

**THREATS AND OPPORTUNITIES FOR SMES
OF JOINING THE SINGLE EUROPEAN MARKET:
CZECH REPUBLIC COUNTRY REPORT**

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PAPER PREPARED FOR THE PHARE ACE PROJECT P97-8178R: *The Adjustment Process of SMEs in Poland and the Czech Republic to the Single European Market*

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1. INTRODUCTION

Before transition, Czech economy, similar to other CEECs, consisted mainly of large enterprises. Privatisation together with new start-ups led to the emergence and growth of small and medium sized enterprises (SMEs). SMEs however had to face certain barriers and constraints to their development which are not faced by large firms such as worse access to finance, regulatory requirements, access to information, instable legal framework, corruption and anti-competitive practices in contract relations as well as weak lobbying power and vested interests supporting large enterprises in the government.

In the developed economies, sector of small and medium sized enterprises has a considerable share on the employment, output, taxes, supply of consumer goods and implementation of innovations and new technologies. (Acs. Z.-Audretsch D., 1988, Birch 1987, Dyker 1997). SMEs are considered to be a major engine of restructuring, as they are able to react fast on the change of the internal as well as external conditions. (Senberger W., Loveman G., Poire M., 1990). Thanks to these characteristics, SMEs have a fundamental importance for the economy in general and for a transition economy especially. Creation and the development of small and medium sized enterprises sector is therefore one of the successful features on the road to the market economy (Mejstrik M., McDermott G., 1993).

The Czech Republic together with other CEECs is preparing for EU accession. It is expected that the Single European Market membership of the Czech Republic will have both positive as well as negative effects on the SMEs sector. The ultimate aim of this study is to assess in what extent SMEs in the Czech Republic are prepared or preparing to operate within the European Single Market, what are the weaknesses and strengths of small and medium size enterprises? In order to be able to answer this question, special survey among small and medium sized firms has been carried out within this project. The starting point is a chapter devoted to the development and position of SMEs in the macroeconomic perspective during the transition. Next chapter provides the description of the data and continues with the presentation of the results of the survey and their interpretation. Concluding remarks are related to the fears and challenges to small private sector in the perspective of EU accession as well as some practicable proposals for policy makers that could assist the adjustment process.

2. SMEs from the macroeconomic perspective

The key macroeconomics elements of the economic reform were put into place on January 1991, when the majority of prices were liberalised, the currency was declared to be "internally convertible," and foreign trade was liberalised. Conservative fiscal and monetary policies have produced relatively stable investment climate with number of opportunities and tax waivers for SME up to 1992 (Mejstrik, McDermott, 1993). Despite all the incentives have been abolished starting 1993, SMEs sector continued to grow for another few years. Maintenance of the SMEs sector growth can be attributed to the positive macroeconomics developments during the period 1992-1996. Small and medium enterprises are more sensitive to the too radical changes in the macroeconomic situation; macroeconomic stability is thus an important assumption for small businesses survival and development.

During the early years of transition (1990-1996), the unemployment rate was low in the Czech Republic. There was significant macroeconomic and mezzoeconomic restructuring but somewhat limited microeconomic and financial restructuring (Mejstrik, 1999). One possible explanation for low Czech unemployment has been that newly established small and medium size enterprises absorbed the employees released from large enterprises. However it can be expected that only small part of new start-up firms will be able to grow. Small, or rather micro, enterprises, which played major role in the creation of new jobs, however are usually both unwilling and unable to grow. Majority of these micro firms is not even self-employed full-time, using self-employment as a complement to their incomes as employees. (Rona A.,)

Table 1 Size structure of firms 1993-2000

Size class	1993	1994	1995	1996	1997	1999	2000
0 - self-employed	89.9*	77.8*	77.7*	76.4*	77.5*	81.9 ¹	82.3 ¹
1-10	8.2	18.3	18.5	19.8	18.9	15.0	14.9
11-49	1.0	2.9	2.8	2.9	2.7	2.4	2.2
50-299	0.7	1.0	0.8	0.8	0.7	0.5 ²	0.5 ²
300-499	0.1	0.1	0.1	0.1	0.1	0.1 ³	0.1 ³
500 and more	0.1	0.1	0.1	0.1	0.1	0.0	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Business register, CSO 1993-2000

* Data not provided

¹ Data not provided and enterprises with no employees

² Data for 50 - 249

³ Data for 250 - 499

The banking sector played during first years a positive role in building SMEs position in the economy. The situation however changed since 1993 when it is almost impossible for small business to get the credit. Few large banks dominated banking sector, which has been privatised only recently and the last is still expecting strategic partner. The banking sector is the sector with extreme power and influence on other industries, new start-ups and SMEs sector development.

The economic policy of the Czech government was aiming to re-integrate the national economy with those of the developed world market through foreign trade and foreign direct investment (FDI). During the period 1990-1995, most of the trade barriers have been either removed; There are numerous small and medium enterprises which became important exporters. (Zemplerova A., 1996). In addition growing medium sized enterprises represent a real or potential competition for large monopoly companies as well as their complementing subcontracting opportunities.

During the period 1992-96, the Czech transition was considered to be successful, however starting 1997 the economy was declining.(see Table 1 in the Appendix). The recession was caused not only by restrictive monetary policies of the Czech National Bank but also by slow restructuring of the economy, namely of large firms. Slow restructuring is related to the privatisation process and corporate governance (Mejstrik,1999).

2.1. Privatisation from bellow and from above

In general, private sector can be established from “above” and from “below” (Winiiecki, 2000). The former approach to privatisation is based on the privatisation of existing SOEs, for the achievement of which the action and full participation of the government is crucial. The later approach allows establishing the private sector through new start-up and expansion of

“new” private firms. In the later case most of actions is based and comes from the market without any participation of government.

In practice both approaches run in parallel, however it is important which one of these two approaches is the dominant one. Each of the approaches generates specific institutions (e.g. the legislation), the economic policies, the market organization and the ethics guarding the rules of the game (Benacek, 2000).

Microeconomic reforms such as creation of a new legal framework and privatisation of state enterprises progressed since the outset of the reform, but naturally at a slower pace than the macroeconomic measures. Privatisation created certain opportunities for establishment of small and medium enterprises sector during the small-scale privatisation or thanks to the restitution. However the property of state-owned small businesses sold in auctions, was small. The sales, proceeding during 1991-93 under the “small-scale privatisation act”, comprised of only US\$ 1.3 billion.

