

Conference introduction paper

Small Business, Big Markets, One World

**ISBC 2002
Amsterdam**

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Preface

This report is the introduction paper to the International Small Business Congress 2002, to be held in Amsterdam, the Netherlands (27–30 October 2002, RAI Congress and Exhibition Centre). The Congress is organised by the Royal Dutch Association for Small and Medium Sized Enterprises with the support of EIM Business & Policy Research and Eurocongres (professional congress organiser). More information on these organisations can be found inside the inner cover page.

The theme of the Congress is "Small Business, Big Markets, One World". Since the introduction of the euro notes and coins will take place on 1 January 2002 - a special reason to organise the Congress for the second time in Europe - special attention will be paid at the Congress to the ongoing economic integration in Europe and its consequences for small business. Europe will be presented as a special case of economic integration.

This report serves two purposes:

- Introduction of the Congress theme;
- Background paper for the speakers at the ISBC 2002.

In order to stimulate the potential ISBC 2002 participants, text boxes (with yellow background) have been included throughout the document. They contain suggested titles and research questions for discussion papers for the 2002 Congress, as in this example:

ISBC 2002 suggestions

SMEs and the Internal Market

- Will the Single Market have more advantages for large enterprises than SMEs?
- How can SMEs profit more from the European integration?
- Will the effects of the European integration differ by sector?
- What actions have to be taken to improve the benefits for SMEs and by whom?
- What are the views of SMEs outside Europe on the European Internal Market? Do they see a Fortress Europe developing?

Draft papers for the ISBC 2002 are welcome at EIM (info@eim.nl) before 1 April 2002.

EIM Business & Policy Research prepared this report. The authors were assisted by a steering group composed of Benne van Popta (Director International Affairs Royal Dutch Association for Small and Medium-sized Enterprises, programme director ISBC 2002), Peter van Hoesel (Director EIM Group), Rob van der Horst (Director International Affairs EIM) and Jacqueline Snijders (Manager EIM). The linguistic revision of the draft text was carried out by Julian Hancock of De Montfort University, Leicester.

1 Introduction

The theme of ISBC 2002

Small Business

In the last decade small business had to go through a tempestuous development. Worldwide the importance of entrepreneurship was revalued. Entrepreneurs and small business are the driving force behind innovation and dynamics. The growth of the number of small enterprises has contributed heavily to employment growth. Therefore, SMEs (Small and Medium-sized Enterprises) are an important source of welfare, employment, economic and social improvement.

Big Markets

At the same time, the markets enlarged. On all continents, processes of integration have been developed: European Union, NAFTA (Northern-America), Mercosur (Latin America) and ASEAN and APEC (Asia). Europe is a good example of this process since it is the most advanced: *one common market, one common currency*. At the same time, the European Union is developing the European Social Model. Small business is the basis of the economic structure in Europe. Overall, small business and entrepreneurs are confronted with larger markets and more competition. Small business has to take up the challenges of economic integration and then reap the benefits.

One World

Finally, the world will become "smaller" due to lower transport costs and developments in information and communication technology. Distances are disappearing, global interdependency increases. One world is in particular visible in the worldwide financial markets and multinationals. One world leads to strong reactions; Seattle, Prague, Nice, Gothenburg, Genoa. One world should be a balanced one world, and the same way for small business.

Small Business, Big Markets, One World

Important economic and technical trends create a completely new environment for small business. What will be the effects of these trends on the economic position of small business? How can small business make the most of this new environment and cope with the threats? What role can small business organisations play in the transformation process that their members have to deal with? What is the meaning of the cultural diversity in a globalised world? These are the major themes of the International Small Business Congress 2002.

This report includes background information on these topics. Chapter 2 deals with the economic integration in Europe and the position of small business in Europe. Chapter 3 outlines the principles of the network economy, and Chapter 4 discusses how small business can profit from the network economy. Finally, Chapter 5 discusses the challenges for small business organisations (SBOs) and the ways in which they can support small business in the network economy.

In the 1990s, large companies increasingly outsourced complete subsystems and sought to limit the number of their suppliers. They went looking for businesses that could act as main suppliers, rather than jobbers that could only handle part of the work to be outsourced. This constituted a serious threat to the Dutch metal and electro-technical sector. Some 95% of the companies in this sector are small or medium-sized, employing less than 100 people. Generally too small - in other words - to act as main supplier. The chances were that companies such as Philips, Stork or bicycle company Batavus would find their main suppliers in other countries. These in turn were more likely to grant their subcontracts to jobbers in their own country, rather than to businesses in the Netherlands. In response to these threats, the Dutch metal industry employers' union in the Twente region decided to start a project that would ensure intensive co-operation between businesses in order to become attractive for large companies as main suppliers. They founded TMG, the Twentse Modulen Groep. TMG submitted the bids for so-called turn-key projects, projects that individual suppliers could not manage because of their limited capacity or because the project required a variety of technologies. TMG then acted as main contractor that subcontracted the work to suppliers. TMG managed the project and organised the purchasing and selling related to the project. TMG's shareholders were suppliers, as well as companies that contracted out this type of projects. Incidentally, TMG targeted clients at an international level, thus enabling Dutch small businesses to take advantage of the opportunities offered by the internal market also. Unfortunately, TMG went bankrupt.

If anything, this example shows that internationalisation does not only affect businesses that trade or invest in other countries or are located near the border. The actions of large companies - subcontracting as in the example or e.g. relocating production - affect the smaller businesses that supply them. The effects are direct as well as indirect, and therefore more far-reaching and more profound than appears at first sight. Secondly, the example shows that co-operation may be a way to exploit the opportunities and cope with the risks associated with globalisation. Finally, it demonstrates how far small business organisations can go in assisting their members in this respect.

2 The European entrepreneur and the fading frontiers

This chapter describes three important phases of the European integration and the impact they will have on Europe's small businesses: the development of a common market, the introduction of a common currency and the forthcoming enlargement of the European Union. A short illustration of the role of SMEs in the EU precedes this analysis.

2.1 Small businesses in the European Union¹

The European Union embodies more than 19 million private enterprises in the non-primary sector. Together these enterprises create some 6,800 billion euro added value in the EU economy, and provide work for some 133.2 million citizens. A closer look reveals the diversity in the enterprises that make up the private sector. Apart from their size, they differ e.g. with regard to the sector they operate in, the ownership structure and their contribution to the total value added. There are also large differences when it comes to their degree of globalisation.

2.1.1 General data

One of the main sources for information on small and medium-sized enterprises (SMEs) in the EU is the annual report of the European Observatory for SMEs², initiated and financed by the Enterprise Directorate-General of the European Commission.

table 1 Main indicators of non-primary EU enterprises, 1998

	<i>Micrc</i>	<i>Small</i>	<i>Medium-sized</i>	<i>Total SMEs</i>	<i>Large</i>	<i>Total</i>
Number of enterprises (x 1,000)	18,040	1,130	160	19,330	38	19,370
Employment (x 1,000 persons)	38,360	21,320	14,870	74,550	38,680	113,230
Value added per occupied person (euro)	30,000	50,000	95,000	45,000	90,000	60,000

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

¹ The European Union (EU) is the result of a process of co-operation and integration, which began in 1951 between six countries (Belgium, Germany, France, Italy, Luxembourg and the Netherlands). After nearly fifty years, with four waves of accessions (1973: Denmark, Ireland and the United Kingdom; 1981: Greece; 1986: Spain and Portugal; 1995: Austria, Finland and Sweden), the EU today has fifteen Member States.

² The first five annual reports were prepared by EIM Business & Policy Research and the European Network for SME Research (ENSR). The sixth and seventh report (ongoing) is prepared by a consortium lead by KPMG Consulting and further consisting of EIM and ENSR. The reports contain detailed quantitative and qualitative information on the performance of SMEs and their business environment in all 18 countries of the European Economic Area together with Switzerland. In the Observatory Reports, the following EU-definition of SMEs is applied: micro 0-9, small 10-49, medium 50-249 and large 250 or more people employed.

According to the most recent annual report, 99.8% of the companies in the European Union non-primary business sector are SMEs. SMEs account for 66% of employment in this sector, and half of the total value added.

table 2 Number of non-primary EU enterprises by sector and size class, x 1,000, 1998

	SMEs	LSEs ¹	Total
Extraction	45	1	50
Manufacturing	2,135	18	2,155
Construction	2,695	2	2,695
Wholesale trade	1,445	2	1,450
Retail distribution	3,990	3	3,990
Transport and communication	1,035	2	1,035
Producer services	4,035	8	4,045
Personal services	3,950	3	3,950
Total	19,330	38	19,370

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

table 3 Employment (x 1,000) of non-primary EU enterprises by sector and size class, 1998

	SMEs	LSEs	Total
Extraction	400	1,290	1,690
Manufacturing	16,390	13,260	29,650
Construction	9,000	1,160	10,160
Wholesale trade	6,130	1,430	7,560
Retail distribution	11,500	4,370	15,870
Transport and communication	4,010	4,540	8,550
Producer services	12,310	8,440	20,750
Personal services	14,820	4,180	19,000
Total	74,550	38,680	113,230

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

2.1.2 Degree of internationalisation

This section deals with the degree of internationalisation of markets for SMEs. Attention is paid to the following issues:

- Exporting by SMEs
- International business contacts by SMEs
- Foreign Direct Investments
- The labour market.

