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DRIVERS OF SMES' COMPETITIVENESS IN A MODERN ECONOMY A GAP BETWEEN NEW CONCEPT OF A FIRM COMPETITIVENESS AND POLISH ENTREPRENEURS' PERCEPTION OF BEING COM- PETITIVE

Key words: competitiveness, SMEs, entrepreneurship, Poland.

Introduction

It is a stylized fact that small and medium sized enterprises (SMEs) play substantial role in a global economy. Important documents on SMEs, as The European Chart for Small Enterprises or The Lisbon Strategy, emphasize that systematic resolving problem of the sector influences general condition of European economy. SMEs are stimulators of socio-economic development and their functioning is a natural symptom of market competition (Skowronek – Mielczarek, 2005). It is also common to attribute them with innovativeness and European integration. Their strengths include: a simple organisation structure, effectiveness of a decision process, as well as creativity and ability to adjust to market demand. Moreover, small and medium enterprises contribute to global competitiveness and generate higher, proportionally to large companies, employment (Beck et al, 2005).

Increased popularity of the sector is also proved by a new approach to treat small and medium- sized enterprise as a drivers of entrepreneurship. In this meaning firm growth is a measure of entrepreneur's success and a SME as a transmission link through which entrepreneurship appears and influences on macro economy (Dominiak, 2005).

Small and medium sized enterprises, as a research area, have both empirical, theoretical and methodological justification (Torrés, 2003). An empirical need to analyze the sector is connected with crucial role that SMEs play in economy but also with their key features,

which are: an ability to adapt, dynamics of growth and high flexibility. From the point of view of economic theories, the revival experiences economics linked with searching their instability and shifts in economy (SMEs are regarded as one of the main sources of restoring market equilibrium) but also role of SMEs in entrepreneurship development. Taking into consideration a methodological aspect, SMEs constitute an excellent area for observation of many economic and social phenomena or processes - it is easier to observe, identify and analyze aspects which in large companies requires simplifications and additional assumptions.

In a contemporary paradigm of economics firms are the agents of growth which shape the global economic order. In this context competitiveness of firms determines the development of economies they operate in. It is associated with growth and prosperity. In the effect competitive companies create precious added value and contribute to social welfare. At the same time, in a globalizing world, competitiveness is perceived as the key to firm survival (*Globalization and Firm Competitiveness...*, 2002). Promoting competitiveness tools and a idea of fair competitiveness, as well as designing friendly legal framework to enable firms to compete, seem to be thus priority in a contemporary economy policy.

Traditionally, competitiveness is understood as a set of abilities of a firm to offer products or services that respond to the quality standards of the local and world markets at prices that are competitive and provide returns on the exploited resources (businessdictionary.com). However, price and quality are not the only factors enterprise may compete with. More up-to-date understanding of competitiveness presents OECD definition where it is described as *the ability of companies (...) to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a sustainable basis* (OECD 1998). Why this definition seems to be more topical? From ages firms, especially small ones, have been facing the problem of competitiveness. Nevertheless, from few years firms experience change of competitiveness context. Traditional competition, based on lowering costs and prices, is being replaced by the competition, driven by: quality, flexibility, design, reliability and networking (Best, 1990). In a complex, globalizing, liberalizing and fast changing world being competitive firm means being able to recognize knowledge, choose and absorb new technologies and adjust to market trends. The processes and phenomena which have changed the competitiveness context for SMEs include: globalization, internationalization, knowledge and innovation spread, clustering, some social trends.

The aim of the paper is to analyse internal and external drivers of SMEs competitiveness, taking into consideration recent changes of the competitiveness context. It is aimed at revealing substantial discrepancy between a new concept of firm competitiveness and

Polish entrepreneurs' perception of being competitive.

