income tax levied on labour income as weighted average of each payment of the personal income tax of each taxpayer, with the weights  $w_j=W_j/Y_j$  attached to individuals payments, reflecting distribution of total wages for different categories of taxpayers.

Some Member States, such as Spain, Italy and Greece, use information regarding tax return data, that is aggregated at a number of incomes' categories or income tax brackets ( $j=1,..,n$ ), but in principle perform the same calculations. The next approach aims to obtain comparable effects of the differences in tax treatment and distribution of income sources in the various categories of taxpayers. Other Member States, such as Austria and Portugal, choose a different approach and use information on tax receipts data from the wage withholding tax and statistical information on the final income tax and apply a number of adjustments.

The tax on income from labour of employees – in particular, tax income from wages – is by its very nature designed to estimate exactly how much debt represents final income tax for holders of wage income, but in some cases there are some adjustments for assessing the income tax, because wage tax retained it is not correctly calculated, given the different jobs or pensions the taxpayer has in one year. There are situations in which the net amount of the corrections shall be deduced from the total amount of wage tax recorded and the pay tax of personal income is adjusted accordingly. The personal (adjusted) income tax is rather divided between incomes generated by self-employment activities and income from capital, using aggregate information from various categories of incomes (Austria).

The recent trend the economists concerned with the monitoring aspects of the fiscal pressure reveal – we think only about the fiscal pressure concerning labour – confirms the importance, or in other words the value of Implicit Tax Rate. Let's say, first, that labour's taxation – represented by the amount of taxes and social contributions generated by income from labour of employees, mostly withheld at source – represents one of the main sources of income in the European Union, providing, on average, over 50% of total incomes.

A second source of income is represented by consumptions taxes, which amount to 25 to 30% of incomes in most Member States. Taxes on income from capital are less important, providing approximately one-fifth of total fiscal revenues.

It's not unimportant, in fact, really, is of great importance the fact is also evident from the statistics that, in Member States with a tax-GDP ratio relatively high, a tendency to collect relatively high amount of social contributions and taxes from labour occurs – and vice versa. The proportion of labour taxes and social contributions in total taxes is significantly below the average of the E.U-15 countries with low taxation, such as Ireland and Great Britain, and also Greece and Portugal. It's noteworthy that recent research illustrates an insignificant decrease of labour taxation, in terms of the tax – GDP ratio (Office for Official Publications of the European Communities).

The implicit tax rate on labour recorded an increase in most Member States, since 1970; from around 1995 there were Member States that adopted measures to decrease the fiscal burden concerning labour incomes, in order to encourage the demand for labour and encourage provision of incentives. Currently, the general trend evidenced in most Member States concerning the increasing of labour taxation has stabilized and even declined slightly – implicit tax rate on labour, in E.U. 25, fell by 0.7 percentage points (in the GDP-weighted average) between 2000 and 2003, but, nowadays, is still relatively high. There are some Member States in which the development of implicit tax rate on labour was influenced by economic growth at the end of 1990 years and slowdown in the years that followed.

In most Member States the implicit tax rate on labour reflects the important role played by wage based contributions in financing the social security system. On average, approximately 65% of the implicit tax rate on labour comes from social contributions paid by employees and employers.

The new E.U. Member States do *not* register significant differences in the taxation of labour, compared with the old Member States. European Commission Reports on “The structure of taxation in the E.U.”, which are based on ESA79 national accounts system, denote a common tendency to increase the fiscal burden related to labour incomes in the 15 EU Member States, since the early 1970s; this overall growth was closely linked to the expanding public sector share in the economy, mainly due to expenditure on social security needs from children and elderly (especially for pensions, health care and other social benefits). Growth in the first half of the 1990s was associated with the increase in social contributions attached to the recession at the beginning of the decade. Moreover, the fiscal pressure increase was associated with budget deficits in the run-up to EMU.

It's noted that Implicit Tax Rate is an effective tool for investigating the impact of fiscal pressure related to labour (in its quality of production factor), for SMEs (more revealing are the effects of labour taxation in the case of employees, but, and just because of this, on the SME in its quality as producer), at least due to the following facts:

1. SMEs pay, at least in Romania, but actually in Romania as in other EU countries, the income tax – in this case, for all incomes, generated by whatever source<sup>6</sup>;
2. Implicit Tax Rate allows a study on the dynamics of fiscal pressure levels over time – because of this, among others, we can identify the most taxed income source in a given period;
3. Total tax, levied on income from labour, as it is calculated by ITR, it is quantified as a weighted average of the taxable income derived from different sources (wages, copyrights, etc.);
4. The majority of EU Member States – including Romania – calculate the tax on labour incomes by multiplying, basically, every payment accounted for an income tax with the ratio of every selected income source to the global income of the taxpayer.

But, let's outline the existing link between advantages – existing as such even for the management of a SME – generated by the use of ITR index and the advantages needed in order to increase the competitive features of such a company.

It is common knowledge that marginal tax rates affect not only labour-supply decisions, but also decisions related to the start in or to the expansion of a business activity. In our case, the small and medium enterprises are subject, in the European Union, and in Romania too, to what may be labelled as *personal* tax rates (in fact, taxes laid upon the *revenues* of the firm), and **not** to corporate tax rates. As a result, a decline in personal tax rates, as a general case, or, in our case, in the tax rates the small and medium enterprises are subject to have an effect on the risk/reward ratio for potential investors. Moreover, it is proved progressive marginal tax rates makes any entry into self-employment a difficult task (Lipsey & Chrystal, 1999). For this, ITR is more than a tool to rely on, for being able to announce the management whenever investment, or the expansion of activity, is a reliable alternative.

The management of any small or medium enterprise must pay attention not only to these matters, but also to another, *id est* to investment decisions (once the existence of a small or medium enterprise is real and stable): if tax rates affect the supply management, any modification of the tax rate will, inevitably, induce an oscillation in the trajectory of aggregate supply (Schiller, 2003). In this respect, the ITR is very important, because, whether the sector of small and medium enterprises in an important one, in a given economy, the expansion of production, started out due to the fact ITR, among, of course, other mathematical instruments, gives the signal to invest more, or to expand even further, will have positive and sensible results in the entire economy as a whole.

Firstly, as we have said, the ITR is able to give a signal to the management to produce more – or, to expand the production capacity; secondly, the small – or medium sized – firm will, therefore, use more resources, found in the real economy itself.

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<sup>6</sup> They trade inclusively on the unique quota system.

The small and medium enterprises are able, as any other company, to produce more/to expand the production capacity if they can hire more workers; these workers, once hired, will reduce the number of *unemployed* workers in the real economy, and, on the other side, the newly generated production will, *caeteris paribus*, lower the pressure of inflation. To put it shortly, if the economic sector of small and medium enterprises goes well, the real economy will prosper.

We must mention that ITR is a very powerful tool from another point of view too: due to its structural ‘power’ of underlying the *source* of incomes mostly – in a given period of time – *taxed*, this index will help the small and medium enterprises to compete with other companies in the sense it will tell the management whether the *form* of a given governmental act of diminishing some tax on another will truly help the company in its quest of – at least as an intermediary goal – winning the commercial battle with the other firms from the market.

This is because not every tax (rate) cut is as good, as helpful, to be precise, for the firm as another can prove to be; for example, a tax rebate<sup>7</sup> is, at least is *more probably* effective for consumers, rather than for producers, and, certainly, has no effect whatsoever on the marginal tax rate – and will **not** encourage the small and medium enterprises to work/produce/expand more (Schiller, 2003).

As a possible conclusion, ITR is a very important mathematical – and, in this way, economic – index in order to help the management of small and medium enterprises in taking the *economic* and *fiscal* decisions necessary when these companies compete – that is, permanently – with the other firms in the real economy.

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## MEASURES FOR THE IMPROVEMENT OF MANAGEMENT IN ROMANIAN TRADE SMEs AFTER EU-INTEGRATION

NICOLAE MARINESCU<sup>1</sup>

**ABSTRACT.** Romanian trade SMEs face a difficult period since the country's accession to the European Union due to various reasons, such as competitive pressure from large retail chains and the increased regulatory burden stemming from EU-norms<sup>2</sup>. This paper analyses the situation of trade SMEs in Romania, especially relevant as they form an important body of the whole SME sector. The internal strengths and weaknesses of trade SMEs are confronted with the opportunities and threats generated by the new tendencies in European trade. Thus, the impact of Romania's integration in the EU on the management of trade SMEs is investigated. A series of five managerial options are proposed as a response to the realities in the sector: IT and internet adoption, orientation towards growth, association in clusters, outward orientation, and differentiation. Summing up, the paper combines internal and external factors affecting Romanian trade SMEs and issues some suggestions for the management of such enterprises, aimed at enhancing the efficiency of their operation.

**Key words:** SMEs, trade, management

**JEL classification:** L81

### Introduction

Trade SMEs represent almost 39% of the total number of SMEs in Romania (CNIPMMR, 2007), contribute with more than a third to the number of jobs and raise more than half of the turnover of the whole SME sector in Romania (ANIPMMR, 2005). Their importance stems not only from the above numbers, but also from their social role, e.g. of satisfying consumer needs, in a way which cannot be fulfilled by large companies. Since Romania's accession to the EU in 2007, trade SMEs face a difficult time due to various reasons. Some of the more significant reasons consist in increased competition from large foreign retail chains that entered the market, shrinking the breathing space of SMEs, and the regulatory burden brought about by EU-norms which incur additional costs and efforts. Due

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<sup>2</sup> The present paper embodies results generated by the specific teaching activities of the Jean Monnet European Module, Agreement n. 2007-1501/001-001 JEA JECHA, concluded between the Education, Audiovisual and Culture Executive Agency of the European Commission in Bruxelles and the *TRANSILVANIA* University of Brasov.

to these facts, this paper focuses on the analysis of the management of trade SMEs and tries to suggest possible solutions for the improvement of their activities and their mode of operation.

### Preliminary Analysis

The analysis was based initially on a vast literature review encompassing various international and Romanian authors who made contributions to the theory of trade SMEs (e.g. Balasescu, Cox, Dunne, Liebmann, Mercioiu, Naghi, Nicolescu, Tietz, Vorzsak et al., to name just a few of them), publications issued by specific institutions and associations of SMEs in Romania, as well as own work of the author. The literature research was completed subsequently through practical observations of the sector, instrumented by two 2 empirical research studies conducted by the author during 2005 and 2006, respectively.

The findings of the research period have been gathered and summarized to extract the strong points and weak points of Romanian trade SMEs (table 1).

**Table 1:**

Strong points and weak points of trade SMEs

Strong points	Weak points
<ul style="list-style-type: none"> <li>- Role of proximity;</li> <li>- Constant contact with community;</li> <li>- Serving the needs of consumer segments overlooked by large firms;</li> <li>- High flexibility and fast decisions;</li> <li>- Prompt delivery;</li> <li>- Recognized image at local level;</li> <li>- Closeness to customer;</li> <li>- Possibility of offering personalized services.</li> </ul>	<ul style="list-style-type: none"> <li>- Low use of IT;</li> <li>- Lack of scale economies in purchasing, distribution and marketing;</li> <li>- Low bargaining power with suppliers;</li> <li>- High turnover and weak training of human resources;</li> <li>- Difficulty of finding skilled employees;</li> <li>- Weak managerial education &amp; training;</li> <li>- Managerial overload with daily tasks and neglect of planning;</li> <li>- Deficient financial management.</li> </ul>

The above list is just a selection of the essential elements that characterize Romanian trade SMEs at the present moment. Strong points are linked to the traditional functions implied by SMEs and their advantages derived from flexibility, whereas the weak points stem from their smallness, the managerial limitations and the difficulties of finding appropriate human resources.

The SWOT analysis is completed with the main opportunities and threats that trade SMEs are facing after EU-integration (table 2).

The opportunities and threats that confront trade SMEs in a general manner are joined by the major tendencies in European trade, which put their mark on the specific activity of the firms under scrutiny. These moves pose several challenges for Romanian trade SMEs in the direction of adopting organizational changes.

**Table 2:**

Opportunities and threats for trade SMEs

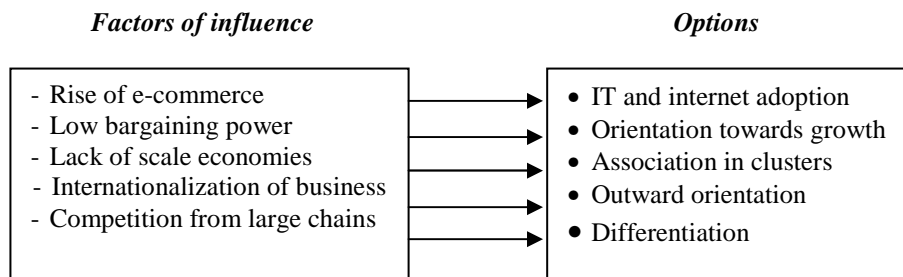
<b>Opportunities</b>	<b>Threats</b>
<ul style="list-style-type: none"> <li>- European integration / single market;</li> <li>- Increasing internationalization;</li> <li>- Rise of China on the world market;</li> <li>- Outsourcing by large companies;</li> <li>- Forms of cooperation (e.g. franchise);</li> <li>- IT adoption and fast spreading of internet and e-commerce;</li> <li>- Development of outlets in the rural area.</li> </ul>	<ul style="list-style-type: none"> <li>- Increasing level of concentration;</li> <li>- Fierce competition from large chains;</li> <li>- European integration / regulatory measures;</li> <li>- Significant seasonality;</li> <li>- Random factors - climatic, social etc.;</li> <li>- Additional environmental norms.</li> </ul>

The main tendencies identified in the European trade sector are:

- Rising number of automobiles / person and of urbanization;
- Increase of purchasing power and changing lifestyle;
- Shorter free time available or different distribution of available time;
- Accelerated growth of consumer credit;
- Lower number of outlets and increase of their average surface;
- Convenience of making all purchases in one place;
- Success of promotional actions of „show-purchase” type;
- Incorporation of wholesale traders through vertical integration;
- Development of new forms of trade (e.g. cash-and-carry), where goods are paid in cash, directly in the store-warehouse;
- Increasing demand of consumers for associated services.

**Resulting Measures**

By selecting from the SWOT analysis just the essential factors that influence trade SMEs, a set of specific options at micro level have been generated so as to contribute to the improvement of management in such firms (fig. 1.).



**Fig.1.** Options for Management in Trade SMEs

These options are detailed below.

- **IT and internet adoption**

The need of adapting to an environment characterized by the ever increasing flow of information and its transformation into a major resource of competitiveness, urges SMEs to switch to the large-scale use of IT and internet.

Overall, computer use fosters an increase of productivity and has several benefits for trade SMEs: fast overview of inventory, tracking of deliveries, drawing up of sales graphs, lower labour costs, etc. IT is costly though, for most SMEs. Additionally, there is opposition due to inadequate software and hardware training on behalf of employees, fear of disclosing confidential data and of unsure payment methods, as well as lack of information by SME managers regarding the available technical options and their advantages. The commitment of the owner-manager towards the use of IT and internet inside the firm is essential.

With the initiation of e-commerce activities, trade SMEs will be able to compete more easily with large firms and will weaken captive relationships with suppliers. There is significant potential for the use of internet in business, especially due to the scarce resources available to SMEs. By means of the internet, trade SMEs can understand better the needs of customers, maintain interactivity, and thus concentrate upon the selection and / or improvement of the most demanded goods and services. This flexibility in relation to the market is a pre-condition for success in trade.

The internet confers trade SMEs a series of advantages, that couldn't be attained otherwise with the same efficiency:

- Cost-reduction for purchasing and storing;
- Interactive way to track inventories;
- Lower logistic costs (products that can be delivered online);
- Close relationship to suppliers and customers (especially if they are widespread);
- Possibility for consumers to place orders from home.
- Nevertheless, the internet poses some challenges to trade SMEs:
- Weakens bargaining power of traditional channels;
- Reduces switching costs from one supplier to the other;
- Transfers power to the end consumer;
- Eliminates some intermediary stages in trade;
- Lowers entry barriers and increases competition in distribution.

In the traditional form of retail, firms were able to extract superior profits through skilful price discrimination between segments, due to the low transparency of the market for consumers. The internet reverses this tendency, equipping consumers with much more information, overall vision of the market and close contact to suppliers.