Exporting

In 1998, EU enterprises exported goods with a total value of 1.967 billion euro. These exports accounted for 16% of the total EU-business turnover. This figure varies from 6% in micro enterprises, to 22% in enterprises with 250 employees or more. These data show that the involvement of SMEs in export is relatively low.

¹ LSEs: large-scale enterprises, employing 250 people or more.

table 4 Average share of exports in turnover by enterprise size

	%
SMEs	11
<i>Micro</i>	6
<i>Small</i>	13
<i>Medium-sized</i>	16
Large enterprises	22
All enterprises	16

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

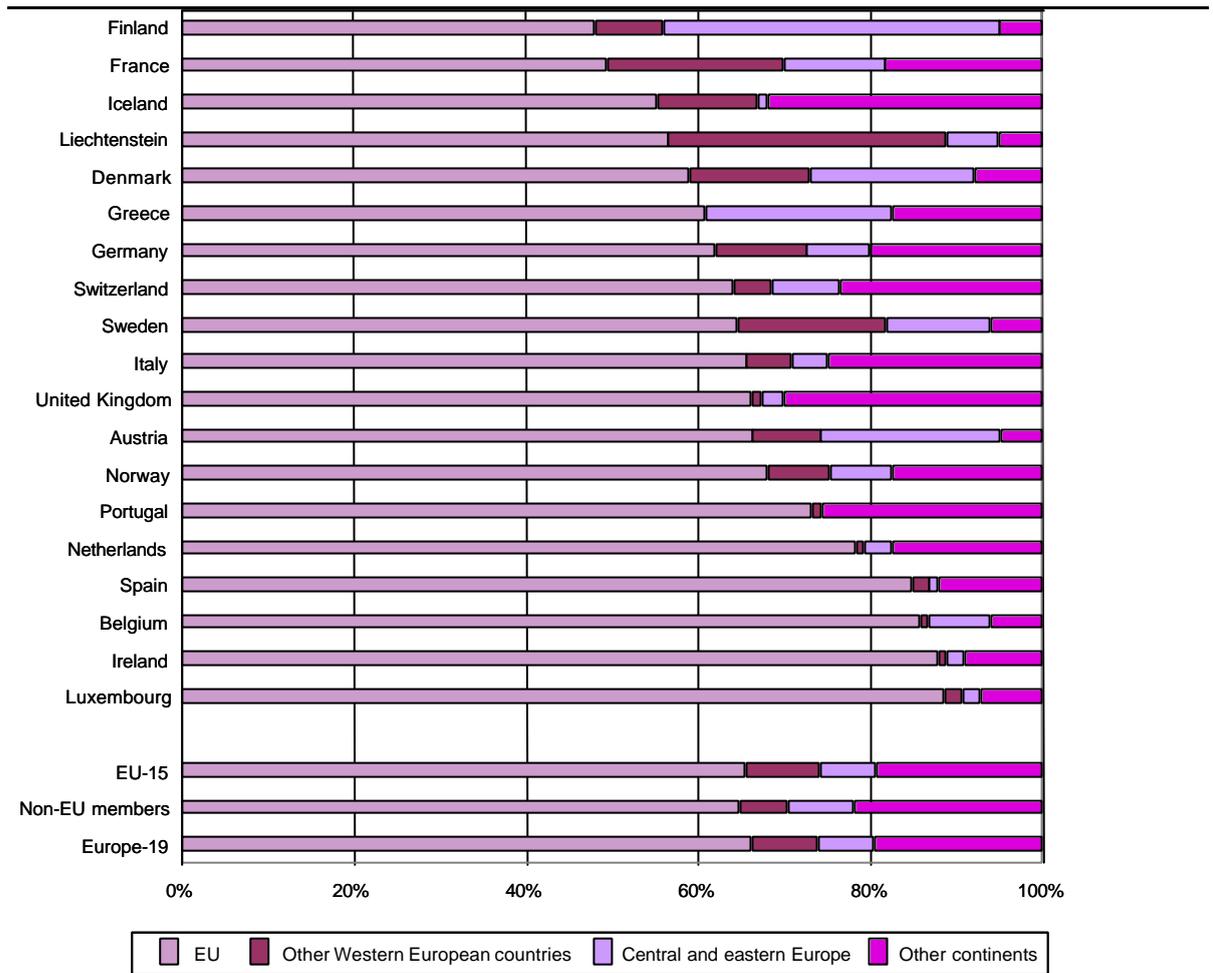
Regional distribution of exporters within the Single Market

Figure 1 shows the distribution over four export markets of goods at macro level for SMEs. The countries are ranked by the share of exports within the European Union. It is obvious that the concentration on EU markets is high for SMEs. There is not much difference between the EU and the other four countries of Europe-19¹. However, individual countries show substantial differences, for example:

- Small, open economies, e.g.: Ireland, Luxembourg, Belgium and The Netherlands have an even higher share of intra-EU exports, whereas some of the larger economies (e.g. France, Germany) have a relatively small share of intra-EU exports
- For some countries their specific geographical and historical situation is clearly shown, especially in the distribution of the non-EU export, e.g. Austrian, Danish, Greek and Finnish SMEs export relatively more to Central and Eastern Europe.

¹ Europe-19 is an indication for the 18 Member States of the European Economic Area (EU-15, Norway, Liechtenstein and Iceland), plus Switzerland.

figure 1 Percentage distribution of export turnover of SMEs to four export markets, by country

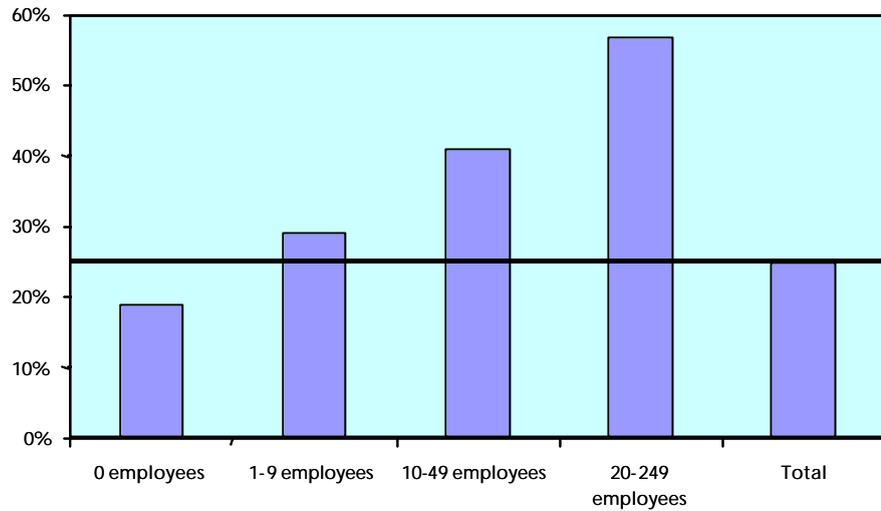


Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

International business contacts

Another measure for internationalisation of business is the number of cross-border contacts. Figure 2 illustrates that during the last five years, 25% of all SMEs experienced an increase in their international business contacts. Of the largest SMEs, 57% were able to intensify their international business contacts. Yet, even the smallest companies (i.e. enterprises without employees) noticed a substantial increase in these cross-border relationships. Of all companies without employees, 19% were able to increase their international contacts. In manufacturing and construction, 27% of the SMEs have more international business contacts than 5 years ago, whilst in trades, this holds for 23% of the SMEs and in services for 24%.

figure 2 Increase in international business contacts of SMEs in the last 5 years, by enterprise size (percentage of enterprises)



Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

Foreign Direct Investments

Foreign Direct Investments (FDI) are cross-border investments, aimed at acquiring a lasting interest in an enterprise abroad. The level and destination of FDI is a third measure for examining the degree of internationalisation of markets.

In 1999, the EU's FDI accounts grew strongly. At close to 500 billion euro, total outflows rose more than 40% in 1999. Direct investment into the EU also grew considerably (27%), reaching nearly 300 billion euro.

Almost half of the outward FDI concerned intra-EU FDI, whereas only a year earlier this was only 38%. In other words, by 1999 half of the Foreign Direct Investments by EU enterprises was made in another EU Member State.