Attributes of small business related to their competitiveness

Small and medium sized enterprises are associated with many characteristics related to their competitiveness. According to Wyncarczyk (1993) small enterprises' attributes are:

- higher level of uncertainty, connected with fact that small firms do not have influence on prices (are price takers from the market) and their clients or products lists are limited (loss of one client may result in bankruptcy). Because of simple organization structure, small firm do not have internal audit or control, which favours fluctuations in their functioning.
- higher level of innovativeness, which is a consequence of operating in a market niche (very often small firms offer less standardized product or service). Innovativeness also results from lower propensity of small firms to copy existing methods of production due to high costs or necessary technical requirements.
- higher level of evolution, being a result of higher probability of changes in small firms (cycle of growth, changes in structure and organization),

Describing small firms based on contrast to large companies, as Wyncarczyk does, is very popular and comfortable. However, it is necessary to remember about two issues. Firstly, small and medium- sized enterprises are not clones of large companies, but are specific and separate entities. Secondly, defining SME by contrasting with large companies should not lead to any judgments, which group of firms – small or large is from economy point of view more important or more competitive.

One of the most important characteristics of small business connected with competitiveness is an ability to adapt quickly to permanent changing environment. This flexibility is a result of usually short term contracts and orders and systematic implementation of modifications. Other crucial attribute of small enterprise is tight relation between a company's output and entrepreneurial competences of a manager (owner) and his contacts with environment (suppliers, clients, employees). In consequence a small firm is more oriented on individual orders of clients. In management, specificity of small firm means broader intra-responsibility of employees for business and strong position of owner in management structure.

Drivers of sme's competitiveness

A growth of a firm depends on its competitiveness, which is influenced by quite a lot of related factors. These determinants may be classified according to their source (internal and

external) and type of influence (positive and negative).

The **external factors** shape the level and character of competitiveness independently from entrepreneurs individual decisions. To this group one may include:

- economic stability and a level of growth of a country,
- legislation in force (tax law, financial law, bankruptcy law),
- effectiveness and complexity of external environment (number and profile of business support institutions and their offers for SMEs)
- the presence of governmental supporting programs towards SMEs;

Internal competitiveness factors are connected with individual decisions made by entrepreneur, according to adopted strategies and planning. They cover:

- capital needs enabling company's investments;
- financial standing, which influences debt capacity,
- own capital (level of auto financing),
- the quality and value of produced goods and services,
- character of marketing strategy,
- willingness and ability to implement innovativeness, especially technological ones,
- qualifications and competences of employees;
- Among the internal factors shaping competitiveness Bossak (2001) mentions also:
- possibility of reduction of unit costs and the possibility to offer lower prices,
- the ability to adjust goods to the demands of the customer,
- decisions concerning organization and management, which ensure a high dynamic of increase in production and sales;

The competitiveness of a firm may be also considered from entrepreneurial competences point of view: propensity to risk, creativity, invention, openness, ability to observe. These factors are personal and to some extent subjective.

Most of mentioned competitiveness factors may have positive and negative influence on SMEs depending the way entrepreneur use or exploit them. Above determinants constitute the potential competitiveness. The process of becoming competitive and a performance – being competitive, are next dimensions of competitiveness. This understanding is to some extent in line with idea of Man, Lau and Chan (1998) who define competitiveness as a threefold concept of: the potential, the process and the performance. However, according to the authors the potential dimension is addressed by both the competitive scope and the organizational capabilities of the firm, whereas the performance dimension comprises multiple indicators.

D.B. Audretsch (2000) distinguishes two concepts of economic role of small enterprises connected with their competitiveness – a static and dynamic one. The former states that small firms produce not enough to profit from economies of scale, as minimal effective production is realized with large productions. This concept indicates higher profitability and economic advantage of big companies. According to Audretsch it is not right to restrict only to one approach. Dynamic concept assumes that new small firms, even operating ineffectively, are interested in implementing innovations. If they adopt new techniques and technologies, they will profit from lower costs and higher quality of offered products and services, so their chances to survive will grow. Entering and running a business is thus not necessarily connected with economies of scale. The economic realities change. The market experiences endless transformation – a lot of phenomena and processes take place and influence SMEs sector in a direct and indirect way. A battle to reach and hold appropriate market position extorts from firms systematic application of innovation and elasticity to change according to variable environment. This constant motion - changes on market, implies dynamic approach to small business. Audretsch (1995) calls small firms agents of change, proving that they are not clones of big companies and due to innovativeness and competitiveness they contribute substantially to changes in economy.