Large privatisation was based on the voucher scheme. Its impact on both the strategic as well as on the operative decisions was crucial. Foreign investors played marginal role in the whole privatisation. Until 1997 the accumulated FDI amounted to the mere \$ 6 bil (168 bil CZK), while the property privatised was 964 bill. CZK, and while the total value of all productive physical assets was 1600 bill. CZK at the book values of 1990. About 35% of the total property officially privatised went through voucher scheme. Another 20% were privatised in a competitive environment (public auctions, foreign tenders), 7% were left for restitutions and 5% were donated to municipalities. The remaining 33% were given away by “direct sales”, managerial buy-outs or by domestic tenders. If we exclude competitive sales and restitution, about three quarters of the property fell into rather non-transparent and dispersed ownership aims of which were not motivated primarily by restructuring.

The privatisation of property under soft-budget constraints (transferred either freely or on a soft loan), that was dominant in the Czech Republic during 1992-95, did not bring about conditions that would lead to well defined corporate governance, stable ownership, dominance of principals over agents and to entrepreneurship that would have long-term productive aims. Restructuring was not objective functions of owners generated by the process of privatisation directed “from above” (Mejstrik, 1999). Only since 1997 one has been able to recognize steady huge grow of FDI reaching \$ 5-6 bill. per year both in green-field and brown-field investments.

The privatisation scheme required to create various institutions and conditions such as commissions for auctions, tenders and public bidding, Ministry of Privatisation, National Property Fund, departments for privatisation at ministries, Regional Privatisation Boards and the network for voucher bidding (Mejstrik, Zemplerova, 1997). Despite the aim was to simulate market, the institutions are necessarily bureaucratic. These institutions integrated with other hierarchies: political parties, central government, regional public administration, state banks and large state-owned enterprises. As a result the number of employees in the Czech public administration increased after the introduction of a “liberal” market economy from 95743 to 177066, i.e. by full 85%. At the same time one should not posit that it might imply an increase in the quality of the government services. High public revenues allow to keep larger public employment, what leads to higher bureaucracy and to a rise in transaction costs for running private businesses. Those who will be negatively hit are small and medium enterprises (Benacek, 2000).

New private sector has arisen not only as domestic firms that were built from an own or borrowed capital but also as green-field investments of foreign direct investors. Together with large foreign investment there exist numerous small and medium sized foreign investment what could be illustrated by Table 2. One quarter of all enterprises was apparently small. Very small foreign investment up to 18 500 USD (0.5 million crowns) were not registered by the official statistics and therefore escaped these statistics. In can be only estimated that average size of investment in first half on 90's was rather small, often with only the minimum capital requirement of 100 th. CZK (or 3 thousand USD).

Table 2 FDI by size

Foreign investment in USD*	Share of enterprises**
18 500 – 37000	25.2%
37 000 - 370 000	22.3%
370 000 – 3 700 000	29.4%
3 700 000 - 37 000 000	21.1%
more than 37 mil. USD	2.0%

Source: Czech National Bank, 1995, * 1 USD = 26.55 CZK,

The analysis of foreign owned enterprises according to their size showed that most of foreign enterprises both in 1995 and 2000 were small. Size structure of foreign enterprises differs from the domestic ones as shown by the table 3a,b. The share of very small firms is lower in case of foreign owned firms and higher for larger size classes than in the case of domestic firms. Dynamics of slightly differently structured data confirm this trend even further as the percentage of large domestic owned firms with over 250 employees declined to mere 0.07%, while in 1995 firms with over 500 employees represented 0.31% of firms. This trend cannot be explained by downsizing of employment, as their restructuring was rather slow. Most of large domestic owned firms filed for bankruptcy (due to the results of leverage buyout privatization) or was acquired by foreign owners (see Mejstřík(1999)).

Table 3a Enterprises by size and ownership (domestic versus foreign) in 1995

Size of enterprises by number of employees	Domestic firms %	Foreign firms %
1-5	74.25	66.61
6-24	18.67	23.90
25-99	5.18	6.80
100-499	1.59	2.22
500-999	0.19	0.27
1000 and more	0.12	0.20
TOTAL	100.0	100.0

Source: Business Register, Czech Statistical Office, 1996

Table 3b Enterprises by size and ownership (domestic versus foreign) in 2000

Size of enterprises by number of employees	Domestic firms %	Foreign firms %
0 and not provided	82.47	78.87
1 – 9	14.87	15.82
10 – 49	2.14	3.60

50 – 249	0.45	1.29
250 and more	0.07	0.42
TOTAL	100.00	100.00

Source: Business Register, Czech Statistical Office, 2000

The privatisation “from below” is dominated by productive objectives; therefore it requires different institutional framework such as functioning market especially the capital markets and banks. Clearly defined and enforceable property rights guaranteed by the State as well as transparent legislation and functioning courts.

The discriminatory treatment of SMEs as compared to large enterprises is expressed by government support by explicit subsidies and bailouts. Meanwhile the former SOEs received approximately \$ 14 bn during 1990-99 as a support from State funds, the support of the SMEs, whose share on GDP was comparable with the share of former SOEs, was less than \$ 1 bn.

May 1997 there was a financial crisis that was followed by a restrictive package of measures. The recession ended in the middle of 2000. Table 2 in the Appendix illustrates that during 1995-98 the industrial sector as a whole was stagnating and the decline of employment in large firms was compensated by the growth in the SMEs. People started those enterprises because they had no other choice. The expansion of the small private sector, therefore, runs counter to the business cycle. Once the recession ends, many people now self-employed should be able to find proper employment in medium-sized or large firms. (Rona-Tas, Akos, 2000).

2.2. Development, structure, position and performance of SMEs

As mentioned above the Czech SME sector has expanded enormously during 1990-95 and then has matured. Within a mere five years it has converged closely to the industrial structures common in Western Europe. Meanwhile there is highest number of enterprises per 1000 inhabitants in the economy and the average size of enterprise is relatively low. Table 4 shows the comparison of the Czech size structure with EU averages. About 48% of total employees in the Czech Republic and 50% in EU countries are employed by small enterprises. However there are more self-employed persons (enterprises with no employees) in the Czech republic compared to EU countries.