Inward FDI into the countries of the EU rose dramatically: in 1999, a 7% drop in inflows from extra-EU countries was combined with an 80% growth in intra-EU flows. According to Eurostat, the increase of intra-EU flows was even more pronounced for the 11 countries of the euro zone for the period 1995-1999. These countries appear to be relatively more focused on markets within the Union, as compared to the EU-15 as a whole. One should, however, remember that the United Kingdom is not a member of the euro zone.

table 5 Origin of inward FDI and destination of outward FDI in EU countries (in million euro and as percentage of total)

	Inward FDI into EU countries				Outward FDI from EU countries			
	1998		1999		1998		1999	
EU	100,704	(46%)	203,824	(68%)	132,743	(38%)	240,037	(49%)
USA	59,737	(27%)	68,354	(23%)	128,676	(37%)	160,850	(33%)
Japan	1,592	(1%)	2,613	(1%)	571	(0%)	3,206	(1%)
Canada	889	(0%)	2,337	(1%)	3,849	(1%)	777	(0%)
Other	54,661	(25%)	22,609	(8%)	80,850	(23%)	85,390	(17%)
Total	217,583	(100%)	299,737	(100%)	346,689	(100%)	490,260	(100%)

Source: Eurostat, *Statistics in focus*, 28/2000, Theme 2, Eurostat, Luxembourg, 2000.

Labour market

Mobility of labour is one of the corner stones of the Single Market. Huge efforts have been made by the Commission¹ in recent years to remove the remaining barriers restricting the movement of people from one Member State to another to find work. The aim of this drive is basically to extend employment opportunities for people across the Union and to tackle problems of skill shortages in particular areas. However, the potential for migration and cross-border commuting has not been exploited fully and certain mechanisms work to hinder the mobility of labour. In contrast to the situation in the USA, there is generally no cross-border mobility culture in Europe.

Cross-border mobility can happen in two ways - either as commuting or as settling and working in other countries. The ENSR Enterprise Survey 1999² revealed that cross-border mobility within the European Economic Area (EEA) and Switzerland is quite limited. In the last three years, approximately 4% of SMEs have employed staff from another western European country. This holds for all sectors.

table 6 Proportion of SMEs that have employed staff from other western European countries during the last three years, by enterprise size, Europe-19*

Employees	Employed staff from other western European countries			Total
	Yes	No	Don't know/no answer	
0	2%	95%	3%	100%
1-9	5%	94%	1%	100%
10-49	11%	88%	1%	100%
50-249	27%	72%	1%	100%
Total	4%	94%	2%	100%

* Europe-19 is an indication for the 18 Member States of the European Economic Area (EU-15, Norway, Liechtenstein and Iceland), plus Switzerland.

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

¹ Amongst others via the following initiatives/programmes: EURES, INTERREG, Socrates, and Leonardo.

² In the frame of the Observatory project, a telephonic survey is held amongst almost 8,000 SMEs in all sectors and the 19 countries covered by the SME Observatory.

Employing staff from other western European countries is most likely to happen in medium-sized enterprises where more than a quarter of the enterprises have replied 'yes' to having given employment to non-nationals within the last three years.

table 7 Proportion of SMEs which faced the following problems when employing staff from other western European countries, by enterprise size, Europe-19

	Number of employees				Total
	0	1-9	10-49	50-249	
Administrative burdens	34%	24%	25%	24%	26%
Problems with labour permits	22%	24%	12%	15%	21%
Problems with trade unions	13%	11%	7%	2%	10%
Problems in understanding foreign qualifications	14%	5%	6%	5%	7%

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

About a quarter of the enterprises found administrative burdens to be a barrier against employing staff from other countries. Furthermore, about a fifth of the enterprises faced problems with labour permits, while trade union issues and difficulties in understanding foreign qualifications were identified as a problem by less than 10% of the enterprises. Only small differences were identified as size-related. The problems are similar for all sectors.

ISBC 2002 suggestions

SMEs and internationalisation

- SMEs are the backbone of the economic structure of the European Union. The degree of internationalisation differs per sector and not all SMEs are internationally oriented. How will exports and imports by SMEs develop in the future? Will they keep on concentrating their activities on neighbouring markets?
- What are the most important international business contacts of SMEs? What kind of value added do they bring?
- In what way are SMEs involved in FDI and how important is FDI for SMEs? Is there a distinction between enterprises in the traditional economy and those active in the new economy?
- Is a real European labour market in the interest of SMEs? Do they need a real European labour market?

2.2 Small businesses and the European integration process

European businesses have had first-hand experience with this type of development since the European integration process restarted again in 1985. By now the introduction of the common currency is well under way and there are twelve applicant countries negotiating to join the European Union. This section describes this process and the impact it may have on SMEs.

2.2.1 Common market

The process

In 1985, the process of completing the European Union Internal Market in 1992 was officially launched. An ambitious programme to remove all barriers to the free movement of goods, persons, services and capital was started. After the official completion

of the Internal Market in 1992, however, many barriers for cross-border trade still remained. In 1999, the present strategy for Europe's Internal Market was developed. Its four strategic objectives are:

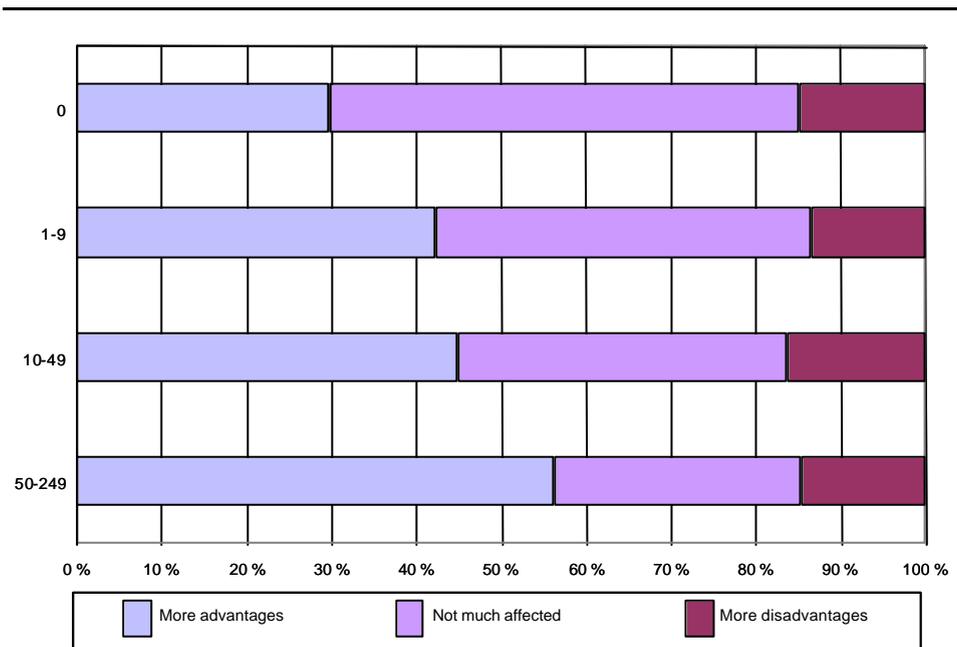
- Improving the quality of life of citizens;
- Enhancing the efficiency of capital and product markets;
- Improving the business environment;
- Exploitation of the achievements of the Internal Market in a changing world.

The emphasis for 2001 and 2002 is on the Internal Market for services, because especially the remaining barriers for cross-border trade are found in this sector.

Its impact on SMEs

The developments of the EU might have important consequences for European SMEs. The question is whether smaller enterprises will profit from the integration to the same degree as their larger competitors. The ENSR Enterprise Survey 1999 revealed that smaller businesses tended to associate more threats and fewer opportunities with the Single Market than large businesses do. On the other hand, 33 percent of all SMEs in the European Union experienced more advantages than disadvantages from the Single Market, whereas only 13% experienced more disadvantages. The effect of the Single Market varies with the size of an enterprise. The larger the company, the more positive the perception of the Single Market.

figure 3 Overall assessment of the Single Market by enterprise size (percentage of enterprises) in 1999



Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

Again the ENSR Enterprise Survey 1999 revealed that on average, SMEs tend to feel the creation of the Single Market primarily as the creation of fiercer competition and increased regulation. The advantages with regard to opening up of a larger selling market, simplification of international collaboration and the advantages of the euro are considered (see table 8) were only considered by SMEs as secondary concerns

table 8 Advantages and disadvantages of the Single Market as experienced by SMEs, by enterprise size (percentage of enterprises), 1999

	Number of employees				Total
	0	1-9	10-49	50-249	
Advantages					
- Larger selling market	14%	19%	25%	28%	17%
- Simplified international collaboration	12%	17%	19%	25%	14%
- The euro	10%	17%	15%	25%	13%
- Larger markets for inputs	8%	17%	16%	20%	13%
- Lower transaction costs	8%	13%	14%	19%	10%
- Larger labour market	5%	6%	6%	9%	5%
- Lower transportation costs	4%	6%	7%	10%	5%
- Lower production costs	4%	5%	4%	5%	4%
- No advantages	64%	48%	43%	33%	56%
- Don't know/no answer	3%	3%	1%	1%	3%
Disadvantages					
- Greater competition	22%	32%	35%	40%	27%
- Increased regulation	16%	16%	21%	27%	17%
- Costs of the euro	7%	8%	8%	8%	7%
- Higher production cost	6%	6%	5%	5%	6%
- No disadvantages	57%	47%	42%	37%	52%
- Don't know/no answer	5%	4%	2%	2%	4%

Note: Since more than one answer was possible, the figures do not total to 100%.

Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

Regarding the advantages, there are slight sector differences. According to SMEs in manufacturing and construction, the major advantages of the Single Market are: the larger selling market, larger markets for inputs, simplified international collaboration and the euro. SMEs in trade mentioned the larger markets for inputs, the euro and the lower transaction costs as major advantages, and finally SMEs in services mentioned the larger selling market, the simplified international collaboration and the euro. Regarding the disadvantages, no differences by sector were identified.

Other studies on the impact of the Internal Market concluded that large firms are more likely to profit from the access to larger markets and achieve economies of scale in production and distribution. These studies also observed that SMEs were slower to adjust to the new developments, because of their smaller resources (Döhrn a.o.,2000).

In the Single Market Scoreboard of November 2000¹, the priority objectives for improving the Internal Market were given by European business. These objectives, identified by a survey among European SMEs and large enterprises, are by rank of importance:

- 1 Simplify administrative procedures imposed on companies;
- 2 Standardise regulation in all Member States;
- 3 Develop co-operation and trade with the rest of the world;
- 4 Remove fiscal barriers to trade;
- 5 Develop creativity and industrial and commercial innovation;
- 6 Improve transport and cross-border logistics;
- 7 Remove national obstacles to free provision of services;
- 8 Remove technical barriers to the free circulation of products;
- 9 Develop European standards for products and services;
- 10 Develop the efficiency of European financial markets;
- 11 Improve electronic communication networks;
- 12 Ensure openness and transparency of public procurement markets;
- 13 Stimulate the mobility of workers;
- 14 Modernise distribution networks and marketing methods;
- 15 Reinforce intellectual property rights.

ISBC 2002 suggestions

SMEs and the European Single Market

- Will the Single Market have more advantages for large enterprises than SMEs?
- How can SMEs profit more from the European integration?
- Will the effects of the European integration differ by sector?
- What actions have to be taken to improve the benefits for SMEs and by whom?
- What are the views of SMEs outside Europe on the European Internal Market? Do they see a Fortress Europe developing?

2.2.2 Common currency

The process

On 1 January 1999 the Economic Monetary Union became a fact for eleven of the EU Member States. Since then, Greece has also joined what has become known as the euro zone. On 31 December 2001 the transition period will expire and the introduction of the euro notes and coins will take place. After a dual period of one to two months, these twelve countries will have one common currency in circulation, the euro.²

¹ European Commission, *Single Market Scoreboard*, 7, Luxembourg, November 2000.

² The three EU Member States not included in the euro zone are: the United Kingdom, Sweden and Denmark.

figure 4 Map of the euro zone in 2001 (12 Member States)



Source: Central Audiovisual Library, European Commission.

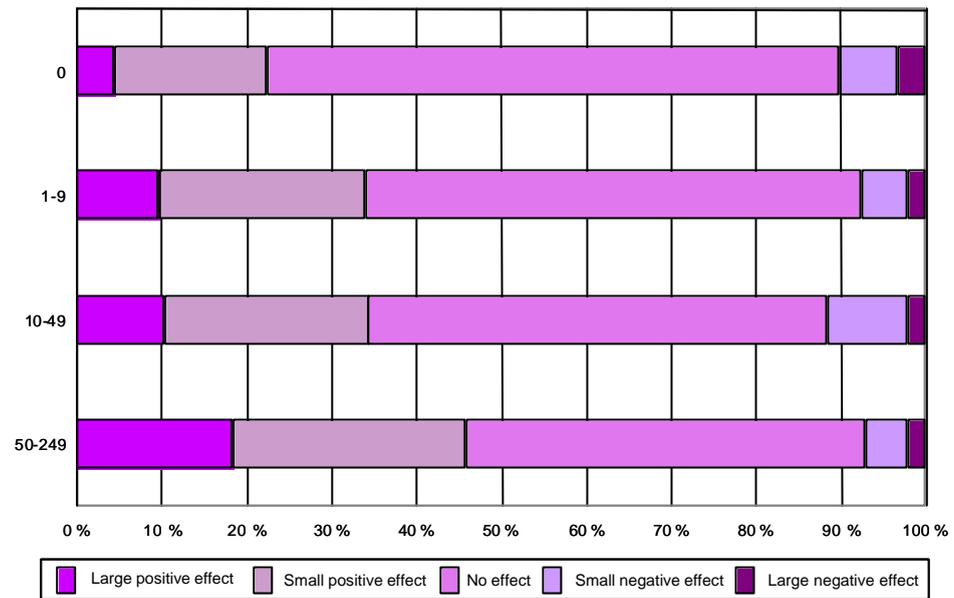
Its impact on SMEs

The introduction of the euro is accompanied by a multitude of operational consequences. They are finite in nature, but will keep businesses busy at least until the transition period has been completed. Small businesses probably experience more problems in this transition process, in as much as their resources are smaller and they are depending on larger companies - customers, suppliers, and business partners - for timing the changeover. These troubles should be offset by the long-term strategic effects.

The objective of establishing the Economic Monetary Union (EMU) is to facilitate trade and other economic actions between the countries concerned. Because of the EMU exchange rate risks, exchange commission costs for transactions between companies in different participating countries, and the need for multi-currency accounting systems for companies operating abroad are eliminated. This should also result in lower administrative and financial costs, resulting in higher competitiveness of businesses. The EMU is expected to lead to the creation of new financial instruments and the convergence of inflation and long-term interest rates. These factors are important for the investment decisions of firms. Finally, the euro will raise price transparency in EMU countries. This may encourage customers, consumers and businesses, to embrace competitors from their regular businesses in or from other countries. Competition, in other words, will increase.

The ENSR Enterprise Survey 1999 of the European Observatory for SMEs concluded that most entrepreneurs do not expect the introduction of the euro to have any consequences for their competitive position. Larger companies expect more positive effects from the introduction of the euro than the smaller ones, as is shown in figure 5.

figure 5 Anticipated effect of the euro on the competitive position, by enterprise size (percentage of SMEs), 1999



Source: European Commission, *The European Observatory for SMEs 2000 - Sixth Report*, submitted to the Enterprise DG by KPMG Consulting, EIM and ENSR, Luxembourg, 2000.

Besides their impact on competition, the effects of the EMU and the introduction of the euro are expected to be felt in the field of:

- Customers, by creating new market opportunities;
- Competitors, by creating the threat of new entrants;
- Suppliers, by increasing the selection possibilities;
- Products and services: doing business abroad generates the necessity to fulfil other needs than those of a business' local customers;
- Business organisation and business partners (banks, etc.): there are effects, but these are short-term effects only.

Not all SMEs will be affected to the same degree. Mitigating factors could e.g. be if customers are mainly based outside the euro zone, if the business is not competing predominantly on price, in case of customised products and services, a local market focus and brand loyalty of consumers exists.

ISBC 2002 suggestions

SMEs and the euro

- What are the major benefits of the euro for SMEs? Will there be more benefits for larger enterprises than for the small ones?
- Will the long-term benefits cover the costs of the changeover to the euro?
- Will the euro lead to lower transaction cost of international financial transactions?
- Will the financing possibilities for small business improve due to a larger offer of financial means by national and international banks and the development of new financial instruments?

2.2.3 Enlargement of the European Union

The process

The Internal Market is gradually going to be extended eastwards in the coming decade. Enlargement of the European Union is steadily being realised, even though it is still being debated in some of the Member States. The procedures and the necessary adaptations figure prominently on the bi-annual EU summits. Businesses need to prepare for a new element in the Internal Market.

Due to the enlargement, the European Union will increase to 500 million consumers, but on the other hand, however, GDP growth in the short run will be limited. The total GDP of 12 candidate countries accounted for 4.3% of GDP of the EU-15 in 1999.

figure 6 Dates of application for EU Membership¹

Cyprus:	3 July 1990
Malta:	16 July 1990
Hungary:	31 March 1994
Poland:	05 April 1994
Romania:	22 June 1995
Slovakia:	27 June 1995
Latvia:	13 October 1995
Estonia:	24 November 1995
Lithuania:	08 December 1995
Bulgaria:	14 December 1995
Czech Republic:	17 January 1996
Slovenia:	10 June 1996

Source: <http://europa.eu.int/comm/enlargement/negotiations/index.htm>.