Renaissance of small business, opposite to supranational corporate entrepreneurship, has began in the late 70-ties and the 80-ties of XX century. What are the reasons of growing competitiveness of SMEs in last three decades. Lall (2000) mentions several of them, including:

- decreasing competitiveness of developed countries in mass-production activities,
- technological progress, that favours SMEs which have an advantage in the early stage of innovation,
- easier access of risk capital for small technology based firms (venture capital, business angels),
- increasing demand for profiled, custom-tailored products and services,
- growing competitive pressures on large firms to limit costs by subcontracting traditional 'in-house' activities to SMEs,
- development of clusters,
- shift in policy and favouring small firms;

Many of mentioned reasons of growing SMEs competitiveness changed the context of their functioning as well.

Change of a competitiveness concept

Traditionally, the most simple and frequently used way to become more competitive on the market is to cut prices of products and services. This method was applied with a success for centuries in all economies. For majority of goods the demand was determined foremost by the price. In consequence entrepreneurs put efforts to limit production costs.

Last years brought some changes. Low price is no longer so obvious or single factor of competitiveness. The quality, brand, design are growing in importance in the eyes of customers. The possibilities to produce also have changed. New markets, new localization, free flow of capitals, technological innovativeness released new potential. The modifications in competitiveness context are therefore two folded. They appear both on the side of customer and environment of a firm. The most crucial changes in a firm competitiveness context was provoked by:

- **Globalisation**

According to European Commission globalisation may be both an opportunity and a threat for SMEs, whose capacities to operate on an international level determine their long-term competitiveness (The Magazine of Enterprise Policy, European Commission, 2008). Certainly, it is a challenge for firms. Because of globalisation scope of operating changed. Opening on new markets means not only new customers but also new competitors. Many firms experienced quite unique situation when they have to compete not only with local competitors but internationally. This challenge requires lot of changes in production, marketing and sales. Globalization caused that place of operating business has a minor role. Global technology progress enabled to profit from international workforce and what is even more important direct access to information. More accessible knowledge provides up-to-date information on market, trends, competitors and innovations all over the world. In that sense being competitive becomes more easy.

- **Internationalisation**

Internationalisation has a lot in common with globalisation. Level of internationalization is correlated with a company size. For smaller firms it is much more difficult to operate on international level. However, much has changed during last years. European idea of common market, free flow of goods, capital and human resources enabled conquering new markets and effective allocation of resources. At the same time process of internationalization has broadened a competitiveness scope. Small firms started to compete internationally. For SMEs possible forms of internalizations in a modern economy are foremost: export, technology

transfers, clustering. Final Report of the Expert Group on Supporting the internationalization of SMEs (2007) states: *Internationalization is an engine for SME competitiveness. Internationalized companies have shown to have better capacity to innovate and grow.*

- **Knowledge, technology and innovation**

Internationalization requires knowledge from small firms. A struggle to win market position forces SMEs to implement systematically innovation and adjust to changes in environment. Innovation may occur on production, product or management side. The key meaning for a firm has: knowledge, innovativeness but also pro – development economy policy.

- **Shortening of a product life cycle**

Fast changing of customers tastes and fashion, technical and technological innovations cause that life cycle of many products has shorten substantially. It concerns mainly products connected with new technologies (like computers, electronic equipment, electronic gadgets). For a firms it means changes in market strategy, more market research, tracking market trends.

- **Clustering**

Cluster is a geographic agglomeration of firm from just one or a limited number of related sectors. The basic drivers of competitiveness of clusters are relations with different agents of close and further environment. The merits of operating into cluster, from firm's competitiveness point of view, are (Ketels, 2005):

- more effective functioning, due to: geographic proximity of suppliers and clients, savings on transport, flow of labour force, use of common technical infrastructure;
- chances to be more innovative, due to: cooperation with knowledge centres, laboratories or universities linked with a cluster, more effective flow of information and knowledge, more pressure on innovativeness, lower (because shared) costs of experimenting, possibility to receive financial sources from regional authorities;
- decreasing barriers of entry onto market.

Above factors influence competitiveness of a firm in a cluster. However, according to Japan Small Business Research Institute traditional virtues of functioning in a cluster, as easier access to cheaper resources, are coming less important in globalizing world. The more important seem to be: ability to profit from flexible of labour share, access to information enabling growth and possibility to profit from cooperation with academic institutions (SMEA, 2006).