For wholesalers, the internet raises mainly threats (see challenges above), but under the circumstances of more intense competition, it also offers some



opportunities for consolidating the competitive position of the firm. Buyers can now inform themselves better, compare prices and qualities, select their preferred supplier through the internet, thus, they choose the partner which suits their needs best. Moreover, the internet lowers transaction costs, situation that threatens the position of the wholesaler. The opportunities consist in lower costs, faster purchasing and delivery times, electronic data interchange with suppliers and customers, and instrumental solving of queries. The internet enables a fully visible integration of the supply chain, so that the easy access to information about products in transit or inside the warehouse, availability of products or the stage of the order placed, leads to increased administrative efficiency.

- **Orientation towards growth**

Trade SMEs can be classified into three categories: some of them close in a short period of time, some survive, but stay small, and some grow. The majority of them fall into the first two categories, and most of the managers of Romanian SMEs are complacent with the idea of just surviving. This mentality needs to be changed, growth being more a managerial problem, than one linked to the financial resources available.

Among the benefits of growth one can count the possibility of mitigating the threats posed by the environment, as well as the creation of a solid base of resources, thus enabling the firm to increase its influence on the market and the bargaining power with commercial partners. The possibility of survival is indeed positively correlated to the size of the firm. Moreover, growth enables managers and employees to enjoy professional fulfilment, as a consequence of higher productivity and efficiency.

Nevertheless, growth brings some major managerial challenges. Subsequently, growth needs to be approached with care and the growth strategy must be closely correlated to the existing resources: employees should exist in sufficient numbers and be well qualified, and the technical plus informational base should be available.

Along with growth, the organizational structure centered on the person of the entrepreneur has to switch to one directed towards task-solving, with distinct areas of activity. The complexity of operations increases and the manager loses autonomy. According to the new type of organization, the managing style must change as well. Tensions arise frequently when the traditional relaxed style is abandoned and special managerial skills are needed to preserve a familiar ambiance. Delegation becomes essential, and the entrepreneur turns into a coordinator of different activities. Available time enlarges and the manager can concentrate solely on essential problems. Employee skills are being developed; decisions are taken faster and more efficient. Planning and cost control becomes more and more important, in order to spot deviations early.

The main empirical difficulties associated with growth for trade SMEs are:

- Cash-flow problems;
- Satisfying customer needs, with a constant guarantee of high quality;
- Serving promptly all orders and demands.

Alongside growth, special care should be given to the recruitment of executive persons, because a managerial team needs to emerge, able to combine marketing skills, with financial and accounting ones. External counselling on specialized problems should complete the knowledge and experience of the entrepreneur and accompany the growth process, by means of implementing the proposed solutions, not just issuing them. Most of the times, Romanian trade SMEs shy away from the costs of external consultants, not thinking that if growth itself fails, the whole existence of the firm is endangered. The first recommendations should come directly from the banks involved in the financing of growth.

There are many ways to grow. Franchise has proved an important opportunity for Romanian trade SMEs, with an accelerated growth in the last few years, especially in fast food and specialized retail. Franchise offers the advantage of a good coverage of the market, a single image and additional revenues with relatively low risks.

Another way to grow is to open branches, first in close locations, so as to satisfy demand, then in other areas. The advantages of such a system consist in synergies (purchasing, distribution, assortment, promotion, administration, and training), single image and geographical closeness to customers. The enlargement of the market area has to take into account the analysis of marginal revenues and marginal costs of opening a new location.

One of the enlargement opportunities today is the move of supermarkets from the periphery of cities to blocks of flats and towns that lack proximity trade. A neighbourhood supermarket, with a range of 3,000-4,000 items, an extended programme of 16 hours and easy access, characterized by the friendliness of employees, would constitute a viable solution of growth for retail SMEs.

Moreover, developing locations in rural areas has great untapped potential, not only for retail units, but also for purchasing and packaging units, due to large numbers of products that otherwise would not reach the market. Collection centres could be the first link for the initiation of wholesale vegetable and fruit markets.

#### • Association in clusters

Due to the lack of scale economies and market power characteristic to SMEs in trade, another option suggested is to associate in clusters.

This is an imperative situation, as previous research shows that Romanian SMEs lack interest in engaging in cooperation arrangements, due to insufficient information or unwillingness to evolve in this direction. From all the sectors, SMEs in trade participate in the lowest degree to some specific business association.

Thus, managers find it difficult to develop the skills necessary for a good cooperation inside a cluster and reap the benefits that arise from it.

Clusters should function at local or regional level, based on interdependence for supplying certain products or services, and specialized either on a particular stage of the value chain or on satisfying special needs of customers or market segments. They are dynamic and try to create competitive advantages by using specific abilities of different partners inside the cluster.

Due to the closeness of the involved SMEs, members in a cluster enjoy benefits such as: access to specialized human resources and suppliers, efficient activity by means of competitive pressure, faster response, sharing of information, innovation through exchange of knowledge and strong interaction with customers, suppliers and other related firms, and the increasing ability of penetrating new markets.

Such a cluster may appear in 2 directions:

- Retail trade: formation of a purchasing alliance, testing of new product introduction, purchasing of new commercial equipment;

- Wholesale trade: association so as to obtain the best sales terms, modernization and improvement of the purchasing process, optimal use of logistics.

The specific benefits that arise from participating in clusters for trade SMEs consist in lowering costs and risks, superior economic and organizational flexibility, as well as facilitating the growth process of the firm, limited individually by internal constraints.

#### • **Outward orientation**

Alongside world trade liberalization, increased international movement of persons and fast development of transport and communication, many of the non-surpassable barriers for the internationalization of firms have disappeared. Thus, trade SMEs gain lots of favourable perspectives if they adopt a strong outward orientation.

European integration enables Romanian SMEs access to an additional market of about 480 million consumers, situation which favours especially wholesale traders with more consistent financial resources in hand, but also offers the possibility for retail trade to expand more easily across borders.

Moreover, SMEs can access valuable European funds. The EU-support for SMEs comprises also supplying relevant information, consulting for strategy build-up and promoting cooperation between enterprises in member states.

In this context, one recommendation for wholesale SMEs is to register in the database of the EuroInfoCentres, the European-wide network. They act in Romania inside the Chambers of Trade, offering free possibility for SMEs to promote their firm and products in EU-member states, with the aim of initiating trade and cooperation relationships with other SMEs.

For retail SMEs, European integration seems to generate more threats, due to increased competition. This leads to price focus (hard discount), to more choice („everything under one roof”), and to service (convenience stores), changing the pattern of trade. Wholesale traders will also face difficulties through the presence of more suppliers and buyers that operate with better sales terms.

On the one hand, the adoption of the EU-acquis ensures the improvement of the business environment and also a more predictable legal and institutional system for Romanian trade SMEs. On the other hand, it brings about higher costs for SMEs, by eliminating fiscal incentives and pushing firms to comply with European standards. These standards have often been considered too costly, too bureaucratic, and even inadequate for SMEs. Trade SMEs will have to implement packaging and labelling norms. The stricter environmental and quality norms will impose on SMEs the acquisition of superior equipment, so as to stay in line with the standards.

The widespread opinion is that those SMEs that implement faster all these norms and will certify qualitatively their mode of operation will gain a valuable competitive advantage and will reap the full benefits of the Single Market, facing thus successfully the increased competition.

Another extraordinary opportunity for trade SMEs is the rise of China on the world market, climbing its way up to the top of the exporting nations’ chart. As a consequence, SMEs able to conclude contracts and foster relationships with Chinese partners will enjoy the benefits that arise from this favourable evolution of the Asian giant.

- **Differentiation**

As fierce competition from large retail chains is gaining momentum, the adequate strategy for trade SMEs should be differentiation. It supposes though strong commitment towards the improvement of the quality of services provided.

Differentiation in trade SMEs encompasses a multitude of elements: products, services, location, adaptability, fast delivery, reputation, employees, etc. It is in fact, a defining aspect of the way in which the firm conducts business, perceived by customers as being unique. The elements listed above may become distinctive competencies of the firm only if they are perceived as such by customers.

The important aspect is that SMEs should adopt a specific positioning and a focus on an essential variable of the business, concentrating on what the firm knows how to do best. Usually, this approach includes market niche positioning, characterized by being less sensitive to price, with higher entry barriers, and more profitable in times of crisis.

The potential success of differentiation in trade SMEs may consolidate on responsiveness (enhanced perception of customer desires and collection of information from the environment), flexibility (better reaction in terms of employees, finance and markets), creativity and ability to innovate (use of new equipment, new approach of customers and new sales techniques).

Some specific suggestions of factors that can help SMEs gain solid competitive advantages include the use of own trademarks, brands and symbols for certain services, the initiation of a catering system for persons with special needs, enhanced interactivity with customers and various means to improve their loyalty.

With the advent of large retail chains, European trade moves towards major changes in the distribution system. Wholesale trade tends to be absorbed by vertical integration. Under these circumstances, wholesale traders can differentiate by becoming specialists in logistics, including transport & infrastructure, warehouse operation, inventory management and delivery options. Continuous contact to customers supposes assistance for introducing new methods of inventory control, instructions about operations management, and regular meetings for problem-solving.

For retail SMEs, differentiation may consist in developing a unique personality for each store that should act as a competitive weapon towards other outlets. Options for small shops comprise:

- Convenience stores: less time, comfort, known brands, large range with few lines;
- Specialized stores: choice, own brands, low range with high depth;
- Style stores: design, originality, exclusiveness, premium prices, high quality;
- Brand stores: reputation, premium prices, limited range, high quality;
- Local specific stores: emotional purchase, traditional products.

The ideal location for such a shop would be in a neighbourhood where no such else exists, or, if this is not the case, then the strong points should be emphasized. The ambiance of the store and the services provided (dressing cabins, long working hours, gift-wrapping, home delivery, refund of non-adequate goods, free parking, children area etc.) may represent competitive advantages for retail SMEs.

### **Conclusions**

Even though European integration was considered by many authors a scare for Romanian SMEs in general, and trade SMEs in particular, many anticipating a massive closure rate, the negative outcomes of this process were largely overstated, as the real situation shows. The research undertaken to analyse the management of trade SMEs reveals some of their specific strong points and several weak points and takes into account the opportunities and threats brought about by European integration. There is surely a multitude of managerial changes that should be undertaken by trade SMEs in face of the new tendencies of the European trade sector, but this paper focuses on five different measures that can enhance the competitive position of such firms. It remains to be seen whether owner-managers of trade SMEs will have the commitment and skill to implement some of these measures. Further empirical research opens up in the years to come to test if trade SMEs have accomplished managerial changes and to what extent has this improved their mode of operation.

NICOLAE MARINESCU

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## THE CHALLENGES OF SMES IN MODERN MARKETING

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**ABSTRACT.** SME's are actually driving Romanian economy, especially after the European Union integration, but the risk of failure is obvious due to the lack of openness to the modern times.

SME's need to upgrade their competitiveness and their knowledge about online marketing and the complexity of the market. Most of the SME's disregard the importance of marketing promotions services. The Internet is also considered an expensive and sophisticated way when it comes to advertising for small companies. Wrong! The Internet offers unlimited resources at present, even many free promotional services, even beyond the geographical borders. Limited online promotions have a great impact on the image of small businesses compared to big enterprises that invest a specific amount of money on web advertising.

When talking about small businesses we confront many difficulties and limited sources of promotion and advertising therefore, limited local promotion online may be the winning solution.

Promotion and advertising beyond the geographical borders is what SMEs should focus on, getting an online identity and to expand the business in a cost efficient way.

This article includes a research on the challenges that SMEs are facing in the modern times and the risk due to the lack of openness towards it. It also presents the advantages and disadvantages for an online successful marketing promotion of the small businesses through direct e-mail marketing and the cost efficiency of the method used in the modern times.

**Key words:** modern marketing, marketing promotion services, online marketing, e-mail marketing, SMEs challenges.

**JEL classification:** M31

### 1. Introduction

Online marketing represents the process of building and maintaining online relationships with customers which facilitate the exchange of ideas, products and services that meet the objectives of both parties<sup>3</sup>.

Online marketing mix is composed of 4 traditional elements (product, price, promotion and distribution) together with two others: community and branding.

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Community represents the relations built on common interests, leading to satisfying the needs of the parties, otherwise unable to be satisfied. One of the unique aspects of the Internet is the high speed of communication and training communities. It is very important what business impact these communities have on small and medium enterprises and the feedback these companies offer.

Branding plays two roles in marketing strategy. First of all, branding is a result of marketing activities performed by an enterprise. Marketing programs affect consumer behaviour and the impact the value of the brand and the brand itself have on these consumers. Second, branding is a part of every marketing strategy,<sup>4</sup> thus, any marketing activity is more efficient if the brand is well known by consumers.

However, these six variables do not capture all aspects of online marketing activity; the concepts of individualization and interactivity are introduced for a better understanding of the implications brought to this new activity that it is so challenging for SMEs.

Individualization refers to the individual level exchange in terms of marketing. In addition to interactivity, consumers expect a personal experience with these online companies. Classical messages offer the same information to the target market, when on the other hand internet allows the company to initiate personal messages to each customer in particular building a strong relationship with each consumer. Besides this, the customer can choose the level of individualization of the message according to its preferences; therefore the level of individualization can be controlled both by SMEs and by customers.

Interactivity represents the bi-directional communication between businesses and consumers, achieving through internet a level of dialog between the two parties unprecedented in the history of economics. Certainly, consumers could communicate with vendors in shops or with managers in a company, but not to the level at which internet allows. Thus, the communication to an extended target market through television or radio is extended to debating, exchanging and conversation<sup>5</sup> which creates a challenge for SMEs for building a strong relationship based on continuous communication with each customer individually.

Interactivity enables an online business to sort its customers, offering them online services for those who need more information, having lower knowledge about the business and different searching services for experts compatible with their high level of knowledge. For example, an Acupuncture site will direct potential customers to a page that presents a video presenting a patient who receives treatment, a dictionary with terms used in Acupuncture, a brief overview of treatments and testimonies of patients who were treated successfully. Experienced patients, however, can be taken to pages containing information about the most recent studies in the field or in the pages that can schedule.

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<sup>4</sup> [www.afaceri.net](http://www.afaceri.net)

<sup>5</sup> Al.Nedelea - *Politici de Marketing în Turism*, Ed.Economica,Bucuresti200, pag 232



These important advantages offered by the Internet, allows the customer to find all the information needed about the SMEs and permits the companies to build strong relationships with the clients in order to win their satisfaction and loyalty on a long time period.

**2. The main challenges that SMEs are facing**

- many customers ignore the email advertising campaigns;
- no face to face communication with clients;
- the easily comparison of prices with competition;
- most of the Romanian customers do not trust online payments.

**Reasons for using Internet as advertising SMEs:**

- 14.6% of those who have a job are regularly using the Internet;
- 87.6% of those who have a job use the internet for different purposes other than work at least several times a week;
- 40% of users use the computer at work to purchase online goods;
- 36% of users use the computer at work to find another job;
- 45% of employers use the internet at work to plan vacations;
- 46% of online holiday period are achieved in the workplace.

These reasons for using Internet as advertising SMEs can only underline the importance that Internet promotion has for some investors.

**Table 2.1:**

Online purchases evolution between 2007-2009

	2007	2008	2009
Internet users who buy online	39.7%	46,4%	50.9%
Number of online purchases	10,81	28,32	32,12
Amount of money spent online	\$70.21	\$100.70	\$102.90

Source: The UCLA Internet Report 2009

Online advertising is about getting the website in front of the people who are interested in your product or service. All you have to do is find the best terms and phrases that people search for who would like to purchase exactly your goods and services. In fact more and more small business owners are using online advertising to market their goods and services to their target audience testing different keywords to specific pages of their website in an attempt to get more leads from their online advertising campaigns. Small business people are finding out that without a doubt advertising online is the best way to sell their goods or services to the Internet<sup>6</sup>.

<sup>6</sup> [www.onlineadvertising.net](http://www.onlineadvertising.net)

According to various market research sources, search engines outperform all other online advertising media in driving visitors to web sites. Moreover, consumers are five times more likely to purchase products after seeing search listings versus banner advertising. In fact, statistics show the following:

1) 77% of Internet users employ search engines more frequently than any other online advertising media, surpassing banner ads, Web links, and e-mail links as the leading tool for discovering information about a product or service.

2) 84% of Internet users who are online four or more hours each day reported they use search engines frequently to discover Web sites and find products or services.

3) 55% of Internet users are more likely to purchase online after seeing search listings versus 9% for banner advertising.<sup>7</sup>

### 3. The advertising structure of the Internet in Romania

The main forms of Internet advertising in Romania are: banners, links sites, news bulletins and e-mails.