Table 4 Distribution of enterprises and employment by size class (in %) compared to EU:

Size class by No of employee	Share on employment EU	Share on Employment CR	Share on No of enterprises EU	Share of No of enterprise CR
0 salaried employee	9,7	16,7	49,7	72,9
1-49 employee	40,1	31,3	49,2	25,7
50 or more empl.	50,2	52,0	1,1	1,4
TOTAL	100,00	100,00	100,0	100,00

Source: Eurostat PECO PANEL

Table 5a : Distribution of enterprises by sectors of activity in EU and CR

Sector of econ. Activity	EU	CR
Manufacture	13,3	16,1
Construction	12,7	15,2
Distributive trade	31,8	28,6
Hotels, restaurants	8,5	5,4
Transport and services	33,6	34,7
TOTAL	100,0	100,0

Source: Eurostat PECO PANEL

Table 5b Share of SMEs with employment up to 250 workers in all sectors of Czech economy
Comparison of 1999 with 1995

	Employment		Sales		Value added	
	1995	1999	1997	1999	1997	1999
Industrial sector	43.1	45.6	33.9	36.6	34.0	37.2
Construction	75.2	76.7	70.3	69.3	74.5	74.1
Trade	85.7	81.9	90.8	87.1	88.5	85.3
Catering	90.8	86.7	85.4	85.8	77.1	80.2
Transport	19.5	22.9	43.7	41.7	29.9	27.3
Other services	82.2	83.8	87.8	88.7	84.2	86.2
TOTAL	64.4	59.1	52.9	53.5	57.4	53.0

Sources: Own estimations for 1995 from industrial database of CSO and estimation of the Ministry of Industry and Trade for 1999

Most of the new private firms have been established in the sector of trade, paid services and construction. Surprisingly a lot of small and medium size firms operate in manufacturing, and their share shows tendency to grow with the time. One should realise that in 1989 the manufacturing firms with less than 100 employees were practically non-existent because the central planning concentrated in developing the large-scale corporate sector only.

There is a long discussion about the performance of the firms according to their size. Most studies confirm growth of productivity with the size of the firm. The explanation is economies of scale. However this is not an iron rule. There exist new technologies which allow to produce more productively even in a small scale. Table 5 shows computation of average productivity by size compared to the average productivity within the sector. Only in manufacturing industry, the average productivity is growing with the size of enterprises, however as illustrated by Table 3 in the Appendix, there are industries such as apparel, metal products, machinery, optical instruments or recycling in which small and medium size enterprises respectively reach higher average productivity on average. There are industries, in which economies of scale are not so important and new technologies might allow producing efficiently even in smaller scale.

Table 5 Relative productivity by firm size and sector (average productivity within the sector for all firms 100%)

	<25 empl.	25-100 empl.	>100 empl.
Mining	101,36	91,63	100,32
Manufacturing	84,64	87,15	103,76
Construction	117,39	165,1	72,52
Wholesale	115,91	93,69	71,11
Retail sale	125,78	94,59	59,99
Transport and Communication	430,38	202,13	66,14
Services (production)	132,45	65,64	85,57
Services (personal)	79,40	105,23	119,53
All sectors	113,99	103,8	94,99

Source: P13-04 1995, CSO Revidované ekonomické výsledky nefinančních podniků a korporací 1995, CSO publikace č.0601-96, only legal persons, own computations

3. SMEs and Single European Market: Survey results

As there exist no simple relation between the firm's size and its efficiency, there exist no clearly cut relation between the firm's size and its ability to adjust to integration processes. Previous studies showed that micro firms (up to 10 employees) are resistant to the integration, but firms between 50 and 250 employees are very sensitive. (Julien, Joyal, Deshaies, 1994). Micro firms never became global or integrated to larger than local markets that are meeting the special local needs. However it is expected that number of such local markets will decrease. (Globalisation - OECD report). Another study showed that the ability to internationalise is positively correlated with the firm's size (Moini 1995, Wolff, Pett 2000). The ability to export is crucial for adjustment to integration. It is expected that the strongest effects will be in the case of medium size firms producing manufacturing products, which are neither local nor global.

Our evaluation of the advancement of preparation of small and medium size enterprises is based on the analysis of survey carried out for the purpose of the project. In the Czech Republic the survey was done in November 2000. Questionnaire has been obtained from the Polish partner, translated into Czech. Questionnaire focused on the following issues: What is the state of internationalisation of SME? What are major barriers to internationalise? What is the state of the awareness and preparedness of SMEs to join Single European Market? Beside this general aim of the survey – to get more information on the attitudes and state of SMEs as related to EU accession - two additional hypothesis should have been proved by the survey.

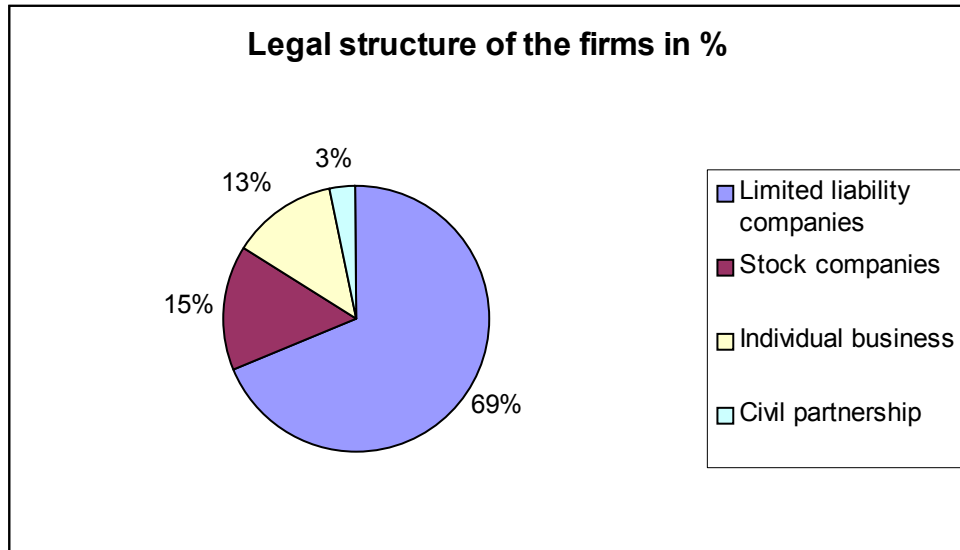
First we would like to compare whether “de novo” private sector has different characteristics that firms established from the previous state enterprises. Therefore a question has been added concerning the way of establishment (of the firm (new green field or firm established from an old previously existing firm). Second, Czech survey includes both traditional industries, namely textile, clothing and wood industries, and also part of the “new economy” representing by information technology (IT). These two aspects should allow to go deeper into the structure of SMEs and its role in the adjustment processes as related to the joining the Single European Market.