Its impact on SMEs

As other countries join the European Union, in principle the benefits and risks increase further.² However, the macro-economic effects of the enlargement have recently been estimated to be limited (Döhrn a.o., 2000). According to this report, the position of the Central and Eastern European countries to some extent resembles that of Western Europe just after World War II. The results of their analysis at sector level confirm the general idea that the competitive advantage of Central and Eastern European countries stems from relatively low labour costs and the possibility to pursue a low price strategy. The European Union countries will see an increasing trade in sectors where quality is the main distinguishing selling point.

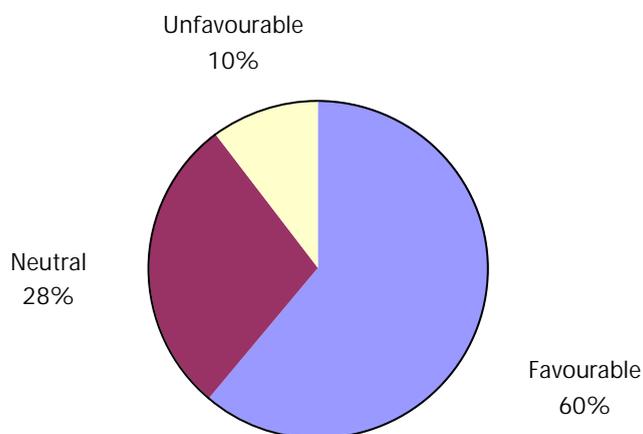
¹ On 8 March 2001 the Council of the European Union decided that Turkey would also be a candidate state. To that end an Accession Partnership was formally adopted.

² Enlargement of the EU goes hand in hand with a restructuring of EU funds, which is likely to have an impact on the funds available for SMEs also. These effects are not discussed here.

Enlargement may, however, have some specific favourable effects for SMEs (Döhrn a.o., 2000). Since the accession countries are close to the existing EU Member States, this time small businesses may actually have an advantage compared to large companies. Since distances are small, the transaction costs that usually deter small businesses from making use of the advantages of the international division of labour do not arise. This will apply, though, mainly to small businesses in the (business) services sector (Döhrn a.o., 2000).

In the business survey carried out by the European Commission in the frame of the Internal Market Scoreboard (November 2000), the Commission asked the European businesses for their opinion on the enlargement process. The survey showed that there are already considerable business relations with businesses in the candidate countries. The average enterprise already maintains relations with more than 3 enterprises in these countries compared to 6 on average with the EU countries.

figure 7 Businesses' opinion about enlargement of the European Union



Source: European Commission, Single Market Scoreboard, 7, European Commission, Luxembourg, November 2000.

The European Commission also asked businesses to list the main obstacles that have to be overcome before candidate countries can join the Internal Market. The major obstacles to overcome are:

- 1 The bureaucracy they impose on cross-border activities;
- 2 Their incomplete legislative framework compared to that of the Internal Market;
- 3 Administrative and juridical capabilities which are inadequate to meet the needs of companies;
- 4 The development, the functioning and the reliability of financial markets;
- 5 The infrastructure for communications, energy and transport;
- 6 Differences in standards and certification procedures compared to those applied in the EU;
- 7 Tariff barriers to trade;
- 8 The absence of application of legislation;
- 9 The attitude of the authorities towards foreign companies and their discriminatory practices;
- 10 The lack of available information on their markets.

It is expected that border regions will experience the effects of the enlargement more than other regions.

ISBC 2002 suggestions

SMEs and the enlargement of the EU

- Will the enlargement bring benefits for European SMEs? Are there sectoral differences?
- Are the effects larger for enterprises in border regions or the neighbouring countries of these new Member States?
- What are the comparative advantages of the SMEs in the new Member States and how can these advantages be exploited?

3 The new network economy

The new economic environment can be characterised by two trends: the globalisation of business and the revolution of the information and communication technology (ICT). Another important trend that originates from the economic situation known from the 1990s is the strategy aimed at cost reduction leading to increasing volumes at decreasing prices. The creation of networks is often mentioned as one of the principles by which this situation can be achieved. For this reason, the new economic situation is also referred to as the new *network economy*.

Principles underpinning the network economy

- The law of plenitude: more gives more
- The law of increasing returns: create virtuous circles
- The law of allegiance: feed the web first
- The law of inefficiencies: don't solve problems

Source: Uyttendaele, 1998.

This chapter discusses the implications for small businesses of the two major trends in the new network economy “development of ICT and globalisation”. Chapter 4 deals with the possible strategies for SMEs to cope with the network economy.

3.1 Small businesses and the ICT revolution

The world is fast developing into an information society. Information and communication technologies (ICT) are enabling information to be collected, processed and disseminated on a global scale for the market. The advances in information and communication technologies will have considerable impact on economic growth, possibly together with (self-enforcing) changes in the optimal organisation of capital markets, co-operation, networking and international trade. The developments in computing, electronic exchange of data and cellular telephony could be crucial. They influence the available opportunities to interact and learn, and, therefore, to organise the internal and external processes of enterprises. Specifically, the leeway for flexibility, co-operation and speed is changing.

Rapid advances in information and communication technology function as a platform for a series of applied innovations across industries. These innovations may substantially impact on the costs of interaction, transaction and information processing for many economic activities. New opportunities and subsequent optimal solutions for the efficiency of organisations, markets and innovation can have complex, compound and radical consequences on the structure and dynamics of the economy. With new ICT opportunities, the SME sector can strengthen its competitiveness. Why is ICT so important for SMEs?

To answer these questions, we shall look at four issues:

- Product features;
- Organisational processes;
- Market processes;
- Innovation and learning.

Product features

Due to the developments in ICT, two types of product should be distinguished: (1) new products from ICT-sectors and (2) 'renewed' products from 'old' sectors. The 'new' products (e.g. hardware, software and e-commerce) can be seen as innovative intermediate goods or components. They are applied throughout the economy, mostly as investments in process innovation. The 'renewed' products (e.g. information products and 'enhanced' services) can be seen as product innovations that create new (niche) markets and close substitutes for 'adjacent' existing products.

SMEs may have competitive advantages in the creation of both 'new' and 'renewed' products and services. Especially in co-operative networks, SMEs can be very efficient in supplying specific competences. They can also be flexible and efficient niche players. On the other hand, reputation will be increasingly critical, which may be a barrier preventing many SMEs from competing. Overall, co-operation and networking might appear to be critical. Aggressive marketing can be a winning strategy if (and as the year 2000 has shown: *only if*) 'old' firms with a large head start in reputation (and brand name) are distant. Using or buying brand names that already exist can obviously be a shortcut here, possibly even into *any* market.

Organisational processes

The opportunities to use improved ICT affect the business processes, especially the key management processes: *strategy formation*, *coordination* and *communication*. The potential costs of interaction within and across the organisational boundaries change, creating new opportunities for efficiency, flexibility and agility in the market place. To benefit from these new opportunities, organisational boundaries must be reconsidered, which, in turn, requires *strategic repositioning*.

For start-ups and SMEs, the traditional trade-off between markets and hierarchies may become less and less relevant. This will really take flight if the challenges to effectively organise learning and information sharing within groups of SMEs are met. A 'truly' entrepreneurial economy may grow, where, as a rule, temporary clusters of businesses produce both the direct and indirect goods and services. As stated, reputation, experience and knowledge are critical elements in this system. Innovation and efficiency could both be cultivated if the (threat of) competition through substitution remains.

Collaborative engineering

The combination of Computer Aided Design with the use of the Internet has given companies the opportunity to work worldwide in engineering teams. To speed up the development of new products, companies all over the world work together in daily shifts. These developments were started within the automotive industry. But also suppliers can join forces and use the instrument of collaborative engineering.

Market processes

New and improved IT tools are likely to have an impact on the mechanisms of markets and thus on the allocation of goods and services. There are ample opportunities for demand and supply to meet each other better, faster and cheaper. Market imperfections may be alleviated, transaction costs may be reduced, and the inertia in the responsiveness of firms is likely to reduce, in close interaction with the above-mentioned improvements in the organisation of business processes.

In principle, the new market mechanisms may create great opportunities for start-ups and SMEs. There are many opportunities to become the new information and product

intermediaries or to become a specialised supplier. Management capabilities and reputation will be critical. New industry structures are likely to arise in many product-service categories, creating new balances in terms of efficiency, in turn (again) impacting the organisation of primary activities (incl. marketing) and support functions (incl. management). On the other side, large enterprises will co-operate more, which will lead to even more competition, the needs for higher quality and just-in-time will be more important.

Innovation and learning

This is probably the most important mechanism in the potential of the network economy. New tools to communicate and process information could trigger and facilitate the incentives for innovators and entrepreneurs to communicate and share information (especially at the pre-competitive stage). This may stimulate technological progress, in particular if the information can easily be found and exchanged. Partly due to the problems to protect information effectively, individual and 'collective' processes of innovation and learning appear to be under change, especially in the ICT-sector.

Effective management of knowledge within and between organisations can improve by the application of ICTs. Within and across the boundaries of the firm, if information becomes cheaper, the allocation of entrepreneurial and innovative capabilities *can* benefit. This means that entrepreneurial initiatives may, in principle, find their way more easily to the most productive use.

