

**FORUM
ON
“AFTER FIFTEEN YEARS OF MARKET REFORMS IN TRANSITION
ECONOMIES: NEW CHALLENGES AND PERSPECTIVES FOR THE
INDUSTRIAL SECTOR”**

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**THE EFFECT OF EU ENLARGEMENT
ON THE SME SECTOR**

by

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HISTORICAL ANTECEDENTS

It is a well-known fact that following World War II, the Eastern European economic and political systems already in use were based on heavily concentrated and centralised despotism in politics and on a directly controlled economy. The primacy of the large-scale state-owned companies was never questioned; small companies and even entrepreneurship and commodity production were denied.

Small enterprises and the idea and practice of breaking away from the system of controlled economy therefore became united.

THE HUNGARIAN EXAMPLE

Development in Hungary was an exact copy of the centralised, despotic model dictated by the Soviet Union. However, the Revolution of 1956 showed more clearly than in any other country that this system cannot be maintained. After the revolution, while keeping to the principles dictated from Moscow, terror-like sternness was loosened up by the leaders of the country year by year, and gradually what the international public named 'Gulyás-communism' was introduced. 'The happiest barrack of the camp', 'the system of Gulyás-communism', were the words of praise about us Hungarians back then and it is worth examining what these attributes actually meant.

In the course of the 'socialist reorganisation' of agriculture, alongside the Russian-type Kolhozes, the so-called 'private husbandries' were introduced, which meant that people living in the country could supplement their income and food by private enterprises set up in their gardens.

Civil society was gradually formed against the oppressive political state. This was embodied in the economy as the growing parallel economy in industry and services.²

By the 1970s this parallel economy was affecting the biggest part of society, so the fact that everybody had some kind of a supplementary income was accepted and ethically acknowledged by the community. In 1982 the political leadership made an attempt to legalise this semi-legal, informal sector and tried to allow for private enterprises within the framework of socialism. Back then we only suspected, but today we know that this endeavour was doomed to failure in that the despotic system was antagonistic to the self-conscious, free citizen, as was the nationalised citizen to one grown up in democracy.

The evolution of small enterprises in Hungary

Although the title of this conference is '15 years after the market reforms in the transitional economies', as we can see from what has been said so far, it was not 15 years ago that the process which resulted in the changing of the political system started, but much earlier. Also, in the early 90s Hungary was a model-country for the transitional economies. Alongside the numerous benefits of this road, it also had its drawbacks which characterize the entrepreneurial culture even today. Let us now take a look at them.

An almost incredible number of private enterprises have started up in just one decade. However, for a long time, and in a way up to this very day, the terms 'small enterprise' and 'private enterprise' have been used synonymously. 96% of the companies were small enterprises; in fact most of them could be referred to as micro-enterprises rather than small enterprises. Small enterprises which contained only

² In Poland, which was in the forefront of the change of the political system, the civil society was not organised by the parallel economy, but primarily by the Church. Therefore, the people in Poland suffered from shortage of goods, poverty and economic crisis for a long time.

the seeds of entrepreneurship started up with less than ten employees; in fact, the entrepreneur could rather be considered self-employed, that is, he actively took part in the business; his own working hours and his mental and physical limits were the limits of his prosperity.

After the socialist equalitarianism, capital had not been able to emerge for a long time, and the process of the primitive accumulation started up very slowly.

The one million plus small enterprises already in existence were small not only in terms of personnel but in financial standing, technical equipment and standards as well. As long as they only had to compete with each other, this did not present a major problem since most businesses were featured by aforementioned shortcomings. Today however, now the competition has been elevated to the European level and the borders are open, problems of competitive strength become ever more perceptible, and a significant number of enterprises that are threatened to be overtaken.

We can rightly be proud of the fact that in a country where there are 5 million people of employable age, there are 1.2 million registered businesses. On the other hand though, an enormous number of people who started up a business lacked many elements of family traditions, professional skills, know-how, managerial skills that their western colleagues had possessed already. Hence, these enterprises are tagged by the lack of human resources as well.

Although we deservedly listed the emerging private entrepreneurship of the 1970s and the 1980s amongst the benefits and the social capital, business knowledge, and some experience acquired by the new-sprung entrepreneurs acquired, it is also true that by today this experience can often be a barrier. To this very day, the entrepreneur does not consider dodging the law to be a crime, avoiding tax regulations especially. He is afraid of expansion and the fast growth of business, his motto is; I do not mind being successful as long as no one notices'. He often has exaggerated demands of governmental protection and support and in case these reflexes had slowed down during the 15 years of market economy, the European Union accession strengthened these attitudes again. It strengthened them, because every progressive political group tries to advocate the benefits of the EU to its voters, and the simplest arguments for this lie with ever so significant EU funds available to citizens.