Companies were selected from the complete address register received from Czech statistical office. Out of the register, there were firms with 10-199 employees have been selected in four traditional industries and each third firm sent the questionnaire. (480 in food, 366 in textile and clothing, 290 in wooden and 152 in plastics). In addition to it all firms in information technology (IT- 520) have been selected. Hence altogether 1807 questionnaires have been sent out. The response rate was about 11%, what is the usual rate in case of such surveys. From the Table 3 at the Appendix it follows, that these industries represent about a quarter of total employment and sales of manufacturing.

Description statistics of the surveyed firms (general information).

Altogether 195 completed questionnaires have been received, of which 39 in food, 45 in cloth, 24 in wooden and 23 in plastic. In addition there are 64 firms active in the information technology industry. With exemption of food industry, were joint stock companies prevail, most of the companies were limited liability as shown by the graph 1. Wood industry is at the same time an industry with largest average size and also highest productivity.

Graph 1



People who need self-fulfillment and independence have mainly established the firms. This holds especially for the new industry – information technology. In case of traditional industries motives such as unemployment or family traditional played a certain role.

Internalisation of SMEs (Export performance, import penetration) and barriers to export growth

There exist several theories of internationalisation, which might be applied to the transitional economy. (See Dominiak P., 2001 for an overview). Although transition countries are in different position compared to standard market economies for which theories of internationalisation were developed, rational behind the stepwise development path (stage development model) works in the conditions of emerging market economies quite well. Starting with exports, the process continues via subsidiary stage to licensing, contract manufacturing and subcontracting stage, and results in establishing foreign production subsidiaries (Luostarinen, 1979).

Export performance of a firm is therefore a crucial indicator of internationalisation. Results of the survey show that about 55% of the firms are exporters. About a third of firms investigated had never exported. More than 10% of firms were exporters in the past but they are not exporting any more. The most frequent reason for stop of the export was bureaucracy related to the export. Another reasons for stop exports in case of firms, which exported in the past, was the fact that they have lost partner on the foreign market. Surprisingly none of the respondents selected the quality of the product as a reason to stop the exports.

Export performance is different according to the industry. Food industry is not export oriented industry, it has lowest export performance among industries under investigation. Half of IT firms are exporters, 58% of wood and over 70% of cloth and plastics, while only 33% of food firms export.

It is important to mention, that the food products are often short-life. For example bread, cakes, ice creams. Moreover, these products are sold directly to the final customer. Internalisation occurs in case of some products of food industry rather via foreign direct investment. In this group of products it was their specifics that eliminated any opportunity of export. Most of the SMEs in that group operate on the local markets, have stable position and own group of local customers. From their point of view the demand on domestic market is sufficient. This group of firms probably will be never involved in export activities as well as will not take an opportunity resulting from internationalisation processes.

In more that one third of exporting firms, the share of export in firms sales is bellow 10%. This is more significant by food and plastics sector. On the other hand 45% of firms in cloth sector exports more than 75%. Table 6 bellow shows the export performance distribution more in detail.

Table 6 Export activity, in %

	Food	Cloth	Wood	Plastics	IT	Total
Has never exported	59	17	25	17	40	34
It is an exporter	33	73	58	73	50	56
Previous exporter	8	10	17	9	10	10
Previous exporter	100	100	100	100	100	100
The share of export in firms' sales (%)						
does not concern	0	0	7	0	6	3
below 10%	46	19	27	63	37	36
10-20%	23	13	13	16	17	16
21-30%	15	6	7	5	6	7
31-50%	0	3	27	0	17	10
51-75%	8	13	7	0	6	7
above 75%	8	45	13	16	11	21
Total	100	100	100	100	100	100

Most of exports are directed to other central and Eastern European Countries, surprisingly low is the share of exports to European Union. With exemption of plastics, where 65% go to EU, it is one fifth on average, in cloth and wooden it is zero.

As major barriers to start export has been revealed lack of adequate connection abroad. Surprisingly entrepreneurs did not see a barrier to export in the product quality or competition on EU markets or not meeting the EU standards. Some are lacking information about foreign markets or have language barriers. Another barrier very important is bureaucracy related to exports. If the quantity exported is small that the bureaucracy id inadequate and increases the costs of exports.

More than half of the firms consider to start export in the future, in plastic even 86%, but in wooden only 38%. Of those who are already exporting 88% consider the opportunity to increase exports, in cloth even 93%. It is interesting that more than half of these exports is planned to be allocated in the European Union. In the framework of the preparation, firms are looking for information, for agent or dealer and analysing the specifics of the respective market. Incumbent exporters are even more optimistic in their plans to increase exports. Almost 90% of existing exporters plan to increase exports and more than half of exports should be directed to the European Single Market. In the framework of preparation works to start or increase the exports they mainly look for information and for agent or dealer.

Industries, which are exporters, are as a rule also importers, this relation have been confirmed also by our survey. About two fifths of firms never imported any goods and two fifths are importers, the rest former importer. The share of imports in the total purchase is relatively in majority of firms. The mere 15% of firms import more than half of its total purchases. About two thirds of total imports come from European Union. Lack of raw materials/materials on domestic market, higher quality and lower prices were the major reasons for imports.

Table 7 Import activity in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>It has never imported</i>	57	30	58	13	44	42
<i>It is an importer</i>	26	60	38	74	38	45
<i>Previous imports</i>	17	10	4	13	18	25
Total	100	100	100	100	100	100
The share of import in the firm purchase in %						
<i>Do not pay attention to it</i>	7	14	8	5	19	12
<i>Bellow 10</i>	57	28	50	37	26	35
<i>10-20</i>	29	14	25	5	29	20
<i>21-30</i>	7	3	8	16	16	10
<i>31-50</i>	0	10	8	11	6	8
<i>51-75</i>	0	17	0	5	0	6
<i>Above 75</i>	0	14	0	21	3	9
Total	100	100	100	100	100	100

Opportunities and threats to SMEs relating to joining EU

As regard to expectations connected with joining the Single European Market, only 23% confirmed that they are afraid of the accession. The number is lower than in Poland (31%). One tenth of owners and managers either do not think about it or have no precise attitude towards the perspective of joining the EU. Almost 70% connect hopes with joining the EU. The results are fairly smooth between sectors with a slightly more fears in food sector and almost no fears in the IT sector.

