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Small and Medium-Sized Enterprises with Foreign Ownership in Poland

Abstract

The aim of this paper is to present determinants of the internationalisation processes of small and medium-sized enterprises (SMEs) and to examine activity of SMEs with foreign ownership in Poland. SMEs are exposed to strong competitive pressures, when barriers to goods, services and capital movements disappear within the integrated area. A common policy towards SMEs and national policies strengthen competitive advantages of domestic firms. At the same time, countries attract foreign direct investors, both large firms and SMEs, to their economies. The paper discusses some characteristics of foreign owned SMEs' behaviour in the Polish economy.

Introduction

This proposed paper aims to examine determinants and to define characteristics of the internationalisation of small and medium-sized enterprises (SMEs). The SMEs' contribution to economic growth and job creation in national economies is recognised in economic literature and governmental policies of many countries. However, SMEs are exposed to strong competitive pressures, when barriers to goods and capital movements disappear within the integrated area. By starting internationalisation (meant as development of exports and foreign direct investment), SMEs are able to stabilise their market position and to overcome some obstacles to their development. Governmental support to their internationalisation seems to be one of the most important tasks of SME policies in the CEE countries.

Some characteristics of SME internationalisation require interpretation and completion in the context of the European integration process. In the new Member States SMEs will probably adjust their export strategies in the integrated area and some new factors will influence their foreign investment decisions. The common SME policy and national policies strengthen competitive advantages of domestic firms. At the same time, countries attract foreign direct investors, both large firms and SMEs, to their economies. Literature studies, analyses of statistical data will be used as the research method. The possible research shortcomings may arise from the unavailability of some data.

1. Theoretical aspects of internationalisation of SMEs

Internationalisation of SMEs, just like internationalisation of the large-sized firms, may develop in different ways. One is a traditional, gradual transition through successive phases of internationalisation (a step-by-step process, like 'rings in the water').The other one has been labelled „Born Globals" (Madsen Servais 1997, pp. 561–583; Madsen, Rasmussen, Servais, 2000, pp. 248 –265). Further, the foreign market entry choice open to SMEs may include: export activities, co-operation and foreign direct investment (FDI) (Hegge, 2002, p. 3). This choice is determined by the assets and competitive advantages a given SME holds. Some SMEs, especially those knowledge-based in the ICT and biochemical sectors, conclude various alliances with large MNEs that are ready to pay for small firms' intellectual properties, such as leading-edge technologies, market knowledge and expertise, as well as their high-quality niche products and services (OECD 2002, pp. 66–67). At present small firms take part in global industrial restructuring in several ways, for instance, operating as:

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

The SME internationalisation process has its specific traits, even though designing a single model explaining SMEs' behaviours is not possible (Matthyssens, Pauwels, Vandenbempt 2001). A number of factors stimulate small- and medium- sized enterprises to go international, but parallel to them there is also a series of determinants that considerably impede the process. Among factors stimulating expansion into international markets are mentioned:

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

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

Problems that the small and medium –sized enterprises face in their internationalisation are related to the following areas (UNCTAD 1994, pp. 19–22):

- firm size;
- the very nature of small and medium- sized enterprises;
- host countries.

Some key points that are characteristic of the internationalisation process of SMEs have been formulated in a UN report (UNCTAD 1994, pp.4–7), i.e.:

- SMEs seek their development opportunities in market niches.
- International activities of SMEs are impeded by significant internal and external constraints. The internal ones are shortages of capital, management and information. The external constraints are connected with the market, with the risk of being taken over and institutional obstacles, both governmental and non-governmental.
- Uncertainty is a crucial factor in the SMEs' decision-making processes. It can be partly offset by active search for information, but this is costly and meshes with management shortages. Short cuts and inadequate evaluation of different alternatives may occur.
- Alternative forms of foreign investment are also used by SMEs. Licensing, turnkey projects and production sharing are considered alternatives to FDI.
- SMEs are vulnerable to technological, political, institutional and market changes, but at the same time their flexibility is often a meaningful competitive advantage.

- Factors motivating SMEs to internationalise are – to some extent – similar to those influencing decisions of large firms, but differences can be found as well. SMEs may be pulled into foreign markets by larger firms, by the imposition of tariffs or other powerful factors. Alternatively, they may be pushed abroad by domestic conditions, such as a declining home market.
- Large transnational corporations dominate in markets of some specific industries, leaving market niches or interstices for SMEs. Some successful SMEs can be found in industries where economies of scale are not important.
- The structure of industries is relevant, as the role of SMEs may change over the life-cycle of a given industry.
- In general international location strategies of SMEs depend on the same factors that determine strategies of large firms.

As a consequence, the questions appears: are foreign owned SMEs in Poland involved in a similar internationalisation process, what are the characteristics of this process?