- **Social trends**

Identifying and following social trends are coming more important for a firm to become competitive. Understanding social need for individuality, standing out, being visible enables creating fashionable goods. The demand for such goods is growing, as for last years development of middle class is experienced. **Middle class growth** changed the conditionality of small business competitiveness. Higher demand and higher expectations towards goods or services caused shift to quality based competitiveness. The potential market grew because of new high growth economies. In developing countries middle class is the fastest growing sector of world population. The share of the middle class in world population rose from 23 percent in 1950 to 54 percent in 2005. The forecasts indicate that in 2025 it will even reach the level of 79 percent (Bhalla, 2007).

Also an **image** of a company, connected with fashion on brands, increases the chances of higher profits. The consumers aspire to buy luxury, custom-tailored and prestigious goods. Originality of products and fashion dictates the price. New competitiveness context requires development of **new marketing practices**. Due to very often aggressive advertisement and high identification of customers with a product, an image of a product becomes more important than its price. Entrepreneurs should also not forget about role of a **design**. Investments in aesthetics of a product and complexity of a services (wrapping, catalogues) is well perceived by customers, thus enable to stay on a market.

Competitiveness factors in the eyes of polish entrepreneurs

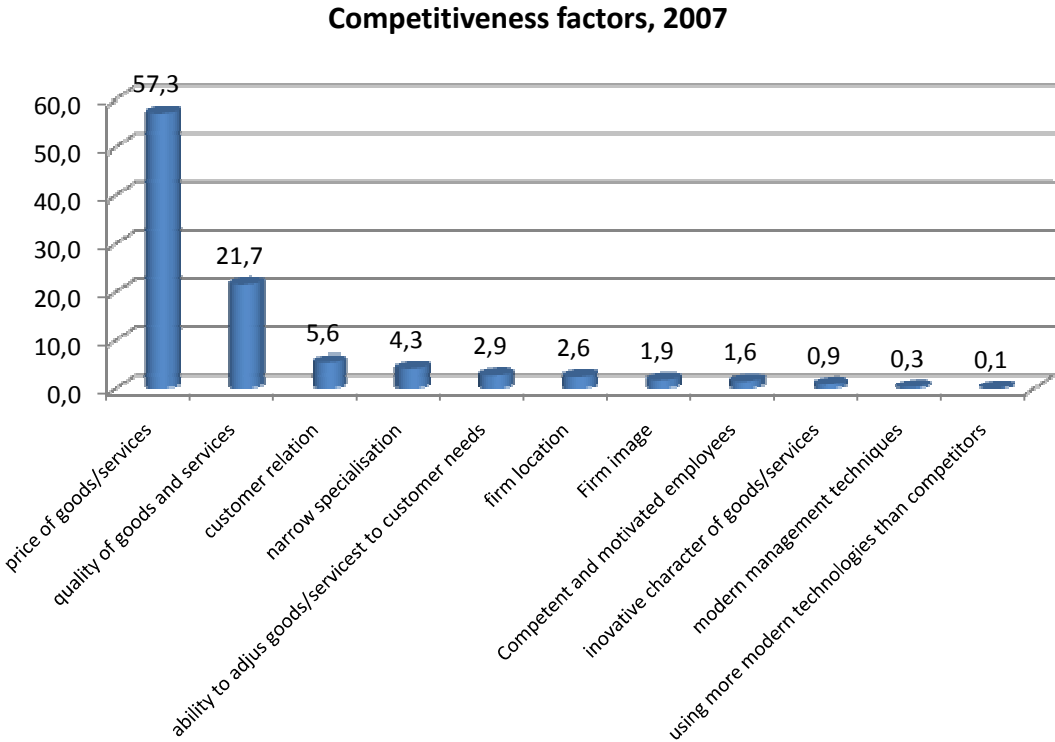
In 2008 Lewiatan¹ produced a report titled *Competitiveness of the SME sector 2007* which embodied the research concerning perception of competitiveness among Polish entrepreneurs. Factors the entrepreneurs could have indicated in the survey included: price, quality of goods and services, customer relationship (quality and sustainability), innovativeness of goods and services, firm localization, ability to adjust to customer needs, narrow specialization (specialized knowledge and competences), firm image, competent and motivated employees, modern management techniques, using more modern techniques than competitors. The result of a research for year 2007 is shown on a graph 1.