In a global, ICT-enhanced and co-operative world, the clock-speed of technological progress can improve greatly. This may even create opportunities for a rise in permanent economic growth.

ISBC 2002 suggestions

SMEs and ICT

- Are SMEs able to cope with the new developments in ICT?
- In what way will the developments in ICT improve the competitive position of SMEs in national and international markets?
- How will ICT influence the globalisation process in the long run?
- What trends in ICT can be expected in the coming five years?

3.2 Small businesses and globalisation

Globalisation can be described as the phenomenon that the number of economic relations in the world, and in particular between countries and continents, is increasing. The result is a functional integration of activities at completely different locations, no company or country being able to operate in a totally independent manner (Muizer and Hospers, 1998; Petrella, 1995). In other words, economies all over the world are becoming more and more interwoven.

The WTO International Trade Statistics 2000 projected that the growth of world merchandise trade in 2000 would be about 10%, twice the rate recorded for 1999, and one of the highest in the decade before. Trade growth has exceeded output growth during the entire period 1990 to 1999, though the difference was expected to be somewhat smaller in 2000. International capital flows, in particular foreign direct investment, continued to be a major determinant of international trade (WTO, November 2000).

Up to now, however, globalisation is still very much a process of regionalisation. The only production factor that seems to know no borders globally is financial capital. Goods are still traded mostly within large regions. The establishment of regional free trade areas, such as the European Economic Community in 1957, ASEAN in 1967, the Asia-Pacific Economic Co-operation - APEC in 1989, Mercosur (Argentina, Brazil, Uruguay and Paraguay) in 1991 and more recently NAFTA, the North American Free Trade Agreement that became effective as of 1 January 1994, and the Free Trade Area of the Americas – FTAA process that was initiated that same year, reinforce regionalisation. Even within regions, however, the mobility of labour is very limited, as is the free movement of services.

The true global players in the world are the multinational companies and financial agents. It is often assumed that small businesses will profit decidedly less from these developments than larger companies do. Presumably, they are less likely to exploit the opportunities offered by larger markets or markets' easier access. Small firms would tend to restrict their activities to the geographical area that directly surrounds them. This is confirmed by surveys on exporting by businesses (e.g. ENSR, 1999). Many small businesses operate in sectors with few export activities. But even in other sectors, small businesses lack the resources and in fact the size to capitalise on economies of scale and scope. Transaction costs are harder to bear for a small company. The role of small businesses in foreign direct investment appears to be even smaller.

On the other hand, various small businesses are already successfully active in global niche markets. Small businesses also have repeatedly been hailed for their greater flexibility, enabling them to adapt quickly to changing environments and becoming innovative forerunners in their field at the international level.

Globalisation affects SMEs in a positive and in a negative way (OECD, 1997). For some companies, the creation of a larger market brings new opportunities, for others it chiefly poses new threats.

- For fast growing companies in particular, it creates opportunities for outward expansion and growth.
- For a much larger group, however, globalisation means above all new competitive threats from abroad.
- SMEs produce about 26% of OECD exports and 35% of Asia's exports. Only about one per cent of the SMEs can be called truly global, in the sense that they are active in more than one continent and have the ability to operate where they see fit. Another 5 to 10 per cent in manufacturing is estimated to be extensively internationalised. Another 10 to 20 per cent of the SMEs in manufacturing in OECD countries draw between 10 and 40% of their turnover from international activity and are active in one to three foreign countries.

Globalisation or regionalisation?

In the seventies, the production of textiles was outsourced to North Africa and South East Asia. The main reason was the low costs of labour. The designing process remained in the western world. Recent developments show that consumers more often don't succeed in buying the clothes they wanted. Furthermore, cataloguers who have extensive experience in selling to consumers at a distance and on the Internet, are receiving ordered goods back to the department because they don't fit. Because of these problems, the retail industry is trying to customize or even individualise the production. The effect is that the producers are looking for suppliers at a shorter distance. A new trend seems to be born: regionalisation.

The OECD estimates that about 25% of manufacturing SMEs, and rather less of service SMEs, already are or are able to become internationally competitive. Between 25 and 50% will probably not survive international competition in their present form. They need to make substantial changes to improve their output quality, costs competitiveness and management practices. The remaining companies are sheltered from international competition (OECD, 1997).

Internationalisation by SMEs is, however, important taking into account their specific role in the economic development. The US-based E.F. Schumacher Society argues that a world economy based on a complex interaction of small enterprises rather than on international conglomerates could actually end up being more efficient than the current global trading. "Schumacher introduced the concept of scale in the modern economic planning, he argues that small-scale enterprises based on local production, would provide greater diversity, flexibility and ultimately economic security" (<http://www.businesseurope.com>, 23 July 2001).

Conclusion

Small businesses seem to face new challenges and require new ways of thinking and acting to deal with them. The increasing interdependency of economies and businesses suggests an approach worthwhile exploring further: co-operation and networking. New information and communication technologies seem to expand the possibilities for co-operation, as well as lower the barriers for small businesses to participate. Chapter 4 deals with this topic.

4 Co-operation and networking

Co-operation, alliances and networks are often considered as a means to compete and survive for small businesses in the new, global economy. This can be co-operation between enterprises but it goes without saying that other organisations than enterprises can also participate. Obvious other partners are universities and research institutes, but customers, consultants, banks, etc. are all potential partners in SME networks.

4.1 Forming partnerships

4.1.1 *Transnational partnerships*

According to the OECD, most SMEs do not begin their internationalisation process before they have established themselves well in their home market. Many SMEs continue to rely on good customer relations abroad also. SMEs typically start their international activities in regions that are geographically or culturally close. However, they do not make much use of networks, alliances and co-operative agreements with foreign firms. Networking is increasing, but an independent approach is still much preferred. From country studies it appears that there is no single successful strategy. SMEs use combinations of different strategies that suit their market, product, their company and the stage of their internationalisation. They go about internationalisation in an evolutionary way, by which they are able to minimise risks (OECD, 1997).

SMEs prefer informal co-operation to co-operation on the basis of written agreement. According to the fifth Observatory report, this is caused by the importance they attach to their independence and to a lack of solid legal assistance for SMEs. Age of the enterprise, satisfaction with current market share and concentration on new product and market combinations are characteristics that influence the likelihood that a business will engage in transnational co-operation. Transnational co-operation occurs more often in younger enterprises, dissatisfied with their market share and focussing on new product-market combinations (ENSR, October 1997).

4.1.2 *Networks, co-operative behaviour and alliances¹*

Every SME, its entrepreneur and its employees are part of a network of relationships: formal and informal, personal and business. This section focuses on a firm's network with other firms, including its customers, suppliers, and competitors. A network is defined here as groups of firms interacting or linked otherwise with each other. More formally it can be defined in terms of nodes and links. The different links in the network provide the SME entrepreneur with resources and information.

¹ This section is based to a large extent on Van Gils, 2000.

The rise of knowledge exchange networks

In different cities around the world networking organisations are founded. The ICT and new media sectors are frontrunners in organizing these networks. Mostly the local city government is involved.

Supporters have full access to information, sources and consultants to prevent business problems or to solve them. Also, supporters are directed to experts within the network. The network is an independent organisation and aims to promote co-operation between active parties in a special sector. For example, the Amsterdam New Media Association (ANMA) concentrates on all new media professionals: from graphic designers to programmers, from start-ups to established businesses (see <http://www.anma.nl>). Main activities are:

- To organize network meetings
- To chart and monitor the new media and ICT industry
- To support start-ups and companies
- To stimulate training and education
- To initialise projects
- To extend the marketing and PR of the industry, the city and the region
- To improve international contacts.

SME entrepreneurs prefer to co-operate with enterprises they have co-operated with before, or with somebody they know (e.g. a friend). Trust and mutual respect are necessary conditions to develop co-operative relationships. However, when the business environment is, or changes into, a competitive setting, SMEs often intensify co-operation or extend their network in order to survive. Consequently, regular informal co-operative behaviour will be transformed into co-operative agreements, i.e. alliances.

Businesses can form tactical and strategic alliances. Tactical alliances are short-term and the information exchange usually does not include critical or vital information on the companies. The information flow in tactical alliances often takes place in one direction only. Many tactical alliances result from client-supplier relationships. Achieving price advantages is the most common goal in tactical alliances. Strategic alliances on the other hand, are long-term agreements based on common strategic goals. These are often concluded for Research & Development. Suarez-Villa (1998) makes a similar distinction, but talks about co-operative outsourcing versus alliances. According to him, firms engaged in (strategic) alliances share or risk more, and usually give up some assets, such as knowledge, facilities or capital.