2. Foreign direct investment of small and medium-sized transnational corporations in Poland

2.1. Characteristics of foreign investors' involvement in Polish economy

In the case of Poland the process for allowing the free capital movements from and to highly-developed countries, including EU, the freedom to establish businesses have resulted in changes at microeconomic level. Firstly, a significant group of companies partly financed by foreign capital has appeared in the secondary sector of the Polish economy, which exerts an influence on the economy as a whole and on the performance of domestic enterprises – this includes the effects of demonstration, co-operation with domestic companies, and competition. Secondly, in the Polish financial sector the dominant position has been gained by foreign investment institutions which also not only affects macroeconomic parameters but above all conditions that companies are made to operate in. Thirdly, the liberalisation of capital transfers other than direct foreign investment has multiplied opportunities for firms to participate in the European capital market.

In the 1990s the number of foreign-owned firms registered in Poland was steadily growing, as a combined effect of the transition and integration into the European Union. In 2001 46,258 foreign-owned firms were registered in the system REGON, which made up 10.6% of all businesses registered in Poland. The observed trends show that registrations of foreign-owned firms were the most frequent in absolute terms in the early transition period; then the annual increments in registrations were smaller and smaller (except for 1996) and in 1998 the share of such firms in the total number of businesses in the national economy started to decline. It should be borne in mind, however, that only part of such firms become active following their registration, some of them suspend business immediately, get liquidated or the foreign shareholders withdraw their interests.

The increased involvement of foreign capital in the form of FDI in Poland can be illustrated by the following figures:

- The ratio of accumulated FDI capital as a percentage of GDP grew from 0.3 % in 1991 to 21.3% in 2000 – similarly the ratio of inward FDI to GDP grew systematically (from 3.1% in 1991 to 5.9% in 2000); the share of the annual FDI stream in gross fixed capital formation grew from 1.8% to 23.4%. (UNCTAD 2002);
- The FDI structure by investor's country of origin shows strong sources of FDI streams in the Member States; the overall size of this stream has grown, as well as its share of the annual inward FDI stream in general. Regardless of the data source used, they confirm that investments made by the Member States predominate – according to the national bank of Poland figures in 2000 this share stood at 94.5%, in studies carried out by GUS it was 79% (GUS 2001 and authors' calculations), and according to PAIZ[1] – 70% (PAIZ 2002 and authors' calculations);
- The structure of FDI by sector, based on PAIZ data, demonstrates a steady reduction in the accumulated FDI share located in the industrial sector and an increase in the FDI share located in the service sector, e.g. financial agencies, trade, transport, and communications. Such changes in the structure of FDI by sector correspond to trends observed in the developed countries (PAIZ 2002 and own calculations);
- The share of foreign capital in the stock capital of commercial banks has grown to 61.3%. By the end of 2001 the capital funds of all banks combined stood at almost 37.7 billion PLN, of which 30.2 billion PLN belonged to banks owned by foreign capital. The growing presence of foreign capital in the banking sector and the consequent mergers led to a higher concentration in the banking service sector and these banks are characterised by a greater ability to generate income, costs, and turnover than banks with prevailing Polish capital, which proves their higher efficiency and ability to generate

[1] PAIZ-State Agency for Foreign Direct Investment.

gains in the banking services market. (Pac 2002, Dąbrowska, Gruszczyński 2001).

- The position of firms with foreign participation in the Polish economy is much more significant than might be expected based on their share in the total number of registered companies in Poland (10.6% in 2000). In the same year, their share in the total income earned by such businesses in the national economy stood at 33.6% – in other words 1/3 of the total earnings was achieved by 1/10 of the firms; and in some sectors of economy the share of the companies in total earnings was even higher e.g. hotel and catering – 51%, the food-processing industry – 46,8%, transport, warehousing and communications – 46,5%. These figures point to the high level of penetration by foreign capital in particular economic sectors (Chojna 2002 and own calculations).
- foreign-owned firms employed 999,500 people in 2000, which represents 10.3% of the total number of employees in the Polish economy. A comparison of the number of employees with company earnings shows productivity rates to be twice as high as the productivity of Polish companies (GUS 2001 and authors' calculations).
- foreign-owned firms slightly tend to export their products, which can be measured by the share of sales from exports against company earnings as a whole (16.2% in 2000), however, their share in the total export was significant and stood at 57.3% in 2000 (Chojna 2002).
- the investment turnover of firms with foreign capital is very high – their investment outlays made up more than 60% of total investment expenditures and in two sectors that share even exceeded 70% in 2000 (transport, warehousing and communications, trade and maintenance services). Also a growth in fixed capital share of the analysed industries in the national economy was noted (32 % in 2000).
- if we use basic economic indicators to compare the situation of foreign-owned firms with Polish firms in general, they show that their financial condition is improving. During 1994–1997 the financial situation of companies solely financed by Polish capital was better than firms with foreign participation. However, since 1998, the situation of the latter has improved and continues to strengthen its position.
- in foreign-owned firms processes of capital concentration can be observed (NBP 2001).