As it is seen on the graph the most frequently indicated answer was a price of products or services. There is a huge difference in percentage between this answer and the next one - concerning quality of products and services. More than 57% of Polish entrepreneurs associate growth of a firm or just its survival with price competing. It reveals that their strate-

¹ Polish Confederation of Private Employers.

gies are based on short term planning and they lack ability to absorb information from the market and to predict in longer perspective. Taking into consideration extremely tough price – competitiveness from fast developing Asian economies, like: China, India or Taiwan, the choice to compete with price based tools seems to be inadequate. Production costs (especially labour costs) are much lower in that countries and less attention to international quality standards (which requires expenses) is paid there.

Usually lowering the price means lowering the quality as well. This is contradictory to answers given by Polish entrepreneurs in the survey, as they mentioned quality of products or services as the second most important competitiveness factor. Probably Polish entrepreneurs do not understand clearly the mechanism of competitiveness. There are more incoherence in the results of a survey. If a quality of goods and services takes second place in the competitiveness factors ranking, why modern techniques and innovativeness are ignored? On what basis the quality is based then?



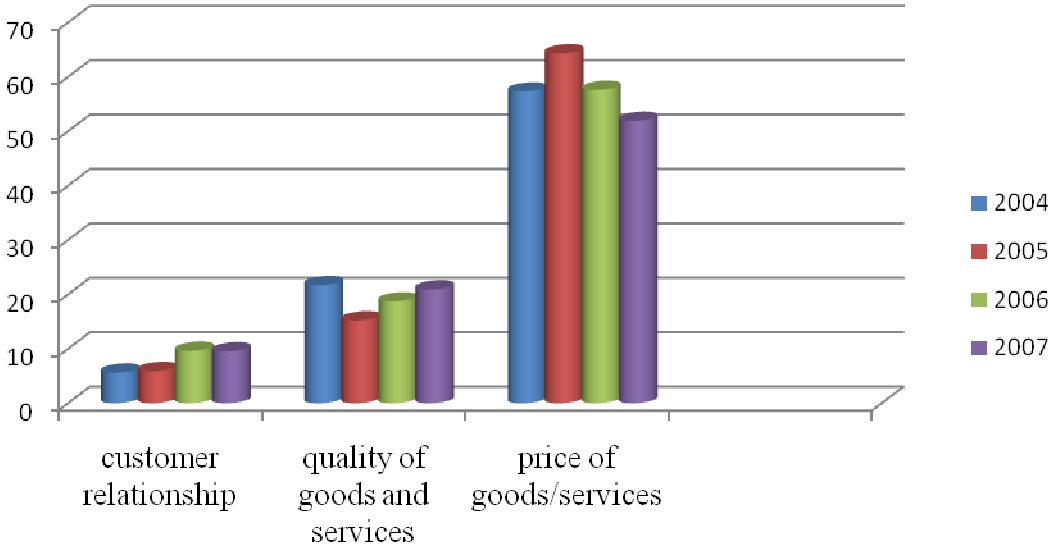
Graph 1. Perception of competitiveness factors by Polish entrepreneurs, 2007.

Source: Monitoring the state of SME sector 2007”, p. 23 – 24.