**Table 2.2:**

Advertising market between 2007-2009 (USD)

	2007	2008	2009
Banner	730 000	745 000	760 000
Links	45 000	52 000	59 000
Newsletter	210 000	225 000	255 000
Others	200 000	235 000	250 000
<b>TOTAL</b>	<b>1 185 000</b>	<b>1 257 000</b>	<b>1 324 000</b>

**Newsletters:** Although not sufficiently developed at present, the increasing number of internet users together with a higher quality of sites made Romania will increase the number of visitors who register on the site. In this way, the newsletter will be sent to subscribers of its website as an attractive advertising tool allowing SMEs to target a well defined category of customers.

Advertising using "**news bulletins**" is perceived rather as a traffic growth method than as a way to make money. For this reason, newsletter history in Romania is more like discussion lists, where a user can join and withdraw at any time, rather than some TV news.

**Email marketing** is a very powerful and valuable method of getting the products, services and ideas out there and if well done, it can even earn you some very good money. It allows the SME to form a relationship with a variety of prospects and customers which will certainly lead to customer loyalty. Nowadays,

<sup>7</sup> [www.onlineadvertising.net](http://www.onlineadvertising.net)

email has established itself as a powerful marketing tool for small and medium enterprises offering an essential component of effective marketing.

**Email design** should be well presented in order to gain the attention it deserves. It is an increasingly powerful and affordable way to turn prospects into clients. It can be used to improve the relationship between a business and its customers or to gain new customers. There are many reasons to use email marketing but often we end up focusing on the money making aspect of it and lose sight of the other areas that are also vital in the world of email marketing.

Unlike direct mail, promotional email campaigns are not constrained by any limits or postal restrictions. Email marketing and direct mail has long been considered an effective marketing tool. One of the advantages of email marketing is the cost efficiency, no print costs to contend and no postage to pay for. Therefore, email marketing campaigns are considered an economic solution that is available to all small and medium enterprises. Creative email design is very important to any email marketing campaign, the design makes the most of the flexibility of this media. SMEs should establish itself as a powerful and cost efficient marketing tool that is essential component of effective marketing.

Most companies use email marketing to communicate with existing customers but many other companies send unsolicited bulk email, also known as spam. They make it very difficult for observers to distinguish between legitimate and spam email marketing. Some marketers report that legitimate commercial email messages frequently get caught and hidden by filters. Nevertheless, it is somewhat less common for email users to complain that spam filters block legitimate mail.

Moreover, without print costs to contend with, envelopes to buy and address and postage to pay for, email marketing is an economic solution that is available to companies of all sizes. Email has now established itself as a powerful marketing tool that is already an essential component of effective online marketing.

Email marketing can often be an outstanding source of both new business and especially repeat business. One of the greatest challenges of email marketing is email list building. Current customers are an excellent starting point of the list building efforts and can substantially increase the customer loyalty.

**The emergence of other advertising techniques:**

- **Lively advertising** (using Shockware applications' effects and combining video and audio) will attract more SMEs;
- The development of **e-commerce** will fill Internet with a wide range of services and information, which will increase the number of direct investors and online advertising budget. In this way the challenges of using internet as a way of advertising of SMEs, will increase their openness to the modern times and promotion techniques.

Placing banners on Romanian sites takes place about 80%, through the exchange of banners, with an exchange rate of 1 to 1. Thus, many sites avoid spending money on advertising. Even if this type of advertising banners appear attractive, it is very difficult to realize an effective advertising campaign based only on the exchange of banners, mainly because many visited sites avoid and dislike this type of advertising.

Also the category of banner advertising includes banner link exchange. This works on the principle of providing advertising exchange, compared to 3:1, 2:1 or 1:1 (i.e. one, two or three exposures of a banner supplied network provides exposure to a banner site participant).

These relationships are formed by two parts:

1. **Home advertising** - selling advertising space to the network.

The sites listed are paid on the number of exposures and / or clicks registered; charging per exposure / click is determined depending on the volume of traffic on the site, e.g. categories:

- Over 1 500 unique visitors per month;
- Over 3 000 unique visitors per month;
- Over 8 000 unique visitors per month.

The price offered by sites that host advertising network is no more than 50% of the selling price of advertising space.

2. **Buyers of advertising** - buys a number of exposures / clicks in the network.

This can select sites that will display ads according to certain criteria (thematic or traffic).

Average prices for the purchase of advertising space:

- Between \$ 0.012 - \$ 0.015 / exposure; least 5 000 exposures;
- Between \$ 0.3 - 0.5 \$ / click; least 500 clicks (the average click-through: 1-2%).

### **3.1. Networks that deal with advertising through the Internet in Romania**

#### **www.goldenbanners.ro**

This network is a very dynamic exchange banner link, created by Yellow Pages in September 2000. It had a rapid growth due to the participation of over 30 sites with different profiles (portals, search engines, with fun and educational content), owned by Yellow Pages bringing together a considerable volume of traffic. It offers 1 000 free entries and periodic special promotions. There are no statistics publications offering the total number of affiliates.

- Affiliated sites + network theme sites: [www.paginiaurii.ro](http://www.paginiaurii.ro), [www.yellowpages.ro](http://www.yellowpages.ro), [www.paginialbe.ro](http://www.paginialbe.ro), [www.whitepages.ro](http://www.whitepages.ro), [www.cdauriu.ro](http://www.cdauriu.ro), [www.pagitur.ro](http://www.pagitur.ro), [www.paginet.ro](http://www.paginet.ro), [www.sigle.ro](http://www.sigle.ro), [www.logo.ro](http://www.logo.ro), offers more than 2 500 000 displays monthly in the network.

#### **www.grafstat.grafx.ro**

It is a service launched in 1999 to provide free technical support for tracking traffic on the site and on a banner link exchange network with purchasing advertising space for websites on the network or outside the network.

- over 250 sites + affiliate network sites theme from Acasa.ro (Valentine - Valentine employer, Martisor and Mother's Day, Easter, Children's Day, Christmas, etc.) Totalling over 400 000 displays monthly in the network.

#### **www.AdServer.ro**

A network banners launched in 1999, which includes: Net Mirabilis (6 sites) + related sites (6 sites like [www.catavencu.ro](http://www.catavencu.ro), [www.nemira.ro](http://www.nemira.ro), [www.radio21.ro](http://www.radio21.ro)). Most visited site: [catavencu.ro](http://www.catavencu.ro) (24 000 visitors per month).

#### **www.telli.com**

It is a global news network that functions as a media agency. It sells advertising for media sites in Romania:

1. Ziua on-line (<http://www.ziua.ro> and <http://www.ziua.net>)
2. Evenimentul Zilei (<http://www.expres.ro>)
3. Monitorul (<http://www.monitorul.ro>)
4. ProSport (<http://www.prosport.ro>)
5. Național (<http://www.nationalpress.ro>)
6. Mediafax (<http://www.mediafax.ro>)
7. ProTV (<http://www.protv.ro/chat/>)
8. Top100 (<http://www.top100.ro>)

Romanian portals for purchase of advertising spaces are:

<http://www.click.ro>

<http://www.acasa.ro>

<http://www.rol.ro> (PC-NET)

An international network of banners for buying / selling advertising space and includes some Romanian sites is [www.valueclick.com](http://www.valueclick.com).

- Related sites: 10 200;
- Ads: 40 000 000 per day.

#### **Reasons for using the Internet market for SMEs:**

- The action of social networking, which generates a very high traffic and multiple opportunities that have a great impact on consumers;
- Need for information and entertainment, which encourages communities to spend increasingly more time online, more and more often.

The customers' attachment to the traditional media channels and the lack of understanding of how online advertising works are the main inhibitor factors for the Internet market.

#### 4. Conclusions

The Internet offers unlimited resources at present that SMEs are using as promotional tools, customers being able to purchase goods and services virtually anywhere, 24 hours a day, 7 days a week, without geographical and temporal boundaries.

Email marketing is by far the most cost effective way to market going into the future, much cheaper than the media investments or printed information about the products or services traditionally used. As a modern marketing tool, online marketing offers the small and medium companies the possibility to save money by having a cost efficient marketing campaign and by building strong relations with customers.

Online advertising is about getting the website in front of the customers interested in products or services offered by the company. More and more small business owners are using online advertising to market their goods and services to their target audience testing different keywords to specific pages of their website in an attempt to get more leads from their online advertising campaigns.

We believe that only by becoming more open to the modern marketing tools, SMEs will increase the number of online customers and will drive the Romanian economy into European Union regulations.

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## ELEMENTS OF STRATEGIC PLANNING PRACTICES IN TRANSYLVANIAN SMEs

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**ABSTRACT.** The purpose of our study was first to investigate to what extent Transylvanian SMEs conduct planning activities and if these activities take the form of written strategic plans. We have analyzed these aspects according to firm size and main field of activity. Then we investigated if SMEs have formulated a mission statement and we tried to determine if this is influenced by factors such as company size or field of activity.

An element of strategic planning is the formulation of goals so we wanted to know what areas the firms participating in our study set objectives for and if there is any connection between these areas and company size or field of activity. We were also interested to know which the overall objective of the company is for the next two years.

**Key words:** strategy, strategic planning, mission, objectives

**JEL classification:** L10, L21, L26, M00

### Introduction

Al Ghamdi, 2005 considers that nowadays, the use of strategic management is not optional any more, being a mandatory decision in front of serious challenges that organizations have been experiencing. Also the author considers that the need for developing a strategy has increased due to globalization, technology advancement, deregulation, emerging of new markets and industries, and economic restructuring. He cites Wilson (1998) who considers that navigation through such an environment requires a strategic compass.

Strategic management, ie strategy content and process (strategic planning) is widely considered to be one of the factors that contribute to small firm growth (Rue and Ibrahim, 1998; Kraus *et al*, 2008 in Kohtamäki *et al*, 2008). Osbourne (1995) maintained that only about one-third of start-up entrepreneurs create comprehensive marketing and financial plans and those who do so increase the probability of venture success. (in French, Kelly and Harrison, 2004)

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Herter (1995, in French, Kelly and Harrison, 2004) opinions that every business, regardless of size, needs an effective, comprehensive business plan as the process of developing the plan forces the entrepreneur to think about the harsh “reality” of the business world, rather than the more common dream world. He believed that this is a necessary first step toward success and that it should have a well-defined format and parts. It should answer age-old questions such as where are you now, where do you want to be, and, most importantly, how are you going to get there?

Planning provides three benefits to people engaged in new venture development: (a) planning facilitates faster decision making by identifying missing information without first requiring the commitment of resources; (b) planning provides tools for managing the supply and demand of resources in a manner that avoids time-consuming bottlenecks; and (c) planning identifies action steps to achieve broader goals in a timely manner (Delmar and Shane, 2003).

Numerous studies have been conducted to establish whether there is a relationship between planning activities and performance. Their findings emphasized the importance of planning for small business success and profitability. Small businesses that engage in contemporary strategic management practices tend to outperform those that do not (Naghi, Negrusa, Gica, 2009). The results of an investigation on manufacturing firms in Jordan on strategic planning- performance linkage, indicated that strategic planners tend to achieve higher return on assets and growth rates in revenue. Also, it was found that strategic planners possess better ability to adapt to their external environment, are more able to attract quality labor force, have higher level of job satisfaction among their employees, and are more able to retain their current human resources (Al-Shammari, Hussam; Hussein., 2007). Schwenk and Shrader (1993) conducted a meta-analysis on the effects of formal planning on small firms’ performance. They overviewed 14 research studies that investigated the link of planning to performance in small firms and they found that some researchers claim that formal strategic planning provides structure for decision making, helping small business managers take a long-term view, and, in general, benefits small firms while others conclude that formal strategic planning has no potential payoff for small firms because it is a heady, high-level, conceptual activity suited solely to large firms and therefore has no effect on the financial performance of small firms. Their analysis is consistent with the claim that strategic planning promotes long-range thinking, reduces the focus on operational details, and provides a structured means for identifying and evaluating strategic alternatives, all of which improve firm performance.

Strategic planning can contribute to performance by generating relevant information, by creating a better understanding of the important environment, and by reducing uncertainty (Hodgetts and Kuratko, 2001 in Kraus, 2008). According to Schwenk and Shrader (1993) strategic planning should be seriously considered by small firm managers. Regardless of whether planning is highly sophisticated



(Bracker et al., 1988 in Schwenk and Shrader 1993), or facilitated by "outsiders" (Robinson, 1982 in Schwenk and Shrader 1993), or simply accomplished in spite of severe resource constraints (Mulford, Shrader, & Hansen, 1988 in Schwenk and Shrader 1993).

The lack of a strategic business plan in small businesses leads to outdated management practices, including an autocratic style of management practiced by the managing director or the proprietor. Business decision making is affected because no one other than the managing director or proprietor can make a decision because other people in the firm do not know where the business is going or how it is going to get there. Consequently, the potential ability of human resources within the firm is undermined and underutilized (Clayton 1996, in French, Kelly and Harrison, 2004).

The purpose of our study was first to investigate to what extent Transylvanian SMEs conduct planning activities and if these activities take the form of written strategic plans. We have analyzed these aspects according to firm size and main field of activity. Then we investigated if SMEs have formulated a mission statement and we tried to determine if this is influenced by factors such as company size or field of activity.

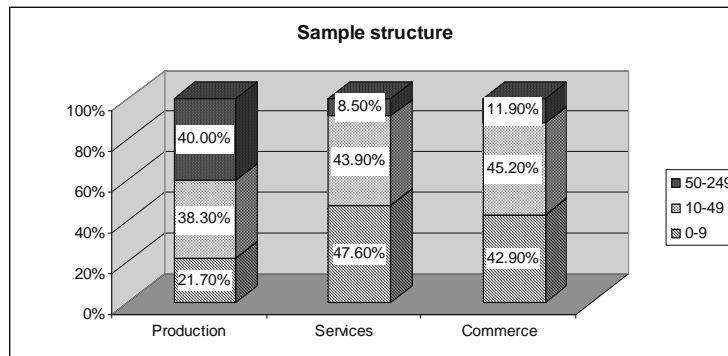
An element of strategic planning is the formulation of goals so we wanted to know what areas the firms participating in our study set objectives for and if there is any connection between these areas and company size or field of activity. We were also interested to know which the overall objective of the company is for the next two years.

### **Research methodology and sample characteristics**

Our paper is concerned with studying the strategic planning activities of Transylvanian SMEs. We have conducted a questionnaire based survey with their entrepreneurs or managers. The sample comprises 226 SMEs from Transylvania (Alba, Bihor, Bistrița-Năsăud, Brașov, Cluj, Harghita, Hunedoara, Maramureș, Mureș, Sălaj, Satu-Mare, Sibiu, Timișoara Counties).

Data collection was conducted via personal interviews done by operators. The questionnaire was accompanied by a letter explaining the project and assuring respondents of the confidentiality of their answers.

Romania has a service oriented economy and this is shown also by our sample structure, the vast majority of the companies acting in the field of services (36.3%) and commerce (37.2 %). Over 95% of the companies participating in this study are Limited Companies. 45.6% of the companies were founded in the period 1991 – 2000. The average turnover of the questioned companies in 2007 has been 6783340.21 RON (approximately 2 million Euros).

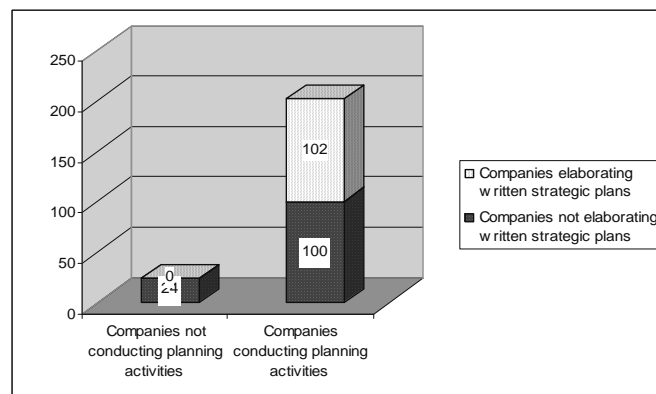


**Fig. 1.** The structure of enterprises based on number of employees and main field of activity

Analyzing the structure of manufacturing companies surveyed by the total number of employees it can be observed that 40% of them are medium size companies, 38.3% are small companies, 21.7% being micro-enterprises. Same criterion applied to services companies reveals a structure consisting of 47.6% micro- enterprises, 43.9% small and 8.5% medium sized companies. The structure of commerce enterprises includes 42,9 % micro-enterprises, 45.2% small companies and 11.9% medium enterprises. The highest proportion of micro-enterprises is acting in the service sector, while small companies are most numerous in the trade. It is not surprising that most medium-sized companies operate in the field of production.