More than half of respondents thinks that it will be more difficult to work out competitive position after accession of EU. Almost one quarter of owners and managers are thinking that gaining good competitive position will be easier because of the access to new markets and

another quarter think that there will be no change. The opinions are fairly smooth between cloth, wood and plastics sector; in the food sector more pessimistic answers and in IT sector more optimistic answers appear. Detailed distribution of perception of threats and opinion by industry show Table 5 and 6 in the Appendix.

As the best opportunity relating to accession to EU, far away, the appearance of new markets were chosen – 30% of total answers. The next three opportunities were improvement of product quality – 16%, better access to foreign capital – 15% and decreasing of technological gap – 10%. The next coming opportunities were improve of managerial standards and decreasing of export costs – both 9%. The rest is other, none or the managers did not answered nor had opinion.

As for the main threats for Czech SMEs connected with joining the Single European Market, the perception of different threats among the Czech SMEs is fairly smooth. None of the threats has over 30% of total answers. The worst is according to the sampled owner/managers the danger of capital shortage – 27%, 17% think that many of managers would like to protect exporters. Such a result suggests that protection attitudes among owner/managers be quite spread and might lead to conclusion that Czech entrepreneurs are afraid of joining EU.

However there are big differences in the approach to protectionism by industry (new versus old) as well as mode of establishment (green field versus incumbent). As for new economy versus traditional industries, the low and high peaks are in the food and information technology sector, with 90 and 67%. The following part is devoted to the attitudes of firms as by the mode of establishment.

New versus old firms – different attitudes?

Taking in account the difference, whether the firm is an old entity or new established firm, the general sample split into two contrasting parts. There are 132 new firms and 57 old firms. The average number of full time employees in new established companies is 32.4 whereas the average in the old ones is 72.4, which implies that strictly concerning the number of employees, the old firms are twice as large as the new firms.

There is a significant difference whether the firm is growing or not. According to employees, between years 1992 and 2000 64% of new firms were growing in comparison with only 49% of old firms. Between 1998 and 2000 still, there were 50% of new firms growing, but only 44% of old firms growing. This shows that new firms are somehow sharper than the old entities. (See the graph). Measured by turnover – there is not significant gap between the grow of new and old firms between 1992 and 2000, although the new firms are again slightly better with 67% against the old 65%. Comparing the last two years, new firms appear to be growing better with 64% against 47% in old. A significant fall in growth of old firms has appeared in contrast with a light fall in the sample of new firms.

Table 8 Mode of establishment, in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	<i>Total</i>
<i>New firm</i>	57	75	70	68	73	69
<i>New form of older subject</i>	43	25	30	32	27	31
<i>Total</i>	20	23	12	12	33	100

New firm also asks for less protection and relies more on the market than on intervention. While 43% of new firms do not think that the government should protect domestic markets compared to the mere 28% in case of old firms. New firms are also more optimistic as for the expectations from accession to Single European Market. In case of new firms 70% hope for development compared to 51% in case of old firms.

Another “Eurochambers field research” produced from Czech side by Czech Chamber of commerce with smaller sample of around 100 SMEs (48% of 207 companies) independently confirmed number of our key findings (Smejkal (2001)).

3. Small enterprises, self-employed and Single European Market

Based on the above analysis it can be concluded that the sector of SMEs reached the dimension typical for the market economies, however differences in the structure of SMEs sector survive. Comparison with developed economies show relatively high representation of the firms without employees (self-employed). The overwhelming majority of the businesses in the small private sector or for that matter in the entire economy is unincorporated and thus is not legally separated from its owner. In 1997, in the Czech Republic, 84% of all companies were registered as “natural persons”. As it is argued, that these small enterprises are not separated from the household. Their budget is a subordinate part of the household budget. Such enterprise is not interested in growth. The (extended) household sets its natural limits. Its calculations are therefore not guided by profit maximisation but rather by the desire to maximise consumption. The main asset of the self-employed is his/her labour and skills. As a result, the two most obvious ways to increase income is to work more and to upgrade skills.

While a real entrepreneur would find business wherever opportunity emerges, fixated on his household, the self-employed are geographically locked into the local market, in the area wherever he lives. This spatial inertia is reinforced by the important role of family and close friends in the operation of the enterprise. However, competitive threats can be limited by certain flexibility of self-employed and their primary focus as service providers. EU accession can increase further tourism and mobility that offers some new specific opportunities for micro-firms based on the substance of services (besides natural competition from international newcomers). New requirements must be met also by those micro-entrepreneurs that arise from the implementation of EU rules, from *acqui communitaire*. In the Czech Republic, there is lively discussion e.g. on suggested wider obligatory application of Double accounting by those micro-firms instead of simple accounting that might increase their costs (need to hire external accounting firm). Another topic of discussion is the utilization of registering cash machines in order to comply with tax rules and avoid money laundering etc. The experts see the gradual implementation of those measures supported by proper communication strategy as the proper answer. Newly introduced limits of international mobility for labor and specifically small Czech (and Polish and other candidates’) entrepreneurs in certain professions suggested recently by several EU countries can hardly affect significant groups of entrepreneurs (looks

to be neglectable Czech threat for EU countries) but causing unnecessary public awareness of EU problems within many tiny entrepreneurs with many election voting rights.

The oversized self-employment sector and micro firm small private sector itself can be also a threat to the health of the economy. Never growing up to become a medium sized company, the “too small and too many” (Gabor 1998) micro businesses create a distorted size structure in the economy replacing the socialist economy of large monopoly enterprises with the opposite but equally undesirable opposite: an economy of small enterprises, that cannot take advantage of real economies of scale, cannot improve productivity by substantial investment in fixed capital, that cannot successfully compete on a globalizing world market (Rona A). As a response to those tendencies many former Czech temporary self-employed started to work for large retail chains, hypermarkets etc. that are mostly EU member countries owned and offered them better terms for job even as an employee.

4. Conclusions

Our conclusions are of importance for economic policy-making. We affirm that the development in transition may depend on how privatisation has been initiated and later conducted. Adjustments may be difficult, as many firms still rely on state interventions and lobbying rather than on own efforts. That was partially confirmed by the results of the survey explained above and by the Czech history of privatisation (Mejstrik,1997, Benacek, 2001).

A relative success of SMEs development must be attributed to the spontaneous motivation of the population to use their entrepreneurial abilities, which played a key role in the revival of private business. The boom in the SMEs was the most dynamic economic factor generating the changes and a surprising stability in the new developments, which were initiated practically from scratch in November 1989. Small businesses contributed to the maintenance of low rate of unemployment, to the improvement of the performance of the economy (SMEs contribute around 50% of Czech GDP formation) and to the creation of the stable political structure of the society during the period of transition. EU accession is providing new opportunities and threats for “middle class” that might have certain political consequences due to the high share of SME related population.