THE PREDICTED EFFECTS OF THE COMMON EUROPEAN MARKET

Euro sceptic voices that worry about how the Hungarian economy will face the challenges of global competition and paint us a picture of Apocalypse are in the minority in the Hungarian media at the moment. The more common approach is, which is also far-fetched, presents the European Union as a mother's breasts (see Cohesion Fund, Structural Funds), we just have to suckle on and then all will be well shortly.

One does not need much proof that this picture of the EU is also unrealistic. To make an exact and realistic picture though, one would need well-founded analyses, scientifically organised surveys and corporate researches.

We have very few concrete research results in this field and even fewer international comparative research results, although I have to point out the conferences and country reports of UNECE from which we were able to learn each other's situation by the help of published presentations in print.

The response to the challenge

The problem is not only that, as I mentioned above, there is little scientifically processed knowledge about ourselves, the characteristics of the entrepreneurial sector and its development, but that the existing research is isolated, they do not get enough publicity and most important, there is a lack of international comparison of the research and practice of the intercultural comparison.

The recent foundation of **ERENET**, the **International Network of Central-eastern European Entrepreneurial Research and Training Institutions**, is the response to this challenge. This network set the goal to reduce these deficiencies and conduct international comparative researches. In the founding statement of the network we can read:

In order to realise and response this historical challenge the members of ERENET decided:

The role of institutions in the higher education has been twofold in this region: on the one hand, it is their responsibility to **teach the most up-to-date business and entrepreneurial knowledge** to the future intellectuals, while they also have to open up towards economic actors and take part in **offering existing enterprises extracurricular, postgraduate trainings and education**.

Signers of ERENET realised the mutual advantages of cooperation and coordination benefits of entrepreneurial researches based on network collaboration and the successfulness of high-standard curriculum and courses created by coordinated efforts.

Taking advantage of international comparisons is of great importance in research issues such as the investigation of enterprises' operation circumstances with special regard to good governance, enterprise-friendly economic and social environment, means of intensifying competitiveness, administrative burdens of operating enterprises and enterprises' financial environment.

Comparing and distributing results of Best Practice researches are undoubtedly useful just like the exploration of entrepreneurs' social responsibility and ethic business attitude in different cultures.

Common researches might help political decision-makers in creating appropriate entrepreneurial environment, finding the best solutions, while they also contribute to modernizing and selecting curriculum of higher education.

⇒ In order to create the organisational framework of their cooperation, **they establish an international network of higher education on teaching and investigating entrepreneurship**.

⇒ In course of regular and continuous exchange of information, **they make each other acquainted with their curriculum and researches**.

⇒ They elaborate and realise common research projects by taking advantage of international cooperation.

⇒ In order to provide financial sources of outlined researches, they **collectively apply** for support in multilateral, pan-European projects.

⇒ **They promote the exchange of their professors**, researchers and possibly students showing considerable interest in enterprise development, furthermore they also support students participating in integrated courses and education.

⇒ In the beginning only on a national level, however, later on also internationally they create a **forum for publications** in order to exchange, document and distribute their research results. The forum for publication is fundamentally an internet-based periodical nevertheless not excluding the publishing of special issues and unique publications.

⇒ By keeping requirements of education development in mind, **they collectively elaborate new syllabus and curriculum**.

⇒ Results of common research projects are regularly exchanged on **workshops** and conferences by taking advantage of researchers' personal mobility.

Knowing the entrepreneurial dynamism of this region, we shall have no doubt that the ERENET will get achieve good results by its researches in the near future.

As a first result of our common researches we have received the Slovenian situation report by *Professor Miroslav Glas*³ considering our topics:

SMEs AFTER A YEAR OF EU ENLARGEMENT – SLOVENIA

Early Expectations

An assessment of the EU impact on the Slovenian economy¹⁾ started with the statement that after a long pre-accession period the EU enlargement would offer new development opportunities due to an increased technology transfer to Slovenia and the better access to the know-how and resources on the single European market. Joining the EMU should have a stronger impact, but the trade and flow of FDI's should work towards improving the situation in Slovenia. The challenges of the enlargement were attributed to the weaknesses in innovation and investment in new technology and know-how (see also Smallbone & Rogut, 2004), however, these weaknesses were considered as a consequence of the delayed restructuring of Slovenian economy and the inappropriate economic policy failing to build a development consensus and to establish right priorities. At the industry and micro-level some negative impact were expected in certain industries (mostly labour intensive and food processing), partly due to the loss of preferential treatment of Slovenian products on the markets of former Yugoslavia. However, the positive impacts of simplified export procedures, FDI's, ending some monopolistic situations and more flexible labour market should contribute a longterm cumulative effect of +5,7 % of GDP. The CAPE 2002 research has shown quite a high optimism of enterprises about their readiness to face the new EU challenge. The Chamber of Crafts was worried for the future of crafts because of the small size of craftshops, the deficiency of the regulation which was "unfriendly" to crafts and micro businesses. SMEs have not done enough on improving supply chains and distribution channels and the clustering and networking has only started. Nevertheless, Slovenia lacked a thorough analysis of the impact of EU enlargement on SMEs. The views that different types of SMEs face different opportunities and that the impact will be quite positive²⁾ were shared by many business-people and experts, while some pessimists have also warned of the danger of large-scale bankruptcies of SMEs only used to do business on the domestic market. Some analyses failed to include Slovenia as a case³⁾, but their conclusions for other countries seem to make sense also for Slovenia.