### Findings and discussion

The first purpose of our paper is to identify whether the Transylvanian SMEs conduct planning activities and what type of planning activities (formal/informal) they engage into. Regarding the conduct of planning activities, 89.4% of the participating SMEs' responded affirmatively. Out of these, 50% elaborate written strategic plans.



**Fig. 2.** Strategic planning activities

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Analyzing the response of companies in terms of engaging in strategic planning activities using the size criterion, we noted that all medium sized companies have declared they perform strategic planning activities. We appreciate as a positive aspect the fact that only 4.42% of the micro-enterprises and respectively 6.19% of the small companies do not engage in strategic planning activities. The same aspect analyzed depending on the main field of activity reveals that the highest proportion of companies stating they do not perform strategic planning activities are services companies, while the highest proportion of companies engaged in strategic planning are the commerce enterprises. The lowest percentage of companies not engaged in strategic planning are recorded among manufacturing companies.

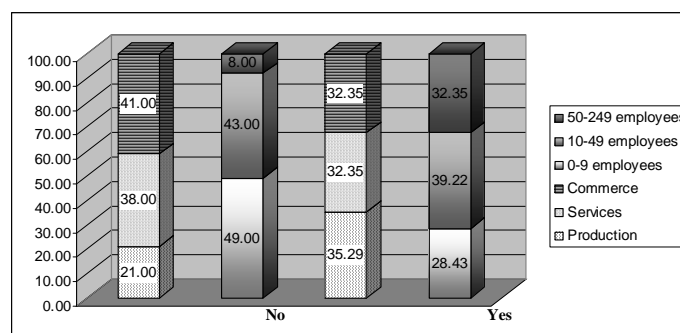
**Table 1:**

Strategic planning activities according to field of activity and company size

Planning activities (%)	Number of employees			Main field of activity			Total
	0-9	10-49	50-249	Production	Services	Commerce	
No	4.42	6.19	0.00	1.33	4.87	4.42	10.62
Yes	34.51	36.73	18.14	25.22	31.42	32.74	89.38
<b>Total</b>	<b>38.94</b>	<b>42.92</b>	<b>18.14</b>	<b>26.55</b>	<b>36.28</b>	<b>37.17</b>	<b>100.00</b>

Formalization indicates the degree to which strategic plans exist in written form. Previous empirical evidence supports the view that formalized planning increases performance. Researchers opinion that small businesses which adopt a more formal planning process will place greater emphasis on improving the quality of the strategic decision making process and as a result of the formal planning process, small firms consider and adopt more strategies (Lyles et al.,1995).

Most companies that develop written strategic plans are the manufacturing enterprises (35.29%), but their number does not differ significantly from that of enterprises in trade and services (32.35%). If we consider the size of the firm, most companies that have responded affirmatively are those with 10 to 49 employees.



**Fig. 3.** Elaboration of written strategic plans by main field of activity and company size

Most companies stating that are not developing written strategic plans are, depending on the field of activity the commerce companies, and depending on size the micro- enterprises.

The development of a mission statement is the start of the strategic management process, providing context for strategies, a reference point for strategy selection (James, 2004) and resource allocation decision (Bart, Bontis, Taggar, 2001). Also mission statements motivate the behaviors of employees toward the achievement of organizational goals (Bart, Bontis, Taggar, 2001) as it promotes a sense of shared expectations among all levels and generations of employees and consolidates values over time and across individuals and interest groups (Pearce, Robinson, 2007).

The principal value of the mission statement is its specification of the firm's ultimate aims (Pearce, Robinson, 2007). A firm's Mission will define the market the firm operates in, and express products and services in terms of the customer's need.

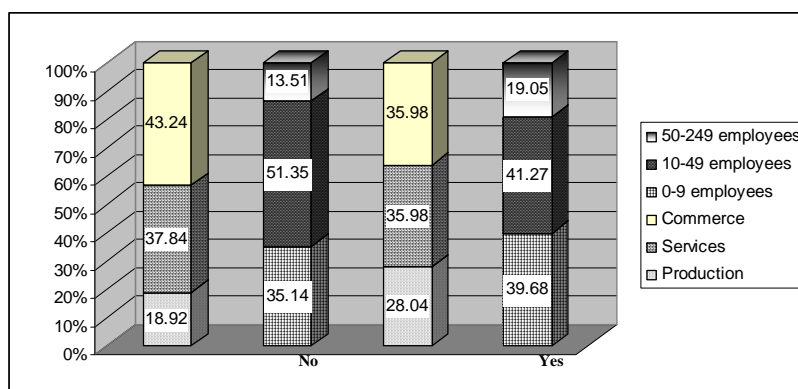


Fig. 4. Mission statement

Regarding the formulation of a mission statement, over 83% of the companies participating in the survey answered affirmatively. Most companies have not formulated a mission are small and depending on the scope of the commerce activity. An equal percentage (35.98%) of firms acting in the services and commerce field declared they had formulated a mission. The Analysis of the same aspect by the criterion number of employees showed that small firms are those who have declared to the greatest extent (41.27%) they have formulated a mission statement.

Chi square test did not reveal an overall significant link neither between company size and formulation of a mission (chi square = 1439, N = 226, df = 2, p = 0,487) nor between the field of activity and the formulation of a mission (chi square = 1419, N = 226, df = 2, p = 0,492). So, in general, neither the size nor the field of activity can be considered determinants of organizational behavior when it comes to mission statement formulation.

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However, analyzing the link between firm size and formulation of a mission it can be observed that for manufacturing firms, there is a significant link between the two variables (size versus formulation mission, chi square = 8.01, N = 60, df = 2, p = 0018 <0.05), about average intensity (contingency coefficient = 0.343). Specifically, we noted that all medium sized production companies have formulated a mission, unlike medium sized firms in other fields of activity. In the case of small and micro-enterprises, the percentage of companies who formulate a mission statement is not influenced by their main field of activity.

Since most of the companies in today's world see growth as a direction towards higher earnings their objectives are related to growth. None of the SMEs who responded to our questionnaire did aim for the next 2 years to sell or close the business, more than 57% of companies having established the overall objective of moderate expansion of business. An approximately equal percentage of SMEs (about 21%) intend a moderate expansion of activity or to maintain current business dimensions.

**Table 2:**  
Future direction of the business by company size and field of activity

				Number of employees			Total
				0-9	10-49	50-249	
Production	General objective	Rapid expansion of activity	Number of companies	0	3	5	8
			Percentage	0.00	5.00	8.33	13.33
		Moderate expansion of activity	Number of companies	9	14	13	36
			Percentage	15.00	23.33	21.67	60.00
		Maintain current business dimension	Number of companies	4	6	6	16
			Percentage	6.67	10.00	10.00	26.67
Total	Number of companies	13	23	24	60		
	Percentage	21.67	38.33	40.00	100.00		
Services	General objective	Rapid expansion of activity	Number of companies	10	4	4	18
			Percentage	12.20	4.88	4.88	21.95
		Moderate expansion of activity	Number of companies	23	21	3	47
			Percentage	28.05	25.61	3.66	57.32
		Maintain current business dimension	Number of companies	6	11	0	17
			Percentage	7.32	13.41	0.00	20.73
Total	Number of companies	39	36	7	82		
	Percentage	47.56	43.90	8.54	100.00		

				Number of employees			Total
				0-9	10-49	50-249	
Commerce	General objective	Rapid expansion of activity	Number of companies	10	11	1	22
			Percentage	11.90	13.10	1.19	26.19
		Moderate expansion of activity	Number of companies	17	22	7	46
			Percentage	20.24	26.19	8.33	54.76
		Maintain current business dimension	Number of companies	9	5	2	16
			Percentage	10.71	5.95	2.38	19.05
		Total	Number of companies	36	38	10	84
			Percentage	42.86	45.24	11.90	100.00

Even though in general there is no link neither between the field of activity and the overall objective for the next two years (chi square = 3915,  $N = 226$ ,  $df = 4$ ,  $p = 0,418$ ) nor between the company size and the overall objective (chi square = 0831,  $N = 226$ ,  $df = 4$ ,  $p = 0,934$ ), it could be identified a partial link in the case of service firms between size and the general objective set for the next two years (chi square = 10,064,  $N = 82$ ,  $df = 4$ ,  $p = 0039 < 0.05$ ) with an average intensity (contingency coefficient = 0.331). It is worth mentioning the fact that no service firm aims at maintaining current business dimension, they wanting a moderate or rapid expansions of activity.

Regarding the areas for which investigated SMEs set objectives, the results show that: 77,9% of SMEs have established goals for sales volume, 66,4% for profit, 38,5% for the return on investments, 28,3% for capital growth, 39,8% for market share, 50,4% rate of profit, 19,5% for international expansion. The percentage of companies who have not set any objective is small, only of 4.42%.

Tests reveal the existence of a link between the company size and setting a target for profit level (Chi Square = 10,244,  $N = 226$ ,  $df = 2$ ,  $p = 0006 < 0.05$ ) but of low intensity (contingency coefficient = 0,208). Only 7.9% of the firms that do not set goals in this sense are middle sized companies, so companies that do not set goals in terms of profit are those who have less than 50 employees, they trying mainly to cover the costs in order to keep themselves in business.

A low intensity link (contingency coefficient = 0168) was also identified between the company size and setting a target for return on investment (Chi Square = 6572,  $N = 226$ ,  $df = 2$ ,  $p = 0037 < 0.05$ ). 87% of firms with less than 50 employees have not established goals in this regard, this revealing that lack of financial resources which prevents them to carry out such activities.

The same low intensity link (contingency coefficient = 0,167) exists between setting a target for market share and company size (Chi Square = 6493,  $N = 226$ ,  $df = 2$ ,  $p = 0039 < 0.05$ ). It can be observed that 84.55% of companies that do not establish

objectives for this area are micro and small enterprises, this emphasizing the lack of interest of these companies regarding the market share they hold .

There weren't identified any links between the company size and setting targets for sales volume, capital growth, the rate of return or international expansion of activity.

Regarding the influence of the field of activity on the establishment of measurable objectives, the only link found was between the field of activity and setting a target for sales volume (Chi Square = 28,840, N = 226, df = 2, p = 0000 <0.05, contingency coefficient = 0,336), 68% of firms that do not set a target for this area being service companies.

### **Conclusions**

Only 45.1% of SMEs participating in our study stated that they prepare written strategic plans. In this sense we believe that practitioners should be more involved in activities of formal planning. Developing a business plan would help them to identify more easily opportunities and risks of the marketplace, so being able to take measures in time, thus increasing their chances of success. Previous empirical evidence supports the view that formalized planning increases performance.

A positive aspect is the fact that over 83% of the investigated companies declared they have formulated a mission. Generally it could not been identified a link between the formulation of a mission and company size or field of activity. An average intensity link was identified between firm size and formulation of a mission for manufacturing firms.

Regardless of main field of activity, more that 50% of the SMEs intend a moderate expansion of activity for the nest two years. Nor the size neither the field of activity influences the overall objective established. Only an average link has been established in the case of service firms between size and the general objective set for the next two years.

The percentage of companies who have not set any objective is small, only of 4.42%. Tests reveal the existence of a low intensity link between the company size and setting a target for profit level, between company size and setting a target for return on investment and between setting a target for market share and company size. There weren't identified any links between the company size and setting targets for sales volume, capital growth, the rate of return or international expansion of activity. Regarding the influence of the field of activity on the establishment of measurable objectives, the only link found was between the field of activity and setting a target for sales volume.

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## THE CHANCE OF SME'S IN TODAY'S MARKET

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**ABSTRACT.** Once Romania entered the European Union the standards of the market and its demands increased in such a way that the Romanian SME's had to adjust in order to survive. Their financial efforts were considerable high and the expected results came only for a few of them. One of the main causes was the unfit adjustment to the real cash flow of the market. Some of them made it through and even expanded, proving to the European world and economy that Romanian companies are competitive and worth taking into consideration. Some of them died.

In today's conditions, the situation tends to get worse. Due to the extended crises, few SME'S are expected to maintain position, and fewer to survive. As optimistic as we all may be, without proper access to European and internal founding programs to sustain them, the lack of money will bend their evolution and further more the entire economic growth.

**Key words:** SME's, competitiveness, European market, money, founding programs

**JEL classification:** A1; A10

### Introduction

Many of Romanian SME's pass today through a hard period that comes after two years of confrontation with the realities of European Union (EU) competition market system.

Because of the lack of resources and strength to modernize in order to align to European standards and demands, in the first two years after acceding EU there has been registered a decrease of SME's number. The bankruptcies registered because of the up mentioned causes are a statistic reality. But, on the bases of the economy with the highest growth rhythm registered, in 2008 new SME's appeared, their owners being mostly from EU member countries.

The SME's market has been sifted ones. The global crises will sift them again. The survival of this sector depends on solving the financing problems as well as the evolution of the market, more and more compressed.

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A reason for concern is the restraint of the activity and the diminution of large companies' production, SME's being most of the time subcontractors for them. Mr. Marian Mihut, president of National Union of Romanian Employers affirms that 30% of SME's will suffer bankrupt this year, this only being the beginning. Beside the personal reorganization inside large companies, the SME's sector will show the same signs of disease. Other fears concern the payment of suppliers, difficulties in contracting credits and ending the financial year with losses. In the same time one of three companies is afraid of bankruptcy. The diminution of orders could lead to a "domino effect" on liquidity, profitability and employees.

As the construction of this year's budget is based on austerity criteria, its philosophy being the drastic reduction of public expenditure, not even those orders will come to SME's at last year's level. To that one can add the much debated problem of flat-rate tax.

In Romania there is a permanent search for solutions in order to sustain the SME's, the providers for two third of working places, by intensifying the contacts between Government, social partners, national bank and other factors that can contribute to defining a coherent politic for the field.

It still wagers on the intense absorption of structural funds, but other solutions and methods of unblocking the credit system are look up in order to provide financing for the sector. One of these is the facility for SME's offered by Investment European Bank (BEI), a global loan, contracted by Ministry of Public Finances. This facility is often accessed by financial agents and consists of a credit line granted by a financial institution or bank that lend at their turn BEI funds to SME's in order to finance projects for this sector. The problem might be the bureaucracy and difficulty of accessing this funds, facts that sometimes lead to obtaining money so late they became worthless.

## **I. Theoretical notions**

**Market economy** is an economic system characterized by the fact that the economic objective purchased by most companies, at national level is maximizing the obtained profit, the function and management of companies rely mostly on economic levers, market has a deciding role in rigging the national economy and private property is predominant.

**Small and medium-sized enterprises (SMEs)** are often referred to as the backbone of the European economy, providing a potential source for jobs and economic growth. SMEs are defined by the European Commission as having less than 250 persons employed. They should also have an annual turnover of up to EUR 50 million, or a balance sheet total of no more than EUR 43 million (Commission Recommendation of 6 May 2003). These definitions are important when assessing which enterprises may benefit from EU funding programs aimed at promoting SMEs, as well as in relation to certain policies such as SME-specific competition rules. European Commission policy in relation to SMEs is mainly concentrated in five

priority areas, covering the promotion of entrepreneurship and skills, the improvement of SMEs' access to markets, cutting red tape, the improvement of SMEs' growth potential, and strengthening dialogue and consultation with SME stakeholders.

**Competitiveness** is a complex concept which, at a general level, expresses the ability of persons, companies, economies, regions to maintain competition on the internal and / or especially international scale, and to get, in terms of a specific business environment, economic benefits, resulting in constant increases in productivity and standard of living.

There are several categories of factors influencing economic development:

Basic factors, such as: natural climate and conditions; productive soil; proximity of geographical placement; basic inputs in the technological process; health and ecology conditions; qualification and structure of manpower.

Advanced factors (comparative and competitive), such as: knowledge and evaluation resources (know-how); information; impact studies; cost profit analysis etc.; access to the capital investments (financial bank market; capital market); professional specialized services which allow global approaches of the markets (ITC; logistics; communication and distribution networks).

Integrative factors (competitiveness and quality), such as: conditions of supply; financial and loan sector; business services; powerful business associations and tight connections with research institutes; industrial cooperation; level of internal competitiveness; assets and withdrawn resources; company and sector strategy.

## II. SME's overview

In order to speak of the actual situation of SME's it is important to establish a trend over the past 18 years.