Certain new preconditions for SME development related to EU integration are now being discussed. The limited availability of loans caused by the banking crisis (writing off huge bad loans) and credit crunch in 1997-1999 has been properly jointly identified both by experts and central bank (Niedermayer, 2001) as the threshold for SMEs that are mostly affected due to their character (high risk involved, low collateral available) with recommended solution to be wider use of leasing (huge growth), venture funds provided often by EU owned companies. New opportunities are offered by the new SME programs of Czech retail banks recently sold into hands of international banks mostly with its seat in EU (Erste Bank, KBC bank, HypoVereins, GE Capital) that are bringing EU widely used products tailored to SMEs. This is supplemented by the limited public support through 17 government programs managed by Ministry of Industry and Trade such as collateralisation of SME’s loans and equity investments, loan subsidization etc.

The main policy instrument, is not only making credit available, but also aiding in upgrading skills. Since the single most important asset these small businesses have is labour, improving

skills help them most. Industrial policy was oriented on large enterprises while neglecting the sector of small and medium firms. The role of SMEs in transition was underestimated similar to the role of foreign direct investment.

The large inflow of FDI reaching Euro 5 bill. in average (1997-2000) generated new global firms plants in the Czech Republic that are export oriented (limited threat to domestic producers) but generate further demand for relevant SMEs either domestic or foreign owned. Rising number of SMEs with positive demand expectations have been able to upgrade their products up to the level required by the international companies and do not any more rely on the only purchaser but offer their products to number of them. New opportunities for SMEs are expected in underdeveloped regions also from EU structure funds. At the same time the SME clusters around old, dying industrial “dinosaurs” (such as metallurgy works in Northern Moravia) must be reshaped and reoriented into new dynamic international players.

Specific impact should be pointed out: Still prevailing relatively insufficient enforcement of law has hampered SME development as SME has not been often able to cash their receivable. Legal services for litigation were too inefficient, costly and especially have been coming too late due to SMEs’ fragile working capital. Newly created clusters around new FDI players bring new internal and external contractual architecture that improves behavioural patterns of Czech SMEs as well as their clients and business is getting less risky then.

The results of our field research survey based on 195 respondents from SMEs, interviews with experts and three SME case studies (Brachacek, Mejstrik, 2001) have shown limited optimism of the Czech SMEs regarding the foreseen impacts of SMEs joining EU single market. Another “Eurochambers field research” produced from Czech side by Czech Chamber of commerce with smaller sample of around 100 SMEs (48% of 207 companies) independently confirmed number of our key findings that were subject of its interest. The most important was limited optimism of Czech SMEs (Smejkal (2001)).

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Table 1 Major macroeconomic indicators	1993	1994	1995	1996	1997	1998	1999	2000
GDP (CZK bill., current prices) ¹	1 020,3	1 182,8	1 381,0	1 572,3	1 668,9	1 798,3	1 836,3	*1929
GDP (% y/y avg.) ²	0,6	3,2	6,4	3,9	1,0	-2,7	-0,2	2
Inflation (% y/y avg.) ⁴	20,8	10,0	9,1	8,8	8,5	10,7	2,1	3
Industrial production (% y/y) ³	-5,3	2,1	9,2	6,8	6,1	0,6	0,0	1
Nominal Wages (% y/y avg.) ⁵	25,3	18,5	18,5	18,4	10,5	9,3	8,0	6
Real Wages (% y/y avg.) ⁶	3,7	7,7	8,7	8,8	1,9	-1,3	4,5	2
Unemployment (%, end year) ⁷	3,5	3,2	2,9	3,5	5,2	7,5	9,4	8
Imports (% y/y, current prices) ⁸			23,5	6,6	20,0	17,7	7,0	28
Exports (% y/y, current prices) ⁹			33,7	13,0	15,3	0,9	7,0	23
Trade Balance (CZK bill., current prices) ¹²	-15,3	-39,8	-97,6	-159,5	-144,0	-82,4	-65,8	*-126
FDI inflow (CZK bill., current prices) ¹¹	19,05	24,99	67,99	38,77	41,25	87,76	218,81	177,3
FDI stock (USD bn.) ¹³	3,42	4,55	7,35	8,57	9,23	14,38	17,55	*22,1
CZK/DEM (avg.) ¹⁴	17,64	17,75	18,52	18,06	18,28	18,33	18,86	18,2
CZK/USD (avg.) ¹⁵	29,16	28,78	26,55	27,14	31,71	32,27	34,60	38,5
Productivity (% y/y) ¹⁶	2,3	2,4	3,6	2,9	1,8	-0,3	2,5	
State Budget Surplus (% GDP)	0,1	0,9	0,5	-0,1	-1,0	-1,6	-2,7	n.a

* preliminary data

** CERGE-EI estimate

Czech Statistical Office, Statistical Yearbook 2000

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Czech Statistical Office

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Czech Statistical Office

Ministry of Labour and Social Affairs

Czech Statistical Office

Czech National Bank, Foreign Direct Investment 1993 - 1999

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Czech National Bank, Foreign Direct Investment 1993 - 1999

Czech National Bank

Czech Statistical Office; GDP in constant prices/employee; years 1993-1997 are in 1994 prices; years 1998,1999 are in 1995 prices

Table 2: Changes in the structure of employment in Czech industrial sector during 1995-98

NACE category	Changes in the structure of employment; 1995 – 1998			
	Total	According to the size groups by employment		
		Small: 0-99	Medium: 100-499	large: 500 +
All industrial sector	0,0	6,2	3,2	-9,4
Including:				
C – Mining and quarrying	-0,9	1,2	0,0	-1,2
Mining of energy materials	-0,9	-0,7	1,5	-0,7
Other mining and quarrying	0,0	13,0	-17,6	4,6
D – Manufacturing industries	1,3	6,5	3,1	-9,6
Food and tobacco	1,0	3,8	-3,7	-0,1
Textile and clothing	-1,1	5,8	1,7	-7,5
Leather and shoes	-0,6	7,8	8,7	-16,5
Wood processing	-0,4	2,0	3,1	-5,1
Paper and printing	0,2	10,6	-2,8	-7,8
Coke and petroleum refining	-0,6	1,4	10,9	-12,3
Chemistry and pharmaceuticals	0,2	3,1	-0,6	-2,5
Rubber and plastics	0,9	7,7	4,6	-12,3
Glass and mineral products	0,4	3,1	0,1	-3,2
Metallurgy and metal products	0,4	9,0	6,1	-15,1
Machinery and equipment	-0,9	8,2	4,5	-12,7
Electrical and optical equipment	1,4	3,7	2,9	-6,6
Cars and transport equipment	0,5	3,4	11,1	-14,5
Other manufacturing	0,0	14,9	-2,7	-12,2
E – Electricity, gas and water	-0,4	0,7	3,5	-4,2