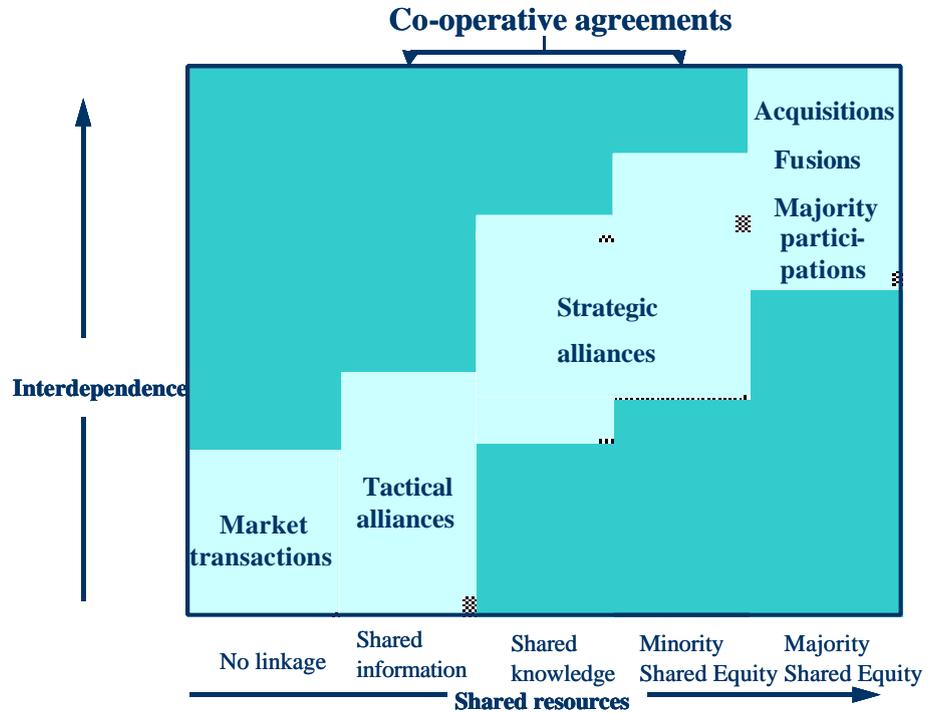
Organizing networks of SMEs

SMEs can create communities or industrial networks for world-class companies in the high-tech manufacturing industry. Advantages are worldwide marketing exposure, expanding the firm's international relationship network, finding new business partners and joining international clusters. An example of a network can be found on <http://www.pdn.com/>

The OECD lists the many forms strategic alliances can take: joint ventures, minority equity investments, equity swaps, joint R&D, joint manufacturing, joint marketing, long-term sourcing agreements, shared distribution/services and standard settings. Mergers and acquisitions, overseas subsidiaries of multinational corporations, and franchising agreements are not classified as strategic alliances (Kang and Sakai, 2000). Co-operative agreements are a way to increase the scope of the business, without resorting to enlarging the business through mergers, acquisitions, etc.

In figure 8 the typology developed above is displayed. It also shows how the interdependence of the businesses involved in the co-operation, and the resources they share, depend on the type of co-operative behaviour.

figure 8 Overview summarising the types of co-operative behaviour



Source: Gils, Anita A.E.J. van, *Cooperative Behaviour in Small and Medium-Sized Enterprises: The Role of Strategic Alliances*, Rijksuniversiteit Groningen, 2000.

Another way to classify partnerships between firms is to look at areas for co-operation, e.g. by following the business value chain (Porter, 1990):

- Finance, planning
- Human resources
- Technology development
- Procurement
- Inbound logistics
- Operations (manufacturing)
- Outbound logistics
- Marketing and sales
- After-sales service.

ISBC 2002 suggestions

SMEs and co-operation

- What are the major problems SMEs have to tackle in international co-operation?
- What are the major types of co-operation SMEs are participating in?
- In which areas are SMEs mainly co-operating?

4.2 Trends that might stimulate co-operation

Businesses increasingly seek each other to pool resources and work together in order to meet the challenges they face. Technological developments and a changing demand (customisation) have both promoted and reinforced this process. The result has also been that product life cycles and the time to market have shortened. Many firms were forced to specialise and focus on their core business again. This stimulated outsourcing and created the need for companies to work together in order to meet the demand of clients and end users.

Globalisation challenges small businesses to participate in international trading activities. Conversely, it forces them to reckon with increasing competition from competitors abroad in their home markets, and one way to cope with this increase in competition could be co-operation.

Trends besides globalisation that might stimulate co-operation

- Individualisation and mass customisation: the process of individualisation in society in general and the client-oriented approaches now demanded of businesses have to be answered by customised production and services. The consequence of this is that products become less relevant in comparison to certain elements of services provided in the pre-sales and after-sales process. Specific activities and skills are needed to realise this. For small business, co-operation can be the way to acquire these factors.
- Speed and innovation: in addition to possessing competencies such as flexibility and innovation, companies have to be fast. Products have to be brought on the market in a short time and venture capitalists want to see fast revenue. To do all the research and development within the companies costs too much time and money. Co-operation can be an answer to this problem and to stay innovative.
- IT-omnipresence: the development and production of products and services require various disciplines and specialists, in particular the ones that are related to new information technologies (IT). More often products carry elements of IT to create more added value, and new services are more often related to IT-tools and IT-networks. For this reason, co-operation with IT specialists is necessary to survive.
- Convergence: the borders between economic activities and between sectors are blurring. Parties from different economic sectors have to work together if they want to develop new activities. Banking and telecom companies, for instance, form alliances to start an electronic marketplace or to develop mobile banking systems.

The trends described above have resulted in a business environment that is more uncertain and certainly more complex than it has ever been.

4.3 Motives for co-operation

Some authors state that working together is necessary to cope with uncertainties and to exploit opportunities. In the global market, competitors have had to become colleagues, or, in the words of Muizer and Hospers, they co-operate in order to remain competitive.

Apart from the question for businesses whether they should work together at all, there is the question in which dimensions they should co-operate and in which they should remain competing. The two activities and relationships should be balanced (Enright, 1995; Kenworthy, 1995). Audretsch and Thurik (1997) have related this necessity to the

characteristics of the entrepreneurial economy that is gradually replacing the managed economy in OECD countries.

The motives for co-operation are related to the trends described in the previous section, as can be seen from figure 9.

figure 9 Motives for co-operation resulting from trends in the business environment

<i>Trend</i>	<i>Main motives for co-operation</i>
More IT in products and services	Knowledge exchange Access to complementary resources
Individualisation and mass customisation	Information gathering Access to new distribution channels and multi-channelling Access to management skills
Convergence	Exchange of knowledge Access to complementary resources or assets Access to distribution channels and technology
Unparalleled opportunity and unprecedented uncertainty	Information gathering Increasing management support/skills Exchange of knowledge Learning
Fast companies and staying innovative	Improve flexibility and innovation Share and reduce costs and risks
Internationalisation	Improve competitive position Overcome cultural differences Expression of cultural values Access to distribution channels

An important motive for co-operative behaviour is acquiring complementarities. Partnerships between different firms can provide SMEs with the necessary access to complementary resources, new markets and distribution channels, technologies, management skills, information and knowledge (Van Gils, 2000).

Other possibilities to acquire complementarity include; participating in networks, associations, meetings of entrepreneurs and professionals, creating knowledge platforms, and maintaining relations with the knowledge infrastructure.

Braaksma and Prince analysed a large number of empirical studies on co-operation and SMEs. Amongst the many reasons why small firms team up with other companies in practice, those relating to technology are the ones most often cited. Nevertheless, aims closer related to globalisation, such as a quick entry into new markets, are also mentioned (Braaksma and Prince, 1995). Not surprisingly, many motives in essence relate to achieving the economies of scale and scope normally out of reach for SMEs.

According to Muizer and Hospers, the gains of co-operation include access to knowledge, inventive resources such as laboratories, more advanced equipment, an expansion of production capacity, or access to an already established marketing and service network.

Anita van Gils studied SMEs in the Netherlands and Belgium. Client satisfaction and other factors that can increase customer loyalty were indicated in her study as the most important competitive advantages for the firms in the food, construction and plastics

and metal sectors in the 'Euregio' that is formed by the province of Limburg in both countries (Van Gils, 2000).

Risks of co-operation

On the other hand, some words of caution should also be given. Co-operation is not an easy way of doing business. A substantial amount of time has to be spent before the actual co-operation can start. There are also risks. Co-operation in projects can e.g. be ended halfway during the project, with severe consequences for the main contractor. According to Braaksma and Prince (1995), the main problems encountered by industrial SMEs in co-operation are:

- Unwanted knowledge transfer;
- Reduction of flexibility;
- Chance of being exploited by the co-operation partner;
- Lack of commitment;
- Time loss due to discussion and meetings between partners.

ISBC 2002 suggestions

Advantages and disadvantages of co-operation

- What are the major advantages of SMEs from co-operation?
- What are the major risks of co-operation?
- Is co-operation a solution for coping with the increased competition? And are there any other solutions?