In accordance with the data provided by The National Trade Register Office (table 1) the highest registration rate for companies was recorded in 2005. The lower, except 1990 was recorded in 2009 (considering the existing data without estimations), fact that reflects "the state of mind" of the present economy.

**Table 1**

Number and structure of incorporations in the trade registers during  
December 1990 - May 2009

Period (year, month)	Registered companies	Structure %
<b>Total</b>	<b>1901373</b>	<b>100</b>
Year 1990	81	0,00
Year 1991	95840	5,06
Year 1992	137456	7,26
Year 1993	117078	6,19
Year 1994	137445	7,26
Year 1995	65479	3,46

Period (year, month)	Registered companies	Structure %
<b>Total</b>	<b>1901373</b>	<b>100</b>
Year 1996	62089	3,28
Year 1997	55663	2,94
Year 1998	63878	3,38
Year 1999	57197	3,02
Year 2000	57291	3,03
Year 2001	61265	3,24
Year 2002	84780	4,48
Year 2003	123582	6,53
Year 2004	144284	7,62
Year 2005	159464	8,43
Year 2006	135371	7,15
Year 2007	144728	7,65
Year 2008	144177	7,58
Year 2009 (months 1-5)	<b>54225</b>	1,24

Source: ONRC statistic report May 2009

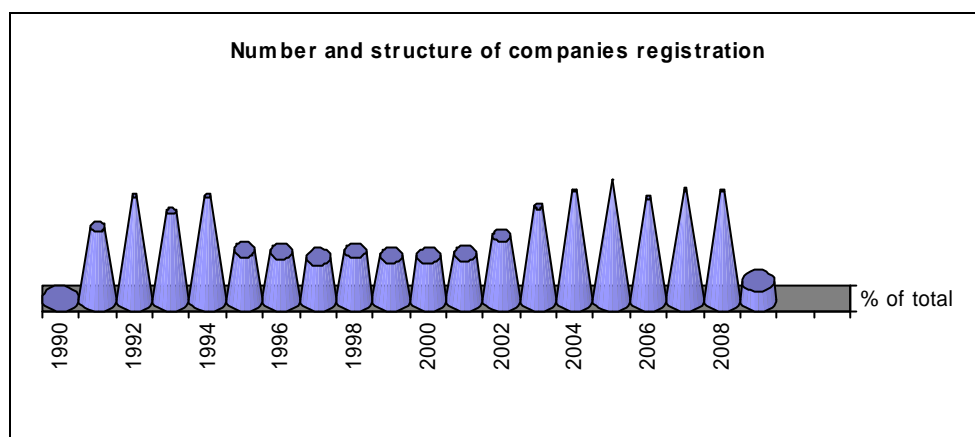


Fig. 1. Number and structure of incorporations in the trade registers: 1990 - May 2009

In what companies' distribution by counties is concerned, table 2 reflects the transition of each category of operations from a year to another for the last 18 years.

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**Table 2:**  
Operations performed in the trade registers by categories of registration  
during December 1990 – May 2009;

Counties	Total of registered operations		out of which :					
			Registered companies		Changes in statutory documents		Strike off companies	
	No.	%	No.	%	No.	%	No.	%
<b>Total ROMÂNIA</b>	<b>11863493</b>	<b>100,0</b>	<b>1901373</b>	<b>100,0</b>	<b>9381352</b>	<b>100,0</b>	<b>580768</b>	<b>100,0</b>
ALBA	171309	1,5	30089	1,6	134882	1,5	6338	1,1
ARAD	268084	2,3	46182	2,4	209921	2,3	11981	2,1
ARGES	281334	2,4	48400	2,6	222181	2,4	10753	1,9
BACAU	260555	2,2	47179	2,5	200519	2,2	12857	2,2
BIHOR	350722	3,0	58066	3,1	276046	3,0	16610	2,9
BISTRITA-NASAUD	136944	1,2	23123	1,2	106680	1,2	7141	1,2
BOTOSANI	107055	0,9	23182	1,2	77393	0,8	6480	1,1
BRASOV	463456	4,0	59163	3,1	390361	4,3	13932	2,4
BRAILA	185076	1,6	25926	1,4	154500	1,7	4650	0,8
BUZAU	201909	1,7	34290	1,8	155718	1,7	11901	2,1
CARAS-SEVERIN	139002	1,2	23138	1,2	106494	1,2	9370	1,6
CALARASI	107095	0,9	19084	1,0	82514	0,9	5497	0,9
CLUJ	526659	4,4	88201	4,6	419727	4,5	18731	3,2
CONSTANTA	500589	4,2	79182	4,2	392747	4,2	28660	4,9
COVASNA	103990	0,9	16278	0,9	82589	0,9	5123	0,9
DAMBOVITA	171938	1,4	35311	1,9	122008	1,3	14619	2,5
DOLJ	314384	2,7	49851	2,6	249788	2,7	14745	2,5
GALATI	304856	2,6	44973	2,4	244460	2,6	15423	2,7
GIURGIU	93612	0,8	15680	0,8	72478	0,8	5454	0,9
GORJ	189389	1,6	22395	1,2	159913	1,7	7081	1,2
HARGHITA	174102	1,5	29655	1,6	138054	1,5	6393	1,1
HUNEDOARA	239886	2,0	38454	2,0	187195	2,0	14237	2,5
IALOMITA	111186	0,9	17711	0,9	86940	0,9	6535	1,1
IASI	387815	3,3	61628	3,2	311672	3,3	14515	2,5
MARAMURES	242479	2,0	48220	2,5	182003	1,9	12256	2,1
MEHEDINTI	125325	1,1	21117	1,1	95767	1,0	8441	1,5
MURES	334801	2,8	47749	2,5	271660	2,9	15392	2,7
NEAMT	259513	2,2	41044	2,2	202799	2,2	15670	2,7
OLT	145867	1,2	26441	1,4	109624	1,2	9802	1,7
PRAHOVA	401240	3,4	63366	3,3	319916	3,4	17958	3,1
SALAJ	101695	0,9	18826	1,0	76934	0,8	5935	1,0
SATU MARE	184009	1,6	32291	1,7	140426	1,5	11292	1,9
SIBIU	266580	2,2	37220	2,0	219155	2,3	10205	1,8
SUCEAVA	278953	2,4	47550	2,5	213112	2,3	18291	3,1
TELEORMAN	130007	1,1	21616	1,1	103170	1,1	5221	0,9
TIMIS	393133	3,3	67433	3,5	307092	3,3	18608	3,2
TULCEA	142073	1,2	19472	1,0	116704	1,2	5897	1,0

Counties	Total of registered operations		out of which :					
			Registered companies		Changes in statutory documents		Strike off companies	
	No.	%	No.	%	No.	%	No.	%
<b>VASLUI</b>	149243	1,3	23907	1,3	116113	1,2	9223	1,6
<b>VALCEA</b>	179196	1,5	30807	1,6	138370	1,5	10019	1,7
<b>VRANCEA</b>	144582	1,2	23020	1,2	116179	1,2	5383	0,9
<b>BUCURESTI</b>	2357589	19,9	357795	18,8	1876070	20,0	123724	21,3
<b>ILFOV</b>	181424	1,5	34254	1,8	139737	1,5	7433	1,3

Source: ONRC statistic report May 2009

### III. General economic frame – influent factors

According to Nicolae Idu, Head of the European Commission Representative Office in Romania, Romania faces the crisis without having solved the structural economic problems which date back to the period of economic centralism and it has not gained a competitive level to allow it to perform well on the European market. The economy is insufficiently diverse and competitive. In addition, certain evolutions from the political spectrum have determined a reduction of Romania's access to international credits; it is about the decisions adopted before and during the electoral campaign from 2008, regarding the increase of certain budget expenses which have determined the rating agencies to lower the country rating so that access to the international financial market has become difficult. We should also add the reaction of foreign investors whose willingness to invest in a country where spending public money does not appear to be carried out in a rigorous manner has decreased. The effects of the crisis in Europe have also been reflected in the deliveries of the Romanian workers from abroad that were almost on the same level with the direct foreign investments, at around EUR 8 billion. As a result of structural problems, all these factors, including the exaggerated level of the current account deficit, because Romania has spent more than it should have, have put the country in a situation of having limited means to deal with the crisis.

Furthermore, bureaucracy and the number of taxes place Romania among the first in Europe but if we add up the level of these taxes, Romania is not the country with the most burdening fiscal policy. By adopting the single quota of 16% it has reduced the fiscal bureaucracy and has stimulated investment.

According to a poll on over 1100 SME's, the strongest negative influencing factors are: a legal frame that does not realistic stimulate the activity (65%); instability and incoherence of legislative system; climate and social tensions, lack of social stability; changes and political disputes (19,3%), that does

not confer a continuity in management in important institutions; the International Monetary Fund politics for Romania are often in contradiction with our economic and social interests (15%); the integration in the European Union, though wanted has a negative impact on the activity, phenomenon explained by the adaptation of Romanian legislation to the European one (10%).

Among the factors with minimum negative impact on SME's activity are privatization (2, 13%) and interethnic tensions (1, 19%).

Concerning the financing sources it has been shown that over half of SME's function based on own resources (60%), 17% go to banks for loans and 8% access other sources. The majority of those who take credits are in industrial sector and the ones who invest their profit function mostly in services sector.

Out of the multiple factors that have influence over the Romanian economy, made 99% out of SME's, we decided to focus on the most debated ones today.

#### **Government Decision no. 34/2009: 3 problems**

- The introduction of minimum mandatory tax on turnover starting May 1, 2009.
- Lack of deductibility for car and fuel purchase
- The cancelation of the facility on taxation of hidden reserves

The black economy accounted for 20% in 2008, and the overall tax fraud regarding VAT exceeded RON 20 billion. 242.000 companies with a turnover of RON 134 billion don't pay taxes; 85% of state budget revenues come from 12.000 companies from a total of 620.000 companies with balance-sheets. It is rather strange though that 110.000 companies have a turnover of less than RON 10.000 and only 67.000 employees, hence these companies are whether not operational or commit tax fraud.

Faced with the fact that the mandatory forfeiting tax will have a negative effect on SME's, the general official opinion is that it is not normal to stay in a business that has losses every year since the main purpose of a company is to obtain profit.

#### **Flat-rate tax**

The mandatory tax on turnover has a negative effect both on new and large investments – purchase of expensive hi-tech equipments (with fast depreciation) and important losses to the state budget.

The law for implementing the Fiscal Code stipulates that any changes must be applied only starting January 1 of the following year. The implementation of up mentioned decision in the middle of the fiscal year is a huge mistake.

As a common knowledge, companies have legitimate expectations regarding the stability of the fiscal and legal framework and they build their year

budgets and strategic plans accordingly. The introduction of the mandatory tax and the changes on deductibility for expenses and VAT for car and fuel purchase should be considered for the following year.

It is unjust and discriminating to impose the same fiscal burden on companies in different situations. For example, if a company had losses in 2008 or had a profit of RON 268.750 the same tax should be paid in the amount of RON 43000. In this case it is normal to conclude that the tax is uncoordinated with the financial capacity of the company, since the one that didn't obtain any profit has to pay taxes, although it does not have the necessary resources.

In the same time this tax has a double taxation on share revenues effect on the companies that have stock in other companies, contrary to the European Legislation on this topic.

The most important visible effect of the tax was that until April 2009, 14000 SME's closed down. Some of them chose the solution of Self-employed Person (PFA). Others chose closing or suspending the company for three years. None of these are actually a good business decision.

In what the cancellation of the facility on taxation of hidden reserves (Paragraph 5i, article 22) is concerned, the general opinion is that the depreciation value will increase starting 2010, leading to smaller profits.

The legislation in the most developed E.U. countries stipulates that the difference in depreciation resulted from reassessment is tax deductible. However, when the asset is estranged (by selling, retirement, distribution to associates/share holders) the difference of revaluation, that was deductible up to that point, would become taxable (the official title is "taxation of hidden reserves").

Until the implementation of Government Decision 34/2009, the additional depreciation generated by the reassessment difference was tax deductible. However, when the asset was estranged, the sums previously deducted were not taxable (under certain conditions). This was a facility for the businessmen that in Romania's case had a permanent and not a temporary fiscal advantage. Foreign investors operating here, well aware of the fiscal legislation in their countries, were encouraged to relocate their businesses in Romania. But, after the Government Decision 34/2009, the additional depreciation is not tax deductible anymore. So, the Romanian legislation does not even stipulate this temporary advantage.

Although the Government Decision stipulates that VAT for car and fuel purchase is not tax deductible, there are some exceptions. Since they are not very clearly stipulated these may lead to interpretations. When the text says "vehicles used for paid services are accepted", it is not very clear whether it refers to courier and transport companies or salesmen that use the office cars.

In Romania companies are obliged pay nearly 100 taxes, as compared to 30 taxes levied in other EU states. These taxes lead to the suffocation of the



business environment and invite to tax fraud and black labor, factors which favor the black economy.

### **Limited founding and exports**

An SME can benefit at the most for 200000 euro grant for three consequent years in order to develop or modernize itself. This help for SME's is regulated in Government Decision no.1164/2007, amended and completed at May 20, 2009 Government meeting.

SME's need open market and loyal competition in order to grow and evolve. Today, fewer than ever export outside their origin market. Statistically, only 8% of SME's export their production. The identified problems are connected to language barrier, huge costs of entering new markets and lack of financing.

In order to change that it is essential to be aware of these problems and support them to engage in internationalizing process.

### **There are problems the SME's are facing to which some proposes have been made:**

- Development of systems designed to eliminate as much as possible contact with the taxpayer from desk officer;
- Electronic services system's expansion at national level (e-government) for an on-line/electronic submission of monthly statements;
- establishing a new layout of the order of payment for the obligations budgetary in a single Treasury account;
- Removal of the register of employees, which is a dual registration and administrative barrier;
- interconnection of institutions databases of the various state and establish a "one stop shop" to be able to provide the setting up of any certificate attesting (number of employees, turnover, payment obligations) possibly signed electronically in the near future ;
- Reducing social contributions, which "exceed the European average", payment to pension fund, the unemployment fund, health insurance accounts for 47.5% of the gross salary, while the average for the social contributions paid by employees of the old Europe is 35.6%.

For SME's innovation is the main instrument of development. Whether we are talking about developing new products or services or identification of the most efficient already existing methods of accomplishment, innovation brings added value to an organization. In the same time allows it to maintain or improve their market share.

One of the instruments used to determine the innovation grade of an SME, used also to convert it from what it is for the moment into an innovative one is technological audit.

Within an international project [8] several audits have been made on SME's and for the present paper we decided to choose the most significant one.

The study made revealed that some perception problems affect the internal climate of SME's, especially when they appear at top management level. If internal climate and management thinking are not pro business orientated then one cannot expect any important improvement in the nearest future or any other future.

### **Case study: SELF- ASSESSMENT DIAGRAMS**

**Table 1:**

Company's placement in comparison with competition				
	Lower		Higher	
<b>1. Adaptation to technological advancement</b>				X
<b>2. Internal technology audit tools</b>	X			
<b>3. Use of new technologies and equipment</b>			X	
<b>4. Development of new (technologically) advanced products</b>			X	
<b>5. Training of personnel</b>			X	
<b>6. Access to sources of technological advancement</b>				X

Several comments and conclusions have been drawn by the auditor:

1. One can observe a good level of adaptation to technological advancement and its sources, implying low production costs and good productivity.
2. The managers make an internal audit over the financial registrations and the technological steps made in manufacturing their products, but there is no any written procedure. The company has to implement the Quality Management System, according to which the internal audit is compulsory.
3. The company uses relatively new technologies and equipment, as those are 2-3 years old, which is an accepted level for manufacturing good quality products. The average renewal rate of the used equipments is around 30%. For the moment, there is no need of making extra investments in purchasing newer equipments.
4. The company has the possibility of introducing new products on the market, considering the client's needs or the market opportunities. The design department, together with the production department, is able to design, produce and test a new product, so as to be ready for the market, in about 6 months. So, the level of developing new (technologically) advanced products is good.
5. Even if the personnel is relatively young and qualified, its potential is insufficiently used, only at its half, from a qualitative point of view. External trainings and experience-exchange with more advanced in the

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field companies are indicated. Furthermore, combining the use of new technologies and equipment with a competent training of the personnel, one can reduce the production time and raise the productivity and employees' utilization.

6. It is well known that innovation stimulates and sustains the competitiveness level of a company and it can lead to the decrease of the production time, concomitantly with the raising of the technological and quality level of the manufactured products. The personnel can easily access on the internet new information regarding their activity field, at the same time, having at their disposal various specialty publications.