Source: Industrial statistics of Ministry of Industry and Trade, 1999
(The structure was computed as shares on total employment)

**Table 3 Comparison of labour productivity by firm size, 1998,
productivity in enterprises up to 49 employees=100%**

	Enterprises according to the number of employees		
	<u>1 az 49</u>	<u>50 az 249</u>	<u>Nad 249</u>
Food	100	158	185
Tabacco	100	696	4265
Textil	100	123	121
Apparel	100	70	82
Leather	100	121	99
Wooden	100	128	131
Paper	100	144	162
Printing	100	105	137
Oil	100	NA	926
Chemicals	100	107	108
Plastics	100	109	105
Minerals	100	141	187
Metal	100	74	88
Metalworking	100	115	121
Machinery	100	84	83
PC	100	936	905
Electricla machinery	100	95	103
TV, radio	100	112	137
Optical	100	102	89
Cars	NA	NA	NA
Other transport	100	96	96
Furniture	100	109	145
Recycling	100	64	57

Source: data CSO, enterprise data PP=book value added per employee

Table 4 Output, export sales, domestic sales, domestic demand ,employment by manufacturing industries 1993,1997 (% , current prices)

2 – digit NACE sectors	L 1993	L 1997	Q 1993	Q 1997	EXPQ 1993	EXPQ 1997
MANUFACTURING	100,00	100,00	100,00	100,00	100,00	100,00
Food products and beverages	9,83	11,63	20,04	17,80	7,46	5,78
Tabacco products	0,19	0,21				
Textiles and textile products	7,96	6,64	4,89	3,70	6,38	5,02
Wearing apparel; dressing and dyeing of fur	2,77	3,46	1,05	0,95	1,56	1,45
Leather; manufacture of luggage, handbags, footwear	3,41	2,15	2,09	0,85	2,34	1,09
Wood and products of wood,cork, except furniture;	2,50	3,05	2,15	2,23	2,44	2,61
Pulp, paper and paper products	1,90	1,91	2,59	2,62	2,42	3,31
Publishing, printing and recorded media	1,34	2,23	1,23	2,14	0,42	0,59
Coke, refined petroleum products and nuclear fuel	1,20	0,40	5,97	3,83	3,73	0,92
Chemicals and chemical products	3,69	4,22	6,59	7,53	8,07	8,17
Rubber and plastic products	2,42	3,52	2,62	3,54	2,17	4,35
Other non-metallic mineral products	6,53	5,99	5,46	5,82	6,59	5,46
Basic metals	9,55	8,03	12,22	10,28	16,59	7,76
Fabricated metal products, except machinery	7,18	10,10	5,18	7,35	4,31	7,72
Machinery and equipment	17,41	13,56	9,40	8,91	12,13	12,02
Office machinery and computers	0,24	0,18	0,09	0,08	0,13	0,12
Electrical machinery and apparatus	4,35	5,44	3,56	4,44	3,13	4,83
Radio, television and communication equipment	1,41	1,80	0,55	1,16	0,66	0,85
Medical, precision, optical instruments, watches,	1,79	1,98	0,65	1,06	0,54	1,07
Motor vehicles, trailers	5,50	4,98	8,24	10,43	12,37	20,03
Other transport equipment	3,38	2,93	2,05	1,73	2,04	1,88
Furniture and other manufacturing	5,04	5,18	2,61	3,06	3,69	4,56
Recycling	0,41	0,42	0,75	0,51	0,82	0,43

Source: CSU, enterprises with 25 and more employees, own computations

Table 5 Main opportunities for Czech SMEs connected with accession in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>New markets will open</i>	54	64	38	39	56	53
<i>Export costs will decrease</i>	5	20	4	48	14	16
<i>Quality of Czech products will increase (also competitiveness)</i>	31	22	38	26	27	28
<i>Managerial standards will improve</i>	16	9	4	22	22	16
<i>Technological gap will decrease</i>	26	11	4	17	25	18
<i>Access to foreign capital will be easier</i>	21	22	25	26	34	27
<i>None</i>	8	9	13	9	0	6
<i>Other</i>	8	9	0	4	6	6
<i>I have no opinion</i>	3	0	8	4	2	3
<i>No answer</i>	0	4	13	4	2	3

Table 6 Main threats for Czech SME sector connected with accession in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Many firms will not survive because of lower quality of product</i>	15	40	25	26	38	31
<i>Many firms will not survive because of higher production costs</i>	33	36	17	30	9	24
<i>Many firms will not survive because they do not keep EU standards</i>	23	16	25	22	28	23
<i>Many firms will not survive because of insufficient capital</i>	62	36	63	74	39	50
<i>Many firms will not survive because of managerial gaps</i>	8	16	8	9	31	17
<i>Acquisition by foreign firms</i>	36	22	25	39	33	31
<i>Other</i>	3	9	4	0	0	3
<i>None</i>	0	2	0	0	2	1
<i>I have no opinion</i>	0	2	4	0	2	2
<i>No answer</i>	0	2	4	0	2	2

Table 7 Way the firm is preparing itself for functioning on the Single European Market

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Does not concern</i>	18	16	25	26	22	21
<i>Attending trainings</i>	10	4	13	13	13	10
<i>Looking for trade partners</i>	26	24	25	30	31	28
<i>Improving quality of products</i>	51	38	42	57	34	42
<i>Learning foreign languages</i>	18	18	21	13	41	25
<i>Starting/increasing export</i>	3	9	4	4	6	6
<i>Looking for new markets abroad</i>	21	27	21	30	31	27
<i>Other way</i>	15	2	4	4	9	8
<i>No answer</i>	8	20	21	9	8	12

Table 8 Co-operation with a foreign firm in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Yes</i>	32	66	58	78	61	57
<i>No</i>	68	34	42	22	39	41
Total	100	100	100	100	100	100