Because 2007 was not a first year Lewiatan decided to do a research on SMEs com-

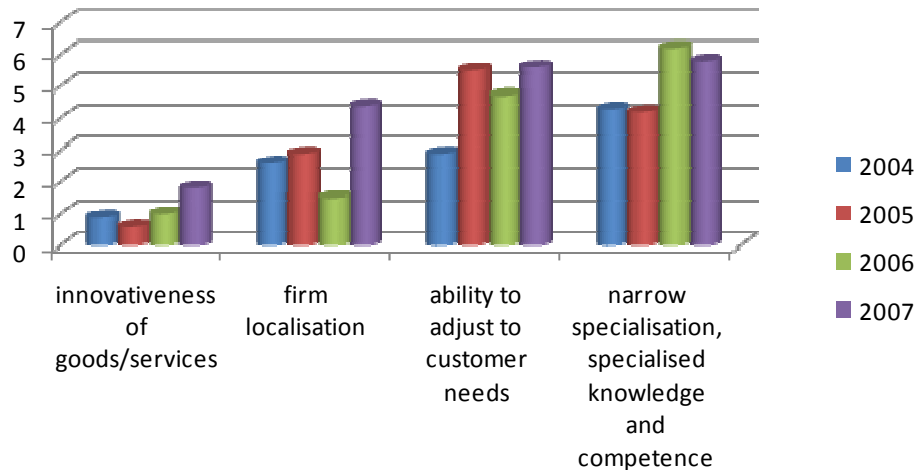
petitiveness, it is possible to compare data for the last four years. This will allow to comment on constancy of Polish entrepreneurs view on competitiveness. The analysis of the graph 2 and 3 leads to a conclusion that their understanding of being competitive is quite stable. On the graph 2 alterations in perception of three key competitiveness factors are illustrated. They did not changed over surveyed time period. Price remains dominative driver of competitiveness, followed by the factor of quality of goods or services and customer relationship. These three determinants are supposed to be key in competitiveness according to Polish entrepreneurs, regardless the changes in the macro environment (the condition of Polish economy in 2004 and 2007 were substantially different). Innovativeness of products or services, firm localization, ability to adjust to customers' needs and narrow specialization are generally regarded as competitiveness minor factors. However the specialized knowledge and competence are growing in importance, which may be a good sign for future.

The most surprising is a distant place of innovativeness factor. From last several years many national and European programs, structural funds, and whole industrial policy was aimed at boosting innovative activities among Polish firms. Innovativeness has been broadly discussed and demythologized. Entrepreneurs seem to separate theory of a modern firm from a practice of everyday functioning.



Graph 2. Perception of competitiveness key factors by Polish entrepreneurs (2004 – 2007).

Source: “Monitoring the state of SME sector 2007”, p. 23.



Graph 3. Perception of competitiveness minor factors by Polish entrepreneurs (2004 – 2007).
Source: “Monitoring the state of SME sector 2007”, p. 23.

The results of a survey shows that Polish entrepreneurs understand competitiveness as a short term process. In majority they do not take into consideration strategic factors and build their competing position on a long time basis. They do not associate competitiveness with investments and do not see correlation between applying modern technologies /knowledge, or investing in innovativeness, and gaining the advantage over competitors. They prefer the easiest, immediate and radical solutions, among which cutting price is dominant. Such approach however lacks planning and may be hard to sustain in a longer perspective.

Conclusions - consequences of a gap

The results of a quoted survey are not coherent with a modern understanding of SMEs competitiveness. The consequences of the gap between a new concept of firm competitiveness and Polish entrepreneurs’ perception of being competitive may be substantial and significant. The most worrying tendencies concern:

- little interest in long – term investments and concentration on short – term business action,
- little interest in R+D investments,
- weak orientation on export and new markets.

Relaying on simple tool as price cut may soon result in real problems with demand and in consequence financial instability. No perspective thinking and not creating sound competitive position may lead to dangerous situation when competitiveness of Polish products and

services will be weak comparing to high quality and innovative goods offered by European firms and their price will be too expensive to be attractive in confrontation with productions from China or India. Poor propensity to export also shows negative side of competitiveness of Polish SMEs. Only 6,6% of SMEs practiced export activities in 2006. In 2007 the share grew to 8,7% but still is not enough (Competitiveness of the SMEs sector, 2008. p. 32).

What also may worry is that according to the survey most of the SMEs do not plan to change their policy regarding competitiveness. Price will remain dominative and most important determinant in creating competitive standing in the nearest future (2-4 years) for most of entrepreneurs who took part in the survey. However quality factor is foreseen to catch up the leader. Second positive symptom is growing role of firm image, modern production technologies and modern distribution channels.

Comprehensive check

- 1) What attributes make small firms more competitive than large companies? And what attributes make them less competitive?
- 2) Which external and internal factors influence the performance of SMEs?
- 3) Which processes and trends provoked changes in firms competitiveness? What is this change based on?
- 4) What may be the consequences of using traditional instruments of competitiveness for Polish entrepreneurs?

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