**Table 2:**

Limiting factors to the company's capabilities		
		Comments
1. Orders for products and services	X	Limited, but relatively constant, determining the 34% rate of machine work time
2. Ageing of products or services		
3. Shortage of skilled workforce		
4. Inadequate workforce training		
5. Operating capacity		
6. Operating efficiency		
7. Sufficient cash flow/credit	X	It is a potential factor. Up to now, the company hasn't needed an investment credit (no unexpected expense caused by an unexpected important contract).
8. Materials/supplies/spare parts shortage		
9. Old equipment		
10. Outmoded technology		

Comments of the auditor:

1. The 34% rate use of machine work time means that the company has not got a real sales market. If it had, the machine work time would be higher and consequently, the equipments would be better used.
2. The company does not consider ageing of products or services as a limiting factor, because this matter is out of the question. The average age of the used equipments being of 2-3 years. On the other hand, the manufactured products are not old, thus concluding that the company works with only a safety stock and does not have overstocks. In this way, the products do not become old or depreciate their quality and/or their selling value.
3. The company has skilled workforce for its activities and sufficient in number, so this is not a limiting factor. The personnel carry out all the production and service requirements, satisfying the market needs at a medium level (see row 5, Table 1).

4. The training quality of the workforce corresponds to what is presently required on the market, so the company does not think that an external specialized training or an experience exchange would be necessary, considering that the way in which it trains its employees is sufficient. But, the actual practiced training is not sufficient for a competitive development of a new product or technology.
5. The company considers that the operating capacity is not a limiting factor, even if the equipments are used only at 34% of their capacity. The auditors think that this item should have been considered as a limiting factor for the company's capabilities.
6. Neither the operating efficiency is considered as a limiting factor, because the company does not have lack of stocks, carrying out in due time all its contracts and, at a global level, it gets profit at a viable level, proving the viability of its applied technology competitiveness level as well.
7. The contracts carried out up to now have used only 34% of its work capacity and the products selling is optimum fulfilled (both from cashing money and selling time points of view), the other company expenses (wages, indirect costs a.o.) being smaller than the profit obtained from selling its own products.
8. The supply and supply sources are not limited, because the company has several suppliers that distribute the same materials, supplies or spare parts. These ones do not frame in the lacking material category (they are not hard to be found).
9. The company does not own old equipments and is oriented to maintain its equipments at a performing level (2-3 years old).
10. The company does not use outmoded technologies, due to its performing used equipments.

### **Conclusions**

Assuring a legal, economic and social stability is important for any economy, especially for the present moment. As mentioned before, there have been many changes in Romanian economy with strong impact at micro level, respectively SME's.

As much as a company struggles to at least maintain position, if not to grow and evolve, on its own the effect are only temporarily. No matter how many resources it has, or how professional its management is, if the environment doesn't provide the proper, at least relative stability, the most it can do is to hold on to the rhythm and maintain.

The Romanian business environment considers the biggest problem in today's economy the impossibility of the governmental environment to adapt to the reality of life. This leads to a chain of determinations: lack of credibility, high costs of credits and the impossibility of the economy to re-boost on its own. If the state does not fix the credibility problem, all the companies will suffer severe consequences.

Identifying opportunities generated by the present crises period is important. Possible options are: rethinking the management system, implementing a professional one based mostly on intellectual capital instead of industrial production; development or reorientation of business toward more profitable activity fields; gaining advantages as a result of a weaker competitiveness of companies or smaller prices for the equipments or raw materials; strengthen the present client portfolio; quit raising the turnover currently and build objectives related to possible acquisitions or mergers; reducing costs generated by suppliers or different administrative expenditure; accessing financing programs, preferably with external financing in order to obtain the really and necessary present capital infusion; if that is a difficult thing for the company on its own, it can always go to trained advisors such as those included in national innovation and transfer network – ReNITT [11], or any other reliable person or company that provides this service, in order to facilitate and finally reach the above objectives.

Beside all of that, proper specialized external training is needed for employees. Otherwise, as much potential as one might poses, it's useless if not properly directed.

To where the flat-rate tax is concerned, the consultants offer more or less healthy solutions, not so constructive for the economy, such as: reporting a smaller taxable turnover; temporarily suspended activity; moving the headquarters of the company to another country with more attractive tax regime; transferring the activity to authorizes person; reducing the number of employees; decrease the number of subsidiaries in case of groups; the underhand payment of some employees where some activities are concerned.

So, one must conclude that only together: external factors and internal management and climate, innovative thinking and orientation, can determine the competitiveness of the company.

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## IMPLICATIONS OF RESTRUCTURING ON THE SME's ACTIVITY

DANIELA CROITORU<sup>1</sup>

**ABSTRACT.** The aim of this paper is to emphasize the importance of the operations of restructuring on small and medium enterprises in the current crisis. Small and medium enterprises can not face alone the current financial conditions imposed in particular by the phenomenon of globalization. Competitive working on world market requires the adoption of those measures for reorganizing the company to be taken in relation to the existing and new operational requirements that are necessary, the adoption of a system of effective flight management and an appropriate strategy.

**Key words:** restructuring, conflict of interests, M&A, LBO, MBO

**JEL Classification:** G34, J2, D74

### 1. Introduction

Most enterprises appeals to internal restructuring operations through mergers, partial consideration of assets or purchase of shares in other companies. The purposes for resorting to such operations may be:

- limiting the number of companies;
- The disappearance of companies that have no object of activity;
- compensation for poor or beneficiary results;
- Harmonization of the periodic and operational structure.

The merger is a form of restructuring operations based on common interests of the participating companies which aims increasing efficiency or elimination of potential competitors that would distort the optimum deployment of specific business.

Mergers were entered in the movements of concentration that have characterized the stage of economic development in the 1970. The aims were essentially economic, because mergers allowed companies to provide the most important technical structure, having direct consequences on the ability of competition. Only companies that have achieved a certain level of economic development were able to allocate resources for investment in research and development, thus have a competition advantage in relation to competitors and be able to penetrate new markets.

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Can perform restructuring operations both companies whose results are favorable but wish to consolidate market position and enterprises in difficulty to prevent a possible liquidation or dissolution of the company.

Such companies may resort to mergers and acquisitions "to gain access to more financial resources to achieve efficiency, to improve the competitive position or even to benefit from new opportunities."<sup>2</sup>

Restructuring operations like mergers have different effects on participating enterprises in such operations primarily through extinguishment of the debt obligations following such compensation between the merging enterprises.

In some cases it is possible that the corporation which was formed by merger to benefit some production capacity of one of the old enterprises which normally would have purchased from third parties paying an appropriate price.

Acquisition are accomplished through the purchase of securities of the society envisaged in a proportion to which offer to the new shareholders the majority advantage in order to influence decisions taken by the newly formed company management.

In the years 2006-2007, the Romanian economy was faced with a number of issues arising from the transition and amplified by: the delay of finalizing the privatization, slow restructuring of some economic sectors of activity, relatively small number of banks, insufficient training of managers, and difficulties in the functioning of markets in a competitive way.

Other reasons which led to the slowing of the economic development: existence of a small number of entrepreneurs to develop well-founded marketing studies, to provide reliable information on the current situation and perspective of various internal and external markets, low level of the technical units of research and development.

In handling the issues related to merger and acquisitions, a very important aspect is the future structure of the corporate shareholders in what will shape the operations of economic restructuring.

Regarding conflicts of interest arising between the old and new shareholders believe that participating companies must know the following information:

- a) In the event of privatization, the introduction of clauses by the state in the merger contract may lead to maintaining a significant capital in new companies created, however, this leads to changing the management team;
- b) A motivation for taking control can lead to conflicts of interest between acquiring firm management and the target, target company taking steps to prevent the transactions;

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<sup>2</sup> Lupulescu Ana-Maria, Reorganizarea societăților comerciale în contextual integrării europene, Editura Wolters Kluwer, București, 2008, p.171



- c) Keeping a part of the capital of the new founded company in favor of the state lead to negative implications with a direct impact on ownership structure, in the direction of dispersion;
- d) Reorganization has positive effects in the case of a concentrated shareholding of the new corporation;
- e) A good cooperation between companies involved in restructuring operations can result in keeping the management team from the target company;
- f) Managers' agreement to start operations restructuring offers potential advantages in the greater opportunities to preserve their jobs.

Management structure in the new corporation can be significantly influenced by the laws and practices in the area in the country of one of the corporate partner where the operations of a company reorganization took place between two or more companies from different countries.

Thus, we should follow the issue on the capitation invested, the proportions of the local and foreign amounts. In this sense, we are particularly interested in whether the proportion of local or foreign capital will lead to the same proportion as the structure of the new corporation? If not, should highlight the factors that determine the changing of the leadership.

## **2. Developments in operations of mergers and acquisitions in Romania**

By the year 2003, our country has recorded a low number of operations and mergers and acquisitions, the attractiveness of foreign investors being extremely low due to low economic growth registered in Romania until this year.

Since 2003, mergers and acquisitions market in Romania has witnessed new forms, some of these being very complex. Unlike ordinary transactions began to appear non-cash, earn-out or increase capital transaction for development.

Regarding the non-cash transactions, "many of them were not completed due to restrictions on the sale of the shares immediately and divergent visions on how to pay, meaning that Romanian shareholders are attracted by cash transactions."<sup>3</sup>

Romania was placed on the fifth place among the 11 countries of Central and Eastern Europe assessed on the activities of mergers and acquisitions in 2006, after Russia, Poland, Hungary and the Czech Republic, according to a report by PricewaterhouseCoopers.

During the year, total transactions reached 5.2 billion dollars, a slight decrease compared to 2005 when he came to 5.8 billion dollars taking into account transactions with foreign capital invested in Romania and the Romanian capital invested in foreign companies.

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<sup>3</sup> Tiron Tudor Adriana, *Combinări de întreprinderi: fuziuni și achiziții*, Editura Accent, Cluj, 2005, p. 140;

But the fundamentals of the market have changed radically: while in 2005 a single transaction (purchase Mobifon by Connex-Vodafone) represented approximately half of the market in 2006 a number of increasingly high-value transactions with average value were completed.

As regards investment flows attracted by transactions in Romania, Austria takes first place in value invested (868 million U.S. dollars), money from the UK and the United States is maintaining the fifth place in the top, but the volume of investments were lower than the previous year followed by Indian investments (Ranbaxy - 324 million) and Romanian (about 8% of market value).

The most dynamic area of mergers and acquisitions in 2006 was the production with 21 deals, maintaining the leadership position during the past 4 years, closely followed by construction (including real estate) with 20 transactions, financial services with 17 transactions, media with 13, pharmaceuticals and services, each of this with 12 transactions.

The most significant acquisitions of local companies in 2007 were the acquisition by Erste Bank for 7.2% shareholding held by BCR employees, estimated at around 543 million dollars, and the acquisition of the Therapy Company by the company Ranbaxy therapy for an amount of approximately 324 million dollars.

The most important acquisitions by Romanian companies of foreign companies in 2006 were the acquisition of RTB Bor Cuprom (complex of mines and foundries in Serbia) for an amount of 400 million dollars and the purchase of Petrom to OMV gas network from Bulgaria for 284 million dollars.

Following Romania's accession to the European Union there is an increasing number of opportunities for businesses in terms of activity that take place in the context of broadening the market and emphasis of the competition.

The mergers and acquisitions in Romania in 2007 have made strong progress, the value of mergers and acquisitions exceeding five billion, according to a KPMG study.

Thus, the biggest transaction was the Rompetrol, 2.5 billion, follows Petromservice approximately 300 million euro investment in Ford Automobile Craiova to 57 million euros etc.

Meanwhile, sectors that have attracted the most important investments in 2007 were real estate, financial services, retail and pharmaceutical.

Forecasts of the KPMG consultancy company showed that activity in the field of mergers in the Central and Eastern Europe in 2008 will increase by 72% while markets in Romania and Bulgaria will be the main target.

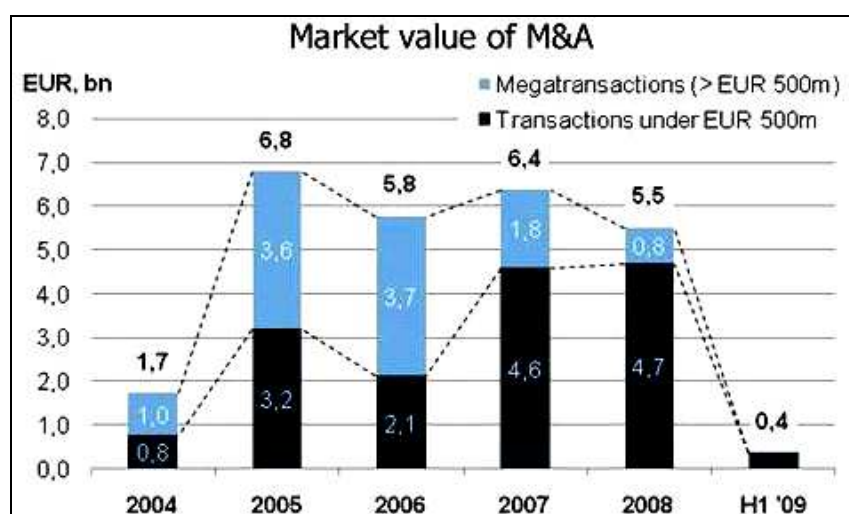
In future, the Romanian economy could be affected in 2008 by structural problems, the current account deficit is one of the factors is taken into account.

Regarding Western Europe, more than 8,000 investments were made in the first 10 months of last year, worth 950 billion euros, while in Eastern Europe were made around 1700 investment values around 120 billion.

## IMPLICATIONS OF RESTRUCTURING ON THE SME's ACTIVITY

Mergers and acquisitions market in Romania recorded 46 transactions in the first quarter of this year, totaling 631.55 million euros, down by 82% compared to the similar period of the last year.

During the first six months of this year have been concluded 78 transactions (of which only 43 announced value), which totaled less than 1 billion euros.



Graph 1. Market value of M&A

Source: Raiffeisen Investment

Global market for mergers and acquisitions (M & A) recorded a strong rebound in the first six months of 2009, returning to the level of 2003.

Consultants' fees obtained in mergers and acquisitions have come in the second quarter to the lowest level of the last decade, based on reducing the number of deals.

M&A Market was contracted worldwide with 36% less in the first half compared to the same period a year earlier, based on the volatility of capital markets and more difficult access to finance, which have "paralyzed" retailers and customers, while attention was captured by government aid.

### 3. Advantages and disadvantages of restructuring operations of enterprises

International practice has revealed a number of benefits of the restructuring operations of enterprises. In some cases it is more buying a business than internal financing of expansion when the replacement price is higher than the market value of the acquired company.

Horizontal mergers or acquisitions of companies that have a low market share, may lead to an increase in their market position and to lower costs. Also, vertical mergers and acquisitions lead to reductions in supply costs and to lower production costs because of the supply of raw materials of high quality and at prices more advantageous.

Effects of the acquisitions can be: “increasing their market power, overcoming barriers to entry, avoiding the costs involved in developing new products internally and bringing them to market, increasing the speed at which the firm can enter a new business, diversifying the firm more easily, and avoiding severe competition, often from foreign firms.”<sup>4</sup>

Besides the advantages already mentioned, there are more issues that are often brought into question before starting the process of restructuring of various enterprises and that is the control on the new holding company formed through merger or acquisition.

The basic idea is that “the transfer of managerial control from the target to the acquirer may affect the internal governance mechanisms of the company, to the detriment of innovation activities.”<sup>5</sup>

In the case of sleeping partners company or firms, partners can yield parts of the interest just in restrictive conditions, if this possibility was expressly provided in the constitutive act. Thus, the personal factor has here a role extremely low in the decision to change leadership of the new company, which may be an advantage for the old leadership in the sense that it can keep the workplace.

In the case of companies with limited responsibility, cession of their parts can be held with the agreement of members holding at least three quarters of the capital, so they may reinforce the old position.

There are situations in which mergers and acquisitions are done in an aggressive or hostile way, when the decision of reorganization does not involve the governing bodies of the target company, often in the case of takeover offers.

In connection with the legal field, in our country, the old shareholders have a preference right at subscribe the new shares issued by the company, in case of the capital increasing. In addition, the new shareholder can have control over the enterprise, if the old shareholders to give up to the right preference.

European Economic Community since 1978 issued Directive III of the mergers and acquisitions of public limited liability companies in order to protect the interests of the shareholders of the merging companies, creditors, bond holders and employees.