Table 9 Geographical distribution of co-operants in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Does not concern</i>	21	0	8	0	6	7
<i>CICs</i>	0	2	0	4	2	2
<i>CEECs</i>	5	9	13	22	19	13
<i>European Union</i>	31	62	54	78	48	52
<i>Other countries</i>	8	4	8	0	19	10
<i>no answer</i>	41	31	33	22	33	33

Table 10 Kind of co-operation in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Does not concern</i>	23	0	8	0	8	8
<i>Firm has foreign supplier of materials/parts</i>	18	33	17	52	23	27
<i>Firm has foreign customer for materials/parts</i>	3	18	25	22	16	15
<i>Firm makes final products for the order of foreign distributors</i>	5	29	21	26	16	18
<i>Firms make final product together</i>	5	11	8	13	20	13
<i>Other</i>	10	2	8	0	16	9
<i>No answer</i>	36	31	33	30	31	32

Table 11 Fears from co-operation with managers from EU countries in %

	<i>Food</i>	<i>Cloth</i>	<i>Wood</i>	<i>Plastics</i>	<i>IT</i>	Total
<i>Yes, because of cultural differences</i>	3	7	0	4	5	4
<i>Yes, I am afraid that their skills are higher than mine</i>	0	11	0	4	2	4
<i>Yes, because of different managerial standards</i>	18	4	21	4	16	13
<i>Yes, because of language barrier</i>	23	20	25	26	23	23
<i>Other reasons</i>	3	2	4	0	2	2
<i>I am not afraid</i>	56	49	67	65	67	61
<i>I have no opinion</i>	8	7	4	9	3	6
<i>No answer</i>	8	9	0	4	3	5

EXECUTIVE SUMMARY

Threats and Opportunities for SMEs of joining the Single European Market: CZECH REPUBLIC COUNTRY REPORT

PAPER PREPARED FOR THE PHARE ACE PROJECT P97-8178R: *The Adjustment Process of SMEs in Poland and the Czech Republic to the Single European Market*, **MAY 2001**

Research team:

M.Mejstrik, V.Dvořák, D.Bracháček (Institute of Economic Studies of Charles University FSV, Prague) with support of A.Zemlinerova (CERGE – IE, Prague) et al.

Our conclusions are of importance for economic policy-making. We affirm that the development in transition may depend on how privatisation has been initiated and later conducted. Adjustments may be difficult, as many firms still rely on state interventions and lobbying rather than on own efforts. That was partially confirmed by the results of the survey explained above and by the Czech history of privatisation (Mejstrik,1997, Benacek, 2001).

A relative success of SMEs development must be attributed to the spontaneous motivation of the population to use their entrepreneurial abilities, which played a key role in the revival of private business. The boom in the SMEs was the most dynamic economic factor generating the changes and a surprising stability in the new developments, which were initiated practically from scratch in November 1989. Small businesses contributed to the maintenance of low rate of unemployment, to the improvement of the performance of the economy (SMEs contribute around 50% of Czech GDP formation) and to the creation of the stable political structure of the society during the period of transition. EU accession is providing new opportunities and threats for “middle class” that might have certain political consequences due to the high share of SME related population.

In our study comparable to similar study made for Poland, first we found out that “de novo” private sector has somewhat different characteristics that firms established from the previous state enterprises. Second, Czech survey included both traditional industries, namely textile, clothing and wood industries, and also part of the “new economy” representing by information technology (IT). These two aspects allowed to go deeper into the structure of SMEs and its role in the adjustment processes as related to the joining the Single European Market.

Companies were selected from the complete address register received from Czech statistical office. Out of the register, there were firms with 10-199 employees have been selected is four traditional industries and each third firm sent the questionnaire. (480 in food, 366 in textile and clothing, 290 in wooden and 152 in plastics). In addition to it all firms in information technology (IT- 520) have been selected. Hence altogether 1807 questionnaires have been sent out. The response rate was about 11%, what is the usual rate in case of such surveys.

Certain new preconditions for SME development related to EU integration are now being discussed by the experts. The limited availability of loans caused by the banking crisis (writing off huge bad loans) and credit crunch in 1997-1999 has been properly jointly identified both by experts and central bank (Niedermayer, 2001) as the threshold for SMEs that are mostly affected due to their character (high risk involved, low collateral available) with recommended solution to be wider use of leasing (huge growth), venture funds provided often by EU owned companies. New opportunities are offered by the new SME programs of

Czech retail banks recently sold into hands of international banks mostly with its seat in EU (Erste Bank, KBC bank, HypoVereins, GE Capital) that are bringing EU widely used products tailored to SMEs. This is supplemented by the limited public support through 17 government programs managed by Ministry of Industry and Trade such as collateralisation of SME's loans and equity investments, loan subsidization etc.

The main policy instrument, is not only making credit available, but also aiding in upgrading skills. Since the single most important asset these small businesses have is labour, improving skills help them most. Industrial policy was oriented on large enterprises while neglecting the sector of small and medium firms. The role of SMEs in transition was underestimated similar to the role of foreign direct investment.

The large inflow of FDI reaching Euro 5 bill. in average (1997-2000) generated new global firms plants in the Czech Republic that are export oriented (limited threat to domestic producers) but generate further demand for relevant SMEs either domestic or foreign owned. Rising number of SMEs with positive demand expectations have been able to upgrade their products up to the level required by the international companies and do not any more rely on the only purchaser but offer their products to number of them. New opportunities for SMEs are expected in underdeveloped regions also from EU structure funds. At the same time the SME clusters around old, dying industrial "dinosaurs" (such as metallurgy works in Northern Moravia) must be reshaped and reoriented into new dynamic international players.

Specific impact should be pointed out: Still prevailing relatively insufficient enforcement of law has hampered SME development as SME has not been often able to cash their receivable. Legal services for litigation were too inefficient, costly and especially have been coming too late due to SMEs' fragile working capital. Newly created clusters around new FDI players bring new internal and external contractual architecture that improves behavioural patterns of Czech SMEs as well as their clients and business is getting less risky then.

The results of our field research survey based on 195 respondents from SMEs, interviews with experts and three SME case studies have shown limited optimism of the Czech SMEs regarding the foreseen impacts of SMEs joining EU single market. Another "Eurochambers field research" produced from Czech side by Czech Chamber of commerce with smaller sample of around 100 SMEs (48% of 207 companies) independently confirmed number of our findings that were subject of its interest. The most important was limited optimism of Czech SMEs (Smejkal (2001)).