Our early research (Glas, Hisrich, Vahcic & Antoncic, 1999) using five SMEs as cases (employing 6-97 employees, exporting 50-100 % of their products) revealed a number of problems with exports (huge paperwork, non-tariff barriers, lack of the access to finance, lack of special labour skills) which SMEs expected to lessen after the EU enlargement. However, they also anticipated significantly stronger competition at home. Their efforts to get ready to the change included improvements in quality management, in MIS, decreasing the number of suppliers, development of market niche strategies, discarding uncompetitive activities, R&D and design improvements. Four of these companies have increased employment, sales and exports while one is facing difficult times because of the relocation of its customer base to low-wage Asian countries and the downturn in its markets, but not related to the EU enlargement.

General Assessment

Economic trends in Slovenia in 2005 were officially considered as rather good,⁴⁾ based on the following facts on macroeconomic results:

- the rate of the GDP growth (4,6 %) was highest for last five years,⁵⁾
- exports increased for 12,6 %, while imports for 12,4 %, both highest growth rates for the last decade, with an exception for export growth of 13 % in the year 2000,⁶⁾
- lowest inflation rate of 3,2 %, even withstanding growing oil prices (IMF experts were not impressed by this achievement and the EU expects improved result to comply with the EMU standards;

³ University of Ljubljana – Faculty of Economics, Centre for Entrepreneurship Development (Slovenia)

- gross wages increased less than the GDP, opening some room for investments, while employment slightly increased, too;
- balance of payments deficit below 1 % of the GDP.

The EU enlargement did not cause overall economic disturbances to Slovenia due to the relative openness of the economy. However, some industries, being earlier well protected from the competition and failing to get ready for the EU challenge (tobacco and food processing) faced serious problems for a number of reasons: the competition from the EU increased also on their domestic market, good weather contributed to an increase in the production and lower prices while they also suffered from the loss of preferential treatment on some markets of the South-East Europe (significantly increased custom duties and some non-tariff barriers). Harming key companies in the respective industries. Further, some industries (textiles, leather, shoes) suffered strongly from the global competition, irrespective of the EU enlargement. In the sum, Slovenia has not really capitalised on the membership like some other new members did increasing significantly their exports, mainly Poland.

Table 1. Popular assessment of the advantages and weaknesses of EU enlargement

<i>Advantages</i>	<i>Weaknesses</i>
cheaper food products	crisis in food-processing industry
open opportunities to study abroad	closed labour markets in EU
low budget airlines coming	inflow of workers from East
Euro	low impact of the membership
obligation to lower the inflation	complications with the EU constitution

Source: What Europe has given and what it has taken, *Žurnal*, April 29, 2005

It is important to say: first, some changes in the Slovenian legislation, particularly the disfunctional tax reform, have caused more harm to the SMEs and population than the whole enlargement process. Second, it is difficult to differentiate between the problems from the effects of the EU enlargement and the impact of other global business trends. Third, one year might be too short to make a good assessment, the real effects of the EU could be expected to show in the period of 2007-2013.

NOTES

- 1) An Assessment of the Macro- and Microeconomic Impact of Slovenia's Entry Into the European Union (2003). Chamber of Economy of Slovenia, Ljubljana.
- 2) Doehrn et al. (2000), Impact of the Enlargement of the EU on SMEs in the Union. RWI Essen and EPRC, University of Strathclyde, Glasgow.
- 3) The Challenges of Enlargement – SME Growth Strategies in Central Europe (May 2005). Economist Intelligence Unit; Smallbone & Rogut (2004).
- 4) According to the traditional Spring Report 2005, prepared for the Government by the Office for Macro-economic Research
- 5) However, Slovenia failed to reach the global 5,1 % rate of economic growth.
- 6) The results in exports fell rather small when compared to Poland and some other Eastern European countries.

SOURCES

Glas M., Hisrich R.D., Vahcic A. & Antoncic B. (1999): The Internationalization of SMEs in Transition Economies: Evidence from Slovenia. *Global Focus*, 11(4), pp. 107-124.
 Smallbone D. & Rogut A. (2004): *From Transition to Accession: The Challenges for SMEs in Candidate Countries*. Paper prepared for IntEnt 2005 Conference in Naples, Italy.