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<sup>4</sup> Ireland Duane, Hitt Michael, *Strategic management*, 2<sup>nd</sup> edition, West Publishing Company, New York, 1996, p. 236

<sup>5</sup> Calderini Mario, Garrone Paola, Sobrero Maurizio, *Corporate Governance, Market Structure and Innovation*, Edward Elgar Publishing, Northampton, 2003, p.60;

Another important aspect of this problem is that the managers in both the acquiring and the target companies are expected to devote a lot of their time and resources to managing the operations, to the detriment of long-term activities and especially of Research and Development (R&D) investments.

#### **4. Conclusions**

In market economies, frequently changes occur in the number and size of enterprises so worldwide, take place concentration and restructuring of the economy achieved through acquisitions and mergers.

Firms must be competitive, innovative, and flexible so they need to use various operations to achieve their objectives.

Merger or acquisition can produce effects on all participants in commercial transactions, financial or otherwise, customers, suppliers, competitors of the donors or reorganized companies.

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## ACHIEVING SUSTAINABLE COMPETITIVENESS IN THE CASE OF ROMANIAN SMALL AND MEDIUM-SIZED ENTERPRISES

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RUXANDRA SAVONEA<sup>3</sup>, ANA VOITINOVICI<sup>4</sup>

**ABSTRACT.** Recently, it has been noticed that the challenges of sustainable development are felt at different levels - national, regional and at the level of small and medium-sized enterprises. Supporting an economic development on the long run highlights the necessity for an increased degree of competitiveness, which should be the base for enhancing the living standard of its inhabitants.

Regarding the assurance of a sustainable development in Romania, we should take into consideration overcoming disparities separating us from the other EU member states. In this context, the competitiveness of small and medium-sized enterprises is closely connected to a series of topical aspects, such as innovation, environmental and risks prevention, investments in energy-efficient technologies. Energy efficiency, for example, enhances the profit of small and medium-sized enterprises in the short, medium and long term, as it means less energy for the same output, or even for a better one. Considering all mentioned before, adapting in a changing market situation is the key issue for Romanian small and medium-sized enterprises.

The Lisbon Agenda, through its objectives, impels the competitiveness and innovation at a new extent, in order to become driving forces of development. Further, this process underpins the New Lisbon Agenda framework, where the emphasis is put on economic development, based on knowledge and innovation. We can state that this strategic paper represents the way to achieve a competitive Europe.

Achieving a sustainable competitiveness should be the driving force for Romanian small and medium-sized enterprises. The new market perspectives urge for finding the best practices and means for adaptation.

**Key-words:** competitiveness, small and medium-sized enterprises, sustainable development, Lisbon Agenda, economic convergence.

**JEL classification:** Q01, Q40, R11, R58

### 1. Introduction

In the last years Romania tried hardly to find its place and role in a continuing changing and reshaping European Union. In the conditions of integration, the competitiveness issues are becoming vital for the Romania's economy. In this

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context, it is urgently necessary to draw up and apply precise strategies at different levels- like the one of the small and medium-sized enterprises or the governmental one- that should include clear objectives and specific actions.

In our vision, competitiveness is associated with specific means and actions that determine the improvement of the living standards and the environmental protection. In other words, this concept takes into consideration the possibility of obtaining sustainable competitiveness' advantages on the long run.

The Lisbon Agenda created a favorable framework for consolidating the position of medium sized enterprises. Their place and role in promoting economic development is highly recognized at the European level. In this context finding the best practices and means of adaptation in reaching sustainable competitiveness are considered to be the main challenges.

Due to the economic crisis, the economic market is facing new types of situations that are requiring urgent multilevel actions. As a consequence of all the transformations that took place starting with 2008 and continuing with 2009, the national governments and the European Commission have begun reflecting on the post-2010 Lisbon Strategy. In this context, they will take the step from urgent crisis management to long-term sustainable economic recovery.

Due to the international recession, the Romanian medium sized enterprises are facing new challenges in their uneasy road to reaching success. Therefore, concepts like regional competitiveness, sustainable development or cluster theory can offer new perspectives regarding the economic development.

## **2. General framework**

### **2.1. Literature review**

This section of the paper is aiming to catch the main trends regarding the linkages among regional competitiveness- sustainable development- economic convergence.

#### ➤ *Regional competitiveness*

The recent papers are showing a constant interest regarding this area of research, highlighting the active role played by competitiveness at national and regional level.

There are discussions about the *profile of an optimal competitiveness area*. In this context, Cojanu (2007) sustains that this type of area is spatially defined, having the base for assuring a sustainable development of its industries and companies, in the conditions of the competition's benefits maximization. The main motivation of the industries and companies to group is directly associated with savings resulted from the chosen location. Cojanu also remarks that the industrial

and commercial activities tend to become spatially concentrated in clusters in one region.

Danson notices that the business cluster's expansion is causing gaps of development and a continuously fight in the case of peripheral companies that are trying to compete with those companies situated in centre, which are benefiting from a competitive advantage determined by factors that should not be easily transferred. (Danson M., 2009)

Porter (2003) suggests that some regions- let's consider them the centre-serve a large market, which will attract those industries with smaller medium prices as the production volume is increasing. Compared with the centre, the periphery is facing the challenges of economic activities delocalization. The regional economic performance is strongly influenced by the action of the companies situated in the *local clusters*. The importance of being part of a cluster is derived from the training effect and from the relation with public bodies. The final result generates the increase in productivity and the setting up of new business centers.

Charlie Karlsson (2008) argues that in the case of a sufficiently larger market the clusters can extend with a direct effect over the economic increase of the considered region. This process is not a linear one; it is more adaptative, having the characteristics of an auto regulatory one.

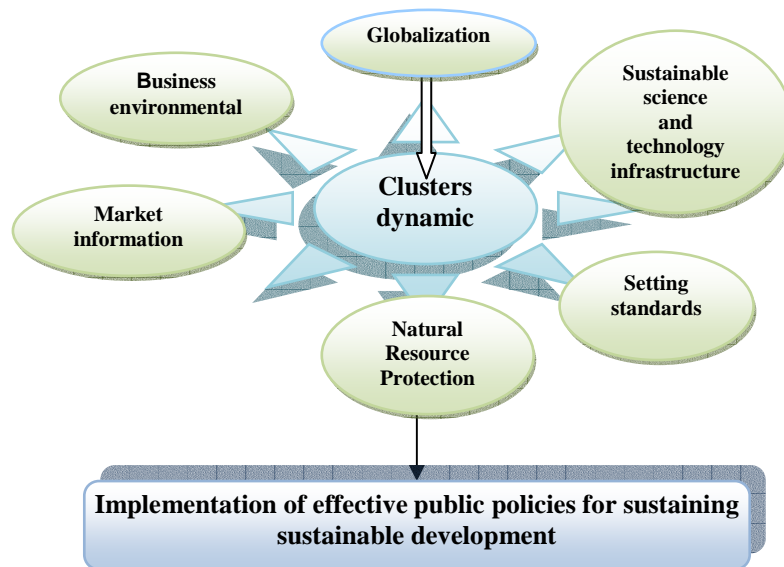
The advantages associated with the status of being part of a cluster are multiple. The main reason is directly connected with an efficient promotion throughout the cluster's level and also throughout the regional level where it activates. Pros this perspective are the following aspects: the existence of strongly linkages between the clusters and the research and development area; the increase of competitiveness for the companies that are members of the considered cluster and an easily access to know-how.

Due to all these, the increase in the number of clusters is directly influencing the local and regional level of a country. A dynamic cluster has all the chances of attracting new investors which are searching competitive advantages, due to the fierce competition on the international market. (Mihaela Ștefănescu et al, 2008)

Another opinion regarding the concept of competitiveness is defined as a 'milestone between collaboration and cooperation' within the network of companies from one region. This perspective is also known as '*the instable triangle of 3 C's*'. (Antamescu D., et al., 2007)

Karen R. Polenske (2004) considers as a sine qua non condition for reaching success the fact that companies should operate synergistically with all the three components: competition- collaboration- cooperation.





**Figure 1.** Driving forces of clusters' development

Source: Mihaela Ștefănescu et al, 2008

Lam, Alice and Lundvall, Bengt-Aake (2007) suggest that the factors which are in favor of the 3 C's turning up are:

- the geographical proximity (the spatial proximity determines the companies from one region to develop more rapidly);
- the confidence (it is developing in time, based on collaboration);
- the learning process represents the only source for having a long term competitive advantage, due to the fact that the ability of learning can assure the development of new competences. This process is directly influencing the performance and the innovation capacity of the companies, being an activity performed in all the fields of the economy.

The learning process can also be put into practice at the level of one region, which takes an active part in it. The companies from regional clusters benefit from a common regional culture represented as a vector for the learning process.

Other perspectives concerning the regional competitiveness are in the phase of development and are dwelling on the dynamical aspect of the regional competitiveness aspect (Boschma, 2004). The main suppositions are referring to the fact that the economies of the regions are different from one another and these differences are persisting in time. Other aspects highlight that the competitive advantage is determined by the economic activity, labor force, the flexibility of its institutions and innovation.

Asheim et al. (2007) underlined the important role played by knowledge in the context of development, and pointed out the fact that knowledge distribution is easily done due to a series of complementary factors (hence knowledge database, shared responsibilities). The authors emphasize the role played by the knowledge spillover effect in the sectors of activity from one region.

➤ *Sustainable development*

The concept of sustainable development is reflected in the specialized literature as an intercorellation between three dimensions: economic- social-environmental. There is a continuous debate regarding the best practices of achieving and measuring it. However, the most known definition is the following: "Economic and social development that meets the needs of the current generation without undermining the ability of future generations to meet their own needs"<sup>5</sup>.

"The solutions for achieving a deeper degree of sustainable development should be found in the incorporation of the sustainable development' principles throughout the society. The creation of partnerships for sustainable development will be an attempt to redirect the development on a new path" (Ștefănescu, Bălănescu, 2008).

In this context, the European Union included the sustainable development in the Amsterdam Treaty (1999), followed by the Göteborg Council where the EU Sustainable Development Strategy was adopted (2002). In June 2006, the revised EU Sustainable Development Strategy was launched, promoting a *dynamic economy, with a maximum level of employment, a high level of education, health protection, social cohesion and environmental protection*.

➤ *Economic convergence*

The challenges associated with the clusters appearance are generating a debate also on the process of economic convergence. The main reason for making this connection is highlighted by Danson M. (2009), who affirms that clusters allow one region to develop, while the others might be in a totally disadvantageous position.

In the context offered by the entrance to the European Union, Iancu A. (2008) observes that the level of a country's development is not a precondition for accession or an issue for the agenda during the negotiation process. Today the process of catching up is an extremely important topic at European level.

Ceapraz I. L. (2008) proposed to analyze the specificity and spatial concentration at the level of Eastern-European countries and of the Romania's regions. The author remarked that in the case of the former, communists stated: "the competition and the markets openness made the necessary changes in the production structure and in the localization of the activities". In author's opinion, the integration into the European Union is bringing about the appearance of a centre -periphery model.

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<sup>5</sup> World Commission on Environment and Development (WCED), known as the Brundtland Commission, 1987

Due to this, we should observe the appearance of the activities concentration processes within a region and relocation of others in the peripheral regions.

As we could see, the concept of competitiveness- in this paper with reference to the regional competitiveness- should be seen in a direct connection with the economic convergence process. The sustainable development aspects should be considered as ubiquitous elements that should be included in any plan that aims to streamline the future effects of development.

In the case of Romania, the convergence process is trying to follow the EU in terms of economic development. The nominal and institutional convergence represents the base for maintaining the stability of the functional framework, but the real convergence is the way to achieve prosperity.

The perpetuation of inequality models- like the one of centre- periphery- determines sometimes a golden rush for overlapping the development gaps from the part of different kinds of actors (hence: *countries* will offer special investment conditions for attracting foreign investors, *regions* will try to create favorable conditions for increasing the living standards of their citizens, *small and medium-sized enterprises* will try to reinvent their strategies of investments etc.)

Romania's international competitiveness ranking is showing several aspects that should be improved hence: market efficiency, business sophistication, education, technology readiness and innovation. When analyzing some different aspects such as the Comparative Advantage or Intra-Industry Trade, we can observe that the current economy is still labor intensive, needing urgently capital infusion in order to increase its degree of competitiveness. For dealing with this necessity there is the Sectoral Operational Program '*Increase of Economic Competitiveness*' which is one of the seven instruments under the Convergence objective, for achieving the priorities of the National Strategic Reference Framework, aiming to strengthen the Economic and Social Cohesion policies across Romania. The main objectives are to increase the productivity of Romanian companies respecting the principle of sustainable development, and reducing the disparities compared the EU's average productivity level.

Ruxandra Savonea highlights, regarding the EU's projects, the fact that in the 2000-2006 programming period, the influence of externalities generated by structural intervention impact on third parties does not propagate through the prices mechanisms. The researcher suggests that their influence arises from the project's economic activity but they are not reflected in prices. Such external effects generated by major projects must be quantified according to standard methods and inserted in the analysis as an actual output of the projects.(Savonea R., 2009)

In order to help the European Small and medium-sized enterprises, the *Enterprise Europe Network*<sup>6</sup>, the largest network for enterprises and innovation in Europe was set up. It offers integrated information, business cooperation, services

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<sup>6</sup> The Enterprise Europe Network has partners in 40 countries, having more than 500 offices all over the Europe and in third countries (e.g. EU's member states, candidate countries, members of the European Economic Space, associated countries to the Competitiveness and Innovation Framework Programme).

of innovation, transfer etc especially for medium-sized enterprises. The network's members support the companies willing to participate within the Commission projects and fulfilling the administrative criteria. This network also supports innovation, by providing brokerage services for technologies' transfer and knowledge.

Due to the recent international evolutions, the globalization of R&D is an issue which must be approached through a sustainable perspective. Large firms are able to finance most of their R&D and innovation effort internally. On the other hand, entrepreneurs must be granted access to external financing for business plans which require a relatively high investment risk and where the expected returns may only be realized on long-term. Venture Capital can play a critical role in the creation and expansion of R&D - intensive SMEs whose research requirements generate knowledge services. (Savonea R., 2008)

## **2.2. The European competitiveness model in the context of Lisbon Agenda**

The Lisbon Strategy was initially designed for helping Europe to become *the most competitive economy based on knowledge* until the year 2010. At the half way, the strategy was reviewed and, due to the results obtained, the emphasis was further put on economic development and employment, based on technological progress.

The research- development- innovation triangle is one of the most known components of Lisbon Agenda and the main framework for beginning specific actions in these areas. In order that all these areas of interest became reality, the European Union's member states undertook to spend from their public budget 1% from GDP for research & development, and to facilitate private spending amount of 2 % from GDP.

The Lisbon Strategy proposes two types of objectives, taking into consideration the time perspective:

- *on the short run*, it aims obtaining a rebalance between demand and supply at the community level;
- *on the long run*, the objectives are directed to increasing competitiveness and the employment level, aiming in this way to harmonize these objectives with those of the cohesion policy.

The Lisbon Strategy objectives are hitting different areas of interest, hence:

- research & development, innovation, informational society;
- improvement and simplification of the legislative framework of business environment;
- *consolidation of the position of medium sized enterprises*. We should take into consideration the fact that the majority of suppliers are medium-sized enterprises, being viewed like a real engine of the development of the European Union;
- completion of the internal market for services (mainly for financial services, logistical support, marketing, management etc.);

- elimination of obstacles regarding the physical, academic and occupational mobility and the development of a common approach regarding migration;
- support for the efforts for counteracting the social consequences of economic reorganization;
- development of human capital, entrepreneurial, labour force flexibility etc.;
- development of transport infrastructure, energy and telecommunication at European level;
- resource sustainable usage, energy efficiency, development of renewable energy and green technologies.

The implementation mechanism of the Lisbon Agenda implies common targets at Community level, but also gives every country the possibility to choose the best ways of action.

The evolutions at European level determined the revision of the Lisbon Agenda, in March 2005. The first signal regarding the degree of accomplishment of the engagements undertaken through Lisbon Strategy had been given by the *Sapir Report* ("An agenda for a growing Europe: making the EU economic system deliver", 2003). The report also noted remarkable progress regarding the institutional part. Unfortunately, when it comes to the economic performances, the report mentioned that the European Union could not foster a satisfactory economic increase.

*The Kok Report* (November 2004) recommended a series of measures in order to correct the absence of national implication with regard to the Lisbon Strategy, in order to ensure the political mix coherence for the participation of all the stakeholders, enhancing the social cohesion at the EU level.