The above figures confirm the hypothesis that a significant group of firms has emerged which are essential to the future economic development of Poland. The economic characteristics of firms with foreign participation indicate that this group generally appears to be better prepared to compete within the Single Market than other companies operating in Poland. This statement is backed by figures showing the size and type of their export markets, continuing efforts to invest despite a general slowdown in economic growth, and the level of expenditure on research and development.

2.2. Foreign-owned SMEs in Polish economy

Activities of the foreign-owned SMEs in Poland in the years 1994–2001 were analysed using Central Statistical Office (GUS) data. 95% of such firms operating in Poland and examined by the GUS were so-called micro firms employing less than 10 persons, and small- and medium- sized enterprises (GUS and authors' calculations). From the total of 14,469 firms covered by the survey in 2001 only 696 were large-sized, employing over 250 workers. Foreign-owned SMEs represented about 45% of the stock capital held by all foreign-owned firms. Shares of foreign capital were relatively high in the stock capital of these firms: 69% in the small-sized and 86% in the medium-sized.

The 2001 structure of FDI by branch shows that foreign investors involved in small firms invested their capitals mainly in transport, warehousing and telecommunications (35.5%), real estate services and business services (21.6%), wholesale and retail (16%). In the period in question activities of the firms clearly shifted from manufacturing to services, with transport, warehousing and telecommunications being particularly illustrative cases.

Foreign investors involved in the medium-sized firms distributed their capitals more equally, between manufacturing and services. Manufacturing received 50.2% of the capital. In this section major foreign stakes can be found in manufacturing of products from other non-metallic raw materials (11.5%), production of foodstuffs and beverages (10.2%), production of rubber and synthetic products (5.7%). In wholesale, retail and repairs the amount of invested capital was 28.9%, and in real estate services – 8.3%.

According to the above data the discussed groups of firms differ in terms of their FDI branch structure, yet their common denominator is involvement of the small and medium-sized foreign investors in the less technologically advanced areas. The branch distribution of investments seems to confirm the thesis that such investors seek niches in the Polish market.

A comparison of the small and medium-sized foreign investor's turnover generated by sales of products and services and total turnover in all Polish economy reveals the degree to which the latter has been penetrated by foreign-owned SMEs. The average rate of penetration is not high; regarding small firms it is only 3.8% and for the medium-sized 7.1%. Nevertheless, the variations become more distinct when looked at in branch terms. The highest rate of penetration by small foreign-owned firms was observed in financial intermediation (16.8%), wholesale and commission business (16.6%) and real estate services (8,%). In the case of the medium-sized foreign-owned firms the degree of penetration is significant in sectors of economy such as: intake, treatment and supply of water (26.1%) production of office equipment and computers (23.2%), production of rubber and synthetic products (18.9%), retail (17.4%), manufacturing of products from other non-metallic raw materials (17%) and production of cellulose pulp, paper and paper products (16.6%).

In 2001 foreign-owned SMEs employed 326,800 persons in total, which represented almost a 59% increase compared with 1994. The firms' workforce made up over 1/3 of all employees in all foreign-owned firms in Poland and approximately 8% of the total workforce in the Polish economy[2].

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

Both groups of firms showed different propensity to export as measured using the ratio of export to total turnover from sales of goods and services. Among small firms the rate was over 23%, and 33% for the medium-sized. Considering the relatively low propensity to export among all foreign-owned firms in Poland, the medium-sized firms reveal more than average internationalisation of their sales.

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

[2] The number of workers in Polish economy was defined as persons employed on the basis of employment contracts, employers and self-employed, excluding persons working on private farms.

The foreign-owned SMEs operating in Poland enhance the market structure in Polish economy. They appear as a result of internationalisation of foreign firms operating in the Polish market.

Conclusions

1. The average rate of penetration of the Polish economy by foreign owned SMEs is not high. Nevertheless, the variations become more distinct when looked at in branch terms.
2. The branch structure of FDI undertaken by SMEs in Poland shows that they are involved in the less technologically advanced areas and seek development opportunities in market niches.
3. Foreign-owned SMEs employed over 1/3 of all employees in all foreign-owned firms in Poland and approximately 8% of the total workforce in the Polish economy.
4. Export of foreign-owned small- and medium-sized enterprises was important for the total export from Poland. The foreign owned SMEs operating in Poland have higher export propensity than domestic ones and their export structure is more capital intensive.
5. The analysed firms are very active in international trade, exporting and importing goods and services. They were net importers in the Polish economy.

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