In the report called '*Keeping up the pace of change*' (December 2007), the European Commission mentioned a series of conclusions regarding the objectives of the Lisbon Strategy accomplishment. In this context the strategy is viewed as 'the European Union vehicle which is accompanying change'.

In 2008, the European leaders launched the second cycle of the renewed Lisbon Strategy for growth and employment (2008-2010).

Faced with the current economic crisis, we should look into the future of the Lisbon Strategy beyond 2010. The reflection process should start by identifying the key priorities for the post-2010 period, taking by all means into account the lessons learned in addressing the current crisis.

Taking some steps forward in the light of the actual economic situation, the national governments and the European Commission have begun reflecting on the future of the Lisbon Strategy. Consequently, the European Commission will open a broad Internet consultation process in autumn 2009, on the revision of the Strategy. The main topics are:

- improving the business environment;
- the knowledge 'triangle' (education, research, innovation);
- energy and climate change;
- assuring a better access to the internal market.

### 3. Research Methodology and Findings: The Romanian small and medium-sized enterprises in the new economic perspective

The European Commission<sup>7</sup> offered in its last economic forecast report an overall picture regarding the current situation throughout the European Union. In the case of Romania, there is mentioned that the growth registered since now is contracting sharply<sup>8</sup> due to the recent international economic situation.

Due to the new economic perspectives, the Romanian small and medium-sized enterprises are facing harsh market conditions. In order to succeed in a European competitive market, there is an urgent need for developing new core competencies, new innovative processes and a closer cooperation for reaching sustainable development. In this case, the simple question *qui bono* has a simple answer; all of us will be the winners. Being an EU's member state has a lot of advantages, but also there are many daunting situations that should be over passed by learning to find solutions.

The Romanian small and medium-sized enterprises are and should be considered as one of the main driving forces for reaching development in order to reduce the gaps between us and other European regions. The main ways are representing viable alternatives for a better collaboration, such as:

- the importance of developing new core competences that should assure a flexible adaptation for small and medium-sized enterprises in a changing international environment;
- paying attention to strategic investments, R&D on the long run development;
- the accomplishment of a new clear vision on the European/ international market, a provocative goal that should be considered as a key element for reaching success.

Other motivations that are pro collaboration are represented by the *external shocks* (sometimes difficult to be foreseen dint their spontaneous character) and by the need for sustainable development (seen as a stringent condition for reaching equilibrium between the economic- social- environmental aspects).

The best possible way in reaching success in the current economic situation for the Romanian small and medium-sized enterprises is represented by the association in clusters. The increase in the number of clusters will have a direct effect on the development: firstly at the regional level and secondly at the national level.

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<sup>7</sup> The report was realized by the Directorate-General for Economic and Financial Affairs.

<sup>8</sup> The report mentioned that the 'GDP growth is projected to turn negative in 2009 to around -4%'. A decline is also viewed regarding the unemployment, which is foreseen to be around 8% in both 2009 and 2010.

In the case of inflation it is projected 'to decrease following lower wage growth and still low international commodity prices.' During this year (2009) the inflation is expected to be 3.5 +/-% (respecting the national bank target).

We can say that between development and competitiveness there is a close interconnection. The key condition for reaching the desired development is the increase of competitiveness. Achieving a high sustainable competitiveness level in the case of Romanian small and medium-sized enterprises is a key priority.

A way to achieve this is by improving energy efficiency. This will enhance competitiveness and thus the ability to raise profit and face the market competition. In the current context of the debates, concerns, meetings and engagements at national, regional or global level, regarding the efforts needed to tackle climate change, to adapt to its negative effects and to limit global warming, improving energy efficiency would also only serve this purpose.

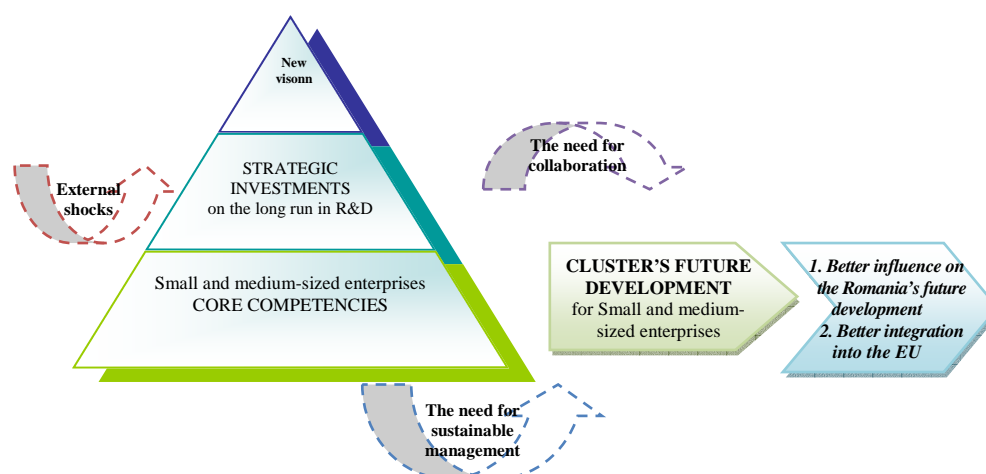
Energy efficiency, practically the most spread and cheap source of energy, is the first pillar of a sustainable energy future. As Cathy Zoi, executive director of the Sustainable Energy Development Authority, Australia, said, “If business is to take energy efficiency seriously, it must not only pay for itself, but in the mid term contribute to improving profitability”<sup>9</sup>. Companies have at their disposal a range of options: reducing energy consumption; increasing the share of renewable energies; investments in renewable energy technologies; insulation of buildings to reduce energy losses; measuring and reducing CO<sub>2</sub> emissions; locating production near consumption. Energy efficiency should be promoted in all sectors of the economy, especially in the current context of global recession, accelerating the transition towards a low-carbon economy, with sustainable growth, which will foster technological innovation, will offer new economic opportunities and will lead to the creation of more and better jobs.

We have tried to offer an image regarding the collaboration’s determinants stressing on the necessity of having a new vision of development- strategic investments- new core competences. In our opinion these three factors represent the first important step towards success, being what we are calling ‘*the basic vision of development for small and medium-sized enterprises*’. The second step that should be taken is the participation into clusters, as a key condition to achieve a future development based on direct access to the R&D. We should keep in mind that ‘the private sector has a positive impact on R&D knowledge generation and innovation process (...) in overall business cycle’ (Savonea R, 2009). Therefore, the innovation process is vital for reaching sustainable development in the case of small and medium-sized enterprises and for their ability for dealing with competition.

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<sup>9</sup> Cathy Zoi, executive director of the Sustainable Energy Development Authority, Australia, quoted in Company Director (Australian Institute of Company Directors), March 1999, p 59.

ACHIEVING SUSTAINABLE COMPETITIVENESS ...



**Figure 2.** Collaboration's determinants in the case of the Romanian small and medium- sized enterprises

Source: Authors own interpretation

In order to better identify the main characteristics of the Romanian Small and Medium Sized Enterprises we have realized a SWOT analysis taking into consideration the macroeconomic aspects and the regional ones.

**Table 1:**

The SWOT Analysis

<b>Strong points</b>	<b>Score</b>	<b>Opportunities</b>	<b>Score</b>
<i>Romania's EU member state status</i>	5	<i>The existence of the European funds and the possibility of financing projects that will bring added-value for development at regional/ local level</i>	4
<i>Macroeconomic stability</i>	4.9	<i>The EU's internal market is a big opportunity due to the great number of consumers</i>	4
<i>Political stability</i>	4	<i>As the number of clusters will increase, we will assist to a higher access to new foreign technologies in the case of Romanian Small and Medium Sized Enterprises</i>	4
<i>Monetary policy</i>	3	<i>The development of entrepreneurial education</i>	5
<i>Romania's geostrategic position and the existence of natural resources</i>	5	<i>The access to the European labor market</i>	5
<i>The existence of an infrastructure for sustaining</i>	4	<i>The rise of foreign direct investments will increase the need for including R&amp;D funds for</i>	3



<b>Strong points</b>	<b>Score</b>	<b>Opportunities</b>	<b>Score</b>
<i>the activity of small and medium sized enterprises (business incubators, specialized consulting firms etc.)</i>		<i>future development (also in the case of Romanian Small and Medium Sized Enterprises )</i>	
<i>Numbers of clusters existed in every region</i>	3	<i>The necessity for inclusion of sustainable development principles in the overall management strategy (represents a cost on short time and a necessary investment on long run for the Romanian Small and Medium Sized Enterprises )</i>	4
<i>Average score</i>	<b>4.13</b>	<i>Average score</i>	<b>4.14</b>
<b>Weak points</b>	<b>Score</b>	<b>Threats</b>	<b>Score</b>
<i>The high degree of corruption</i>	4	<i>The fiercely competition existing at the European and international level and the necessity for adaptation from the part of Small and Medium Sized Enterprises</i>	4
<i>Romania's national competitiveness</i>	3	<i>The global economic crises and the asymmetric shocks associated with direct effects throughout all the society</i>	4
<i>The existence of regional development gaps</i>	4	<i>An insufficient preparation for the new changing market conditions in the case of Small and Medium Sized Enterprises</i>	3
<i>The lean infrastructure</i>	4	<i>The brain drain effect</i>	4
<i>The structure of the national economy</i>	3	<i>The incapacity to allocate funds for the R&amp;D in order to have competitive products</i>	4
<i>The relative small number of projects from European funds in the case of Small and Medium Sized Enterprises</i>	3	<i>The administrative and financial burden existing in the case of Small and Medium Sized Enterprises</i>	4
<i>The high costs for implementing the sustainable development principles and the need for a greater governmental involvement</i>	4	<i>Frequent changes in the legislation</i>	4
<i>Average score</i>	<b>3.57</b>	<i>Average score</i>	<b>3.85</b>

Source: Authors own interpretation and the Global Competitiveness Report- 2008-2009

The results of the SWOT analysis should be interpreted in close relationship, in order to have a better perspective over the studied aspects. Therefore we will have a dual approach: strong points- opportunities and weak points- threats.

The image of the *strong points and opportunities* is suggesting the idea that Romania's European Union membership represents a net benefit on a range of multilevel.

The sine qua non condition for obtaining a sustainable development on the long run stands in a series of determinants like: macroeconomic, political and monetary stability. The key for Small and Medium Sized Enterprises' success depends on the quality of the national economic environment and the degree in which this stimulates or not the development. The creation of a solid infrastructure for sustaining the activity of small and medium sized enterprises (business incubators, specialized consulting firms etc) will have a large contribution for future actions.

Regarding the opportunities, these are directly connected with the European funds and with the necessity to have good projects for being financed. For The Romanian Small and Medium Sized Enterprises, the access to EU's internal market will be a good opportunity for testing their capacity of action. A possible solution for dealing with the increasing fierce competition on the European or international markets will be the participation in clusters. If we want in the future to change the existing situation, we should pay attention to the solid development of entrepreneurial education.

*The weak points and the threats* design the importance of having a good internal and external environment in order to obtain a sustainable development. The presence of denaturalized phenomena like global economic crisis, a high degree of corruption, migration effects, regional development gaps etc. will have negative impacts on long term over Romania's development. Summing up it is necessarily to find the best ways of creating a favorable environment for developing Small and Medium Sized Enterprises. In doing so, it is better to reduce the effects of administrative and financial burden and to avoid too many changes in the legislation.

For a better image the National Council of Small and Medium Sized Private Enterprises in Romania had developed in its reports the *Index of Evolution of Small and Medium Sized Enterprises*<sup>10</sup>. The main sub indexes are represented by:

**Table 2:**  
The Index of Evolution of Small and Medium Sized Enterprises

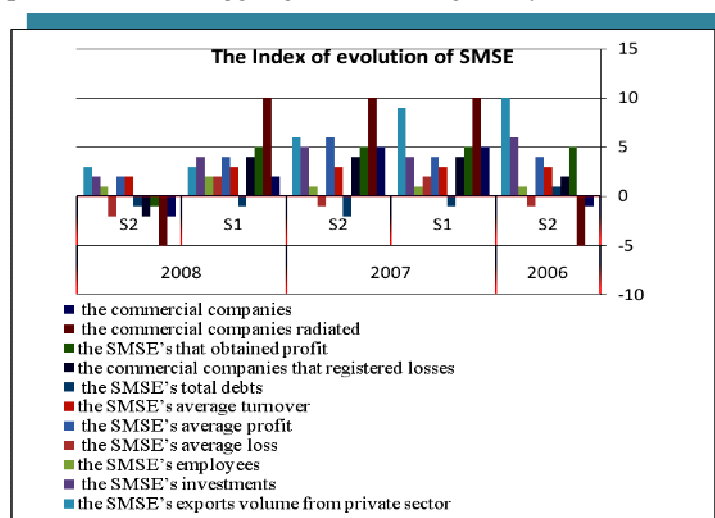
No	Index	Score effectively obtained				
		2006	2007		2008	
		S2	SI	S2	SI	S2
1.	The evolution of the number of the commercial companies registered at the Commerce Register	-1	5	5	2	-2
2.	The evolution of the number of the commercial companies radiated	-5	10	10	10	-5
3.	The evolution of the SMEs that obtained profit	5	5	5	5	-1
4.	The evolution of the number of the commercial companies that registered losses	2	4	4	4	-2
5.	The evolution of the SMEs total debts	1	-1	-2	-1	-1
6.	The evolution of the SMEs average turnover	3	3	3	3	2

<sup>10</sup> The Index of Evolution of Small and Medium Sized Enterprises is obtained as a sum of the 11 sub indexes composed. The maximal value is 100 points.

No	Index	Score effectively obtained				
		2006		2007		2008
		S2	S1	S2	S1	S2
7.	The evolution of the SMEs average profit	4	4	6	4	2
8.	The evolution of the SMEs average loss	-1	2	-1	2	-2
9.	The evolution of the SMEs employees	1	1	1	2	1
10	The evolution of the SMEs investments	6	4	5	4	2
11	The evolution of the SMEs exports volume from private sector	10	9	6	3	3
<b>General score (points)</b>		<b>25</b>	<b>46</b>	<b>42</b>	<b>38</b>	<b>-3</b>
<b>Average score (points)</b>		<b>44</b>			<b>17.5</b>	

Source: The National Council of Small and Medium Sized Private Enterprises in Romania and authors interpretation

As we can observe, the value of the Index of Evolution of Small and Medium Sized Enterprises is fluctuating in time: we have an increase with an average score of 44 points for the year 2007 (the highest value) and a decrease with an average score of 17.5 points on the year 2008. Due to the last negative economic outcomes foreseen, we estimate that the trend of decreasing will be also continuing during the year 2009. The impact is consistent in the case of the Small and Medium Sized Enterprises that are struggling to find the right way in this time of crisis.



**Figure 3.** The Index of evolution of Small and Medium Sized Private Enterprises (SMSE)

Source: The National Council of Small and Medium Sized Private Enterprises in Romania

There are many aspects that should be improved regarding the Small and Medium Sized Enterprises. One is the number of regulations and laws that are continually changing, especially as a consequence of the harmonization with the European standards).

Another negative point is bureaucracy. According to data released by '2006 White Chart of Romanian SMEs', it is perceived by entrepreneurs as being the second most significant difficulty faced by SMEs (64.62%) after high taxation. A better legal framework and reduced bureaucracy represent two of the top five priorities that entrepreneurs recommended to the National Agency for Small and Medium sized Enterprises to focus on.

#### 4. Conclusions

The integration into the European Union is bringing a lot of new challenges for Romania. The small and medium sized enterprises are playing an important role within any market economy, due to the fact that their presence is fostering income stability, growth and employment. We can say that their competitiveness is vital influencing the competitive position of the overall economy.

For succeeding on the international market, it is extremely important to pay attention to the established collaboration's determinants in the case of small and medium sized enterprises. The existence of the 3 basic components - *a new vision of development- strategic investments- new core competences-* can represent the difference in terms of success. In our opinion, these three factors are considered the first important step towards success, being what we had called 'the basic vision of development for small and medium-sized enterprises'.

In order to obtain a sustainable competitiveness on the long run, the SMEs should pay attention to the triangle '*research- development- innovation*', as a key factor for dealing with new challenges. The importance of these aspects is high lightened in the Lisbon Strategy, representing primordial factors in reaching the economic development.

Achieving a sustainable competitiveness is the key for reaching sustainable development and the convergence on long run. Romania should reconsider its strategy in order to consider the small and medium sized enterprises as the driving forces of future development.

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