4.3.1 *Co-operation between large and small firms*

Co-operation can take place among SMEs, but also between SMEs and large enterprises. The arguments in favour of this all relate to the complementarity of SMEs and large firms. An important aspect is whether this co-operation takes place at an equal level.

Suarez-Villa distinguishes three basic structures in networks, ranging from non-hierarchical to very hierarchical. He assumes that a very hierarchical network often consists of SMEs and large firms. In these kinds of network, co-operation is less spontaneous and less fluid. SMEs run the risk of their interests being subordinated to those of the larger enterprises. Specialised roles may develop over time, and this may make it more difficult for enterprises and for SMEs in particular to exit from the network. The most important benefit of the development of hierarchy within an alliance may be the expanded support for continuous innovation that it can provide.

The European Round Table of Industrialists consists of 45 leaders of major, large European companies. In 1997, the ERT performed 43 case studies on partnerships between large and small companies. They contend that co-operation between large and small companies is part of the transformation process going on in the world. Competition forces all companies to focus on their core business. SMEs have the flexibility and speed to foster new ideas and the cost control to maximise efficiency. Large companies have power, resources and experience.

Other authors point out that the advantages related to innovation are predominantly *material* in the case of large firms, and mainly *behavioural* for small firms (Vossen, 1998; Rothwell, 1995). Again, small and large firms are well suited to supplement each other.

The ERT report claims that large firm – small firm partnerships do not only benefit the firms themselves. According to the report, these partnerships may also have a profound impact on job creation and local economies.

ISBC 2002 suggestions

Co-operation between large firms and SMEs

- What are the major advantages and disadvantages of co-operation between large and small enterprises? And what are the threats?
- Do the large enterprises benefit more from these types of partnership than the SMEs?
- What actions have to be taken to stimulate these types of partnership and by whom?

5 The role of small business organisations

5.1 Small business organisations: great diversity

The main goal of most small business organisations (SBOs) is to influence the entrepreneurial and business environment since a good business climate stimulates the performance of their members. Although nearly all SBOs pursue this goal, there is a great diversity in the institutional structure and activities of SBOs¹. This diversity is due to differences in membership status, activities and status between SBOs:

- Membership:
 - Voluntary (purely private) or obligatory (private organisations based on public law) membership;
 - Members in retail and/or crafts and/or other economic sectors;
 - Local and/or regional and/or national members;
 - Individual entrepreneurs or branches and regional associations (umbrella organisations) as members.
- Activities
 - Interventions in the public policy making process, on all SME-issues or on some more specific issues, promoting and defending the interest of their members;
 - Direct business support to members;
 - Organisational support to branches/regional associations (“economies of scale”);
 - Active in social dialogue, representation vis à vis trade unions, collective bargaining.
- Status
 - Recognised as a social partner;
 - Recognised by governments;
 - Representational power (number of members, number of SBOs representing the same group of members (“competing SBOs”), resources (manpower, financial));
 - Reputation in politics, press, media, general public;
 - Position in relevant networks.

In practice, there is a variety of SBOs, ranging from the one and only, strong, nationwide, umbrella SME-organisation, participating in all relevant networks, to the small, weak, local associations only representing retail shops and active in some business support.

The role and functioning of specific SBOs is determined by historical, cultural, economic and political factors. Therefore, there is no unique institutional structure for an SBO.

¹ Apart from organisations representing small businesses exclusively (whatever the definition might be), there are business associations representing businesses of all sizes, e.g. in a certain sector, region or country. Although the majority of their members might be small and/or medium-sized, their larger members quite often dominate their work. During the last decade, however, these general business associations are more and more focusing on the specific needs and interest of their smaller members.

ISBC 2002 suggestion

The role and functioning of SBOs

An exchange of different (best) practices at the ISBC 2002 will be a stimulating learning experience.

5.2 Small business organisations: some general challenges

Although different types of SBOs exist, all SBOs have to deal with some common challenges. The diversity of the answers to these challenges is another explanation for the variety of SBOs. The challenges and answers to these challenges are discussed in this paragraph.

A. Membership and free riding

SBOs deliver public goods¹, which means that no individual entrepreneur can be excluded. An example is the intervention in the public policy making process for the benefits of their members. This type of activity of SBOs is in the interest of all entrepreneurs, regardless of membership. So there is always the threat of free riding. The crucial question is: why would an individual entrepreneur become a member of an SBO? The fixed costs (to be reimbursed by the membership fees) of an organisation are relatively high compared to the individual gains of being a member. Therefore, some organisations of larger enterprises offer membership to SME-entrepreneurs for a relatively low fee. The main reason is that more members means wider representation for the organisation and consequently a better public reputation. Some SBOs are only active on a small scale, for example at branch or regional level. In practice, there is often only one organisation for the large enterprises and many ('competing') SBOs in a specific country. This situation can result in a weak position for SBOs.

The government is, however, not always passive. Some politicians are of the opinion that SBOs, as every interest group, are rent-seeking organisations². But on the other hand governments have to provide an efficient and effective delivery of public and merit goods³ for which they need the co-operation of SBOs. Therefore, they develop instruments (financial support, organisational support, kinds of privileges) to strengthen the position of SBOs and they set up agreements to involve the SBOs in the development and implementation of public policy.

Apart from delivering public goods, some SBOs deliver products and services for which their members have to pay. These products and services are often delivered in close co-operation with private economic agencies. Sometimes, co-operation brings opportunities for cross subsidising their lobby activities.

¹ Public goods are goods that would not be provided in a free market system, because firms would not be able to charge adequately for them

² Rent seeking organisations can be defined as those that make use of resources for the purpose of obtaining rents for people where the rents themselves come from some activity, which has negative social value.

³ Merit goods are goods that would be provided in a free market system, but would almost certainly be under-provided e.g. education, health, fire service.

The diversity of SBOs is partly the result of different answers to the question of membership versus free riding. And behind this is the balance between becoming a strong organisation and staying independent from politics and/or private agents.

ISBC 2002 suggestions

SBOs and free riding

- Does this analysis highlight the most important institutional questions of SBOs?
- In which way are SBOs in different countries attempting to solve this problem?
- Do the solutions differ between countries and/or continents?

B. Intervention in the policy making process: optimisation under constraints

The policy making process can be described in six phases, and SBOs have different instruments to intervene in this process. This leads to the matrix presented in figure 10. Each phase in the policy process cycle has a different character, which means that different instruments are needed to influence the process. Due to certain constraints, for example lack of resources or a weak position in the network, SBOs are often not able to be active in every phase of the process. So, the matrix poses a question of optimisation under constraints. Some phases are more important than others, and some instruments have a higher cost/effectiveness ratio than others. Also it is often possible to develop co-operation with other associations or institutions to develop joint activities or to participate in relevant networks.

ISBC 2002 suggestion

SBOs and the policy making process

To which extent can the matrix be used as a framework for the exchange of best practices of services rendered by SBOs?

figure 10 The policy-instruments matrix for SBOs

	<i>Publicity</i>	<i>Networking</i>	<i>Negotiating</i>	<i>Reporting</i>
Agenda setting				
Diagnosis of policy problem				
Construction of instruments				
Decision making				
Implementation				
Evaluation				

C. Business support: the market for business support

As mentioned above, many SBOs also deliver products and services for which their members have to pay. These products and services vary from business accounting support to the organisation of trade missions. Sometimes, these products and services are delivered by the SBO itself but often they are organised in strategic alliances with private and/or public agencies.

It is in the general interest of society that the small business sector functions well and is able to adapt to new circumstances. However, in most countries, there is often a discussion about which products and services have to be delivered by the government (as a kind of a merit good at a discount rate) and which have to be delivered by SBOs.

ISBC 2002 suggestions

SBOs and business support

- What are the most important goods to be delivered by SBOs?
- What are the most important merit goods to be delivered by government or government agencies?
- Is there a big diversity between countries and continents?
- Is there an optimal solution or are solutions depending on national circumstances?

5.3 Small business organisations and the new economic environment

The new economic environment may lead to a new role for small business organisations. The first paradox that has to be dealt with concerns the increasing importance of the local level in a world that is increasingly becoming a 'global village'. Whereas ICT, globalisation and worldwide integration make borders and distances fade away, public policy decisions are increasingly made at sub-national levels. The only way to reconcile this paradox is to accept that each economic activity must be allocated somewhere. Even companies whose activities are theoretically not tied to a specific location value certain region-specific aspects, such as cultural values or the proximity of specific knowledge and technology. In addition it could be argued that smaller companies become even more dependent on their direct environment, since a solid and dynamic, local and regional business environment is essential for operating in an international market (ING Bank, 2000). The OECD has called attention to a similar, albeit not identical paradox: the globalisation of economic activities compared to the localisation of competitive advantages (Enright and Ffowcs-Williams, 2000). The implication for SBOs is that their services are required at geographically speaking extreme ends: at the local as well as the international level.

International lobbying and business support

Although certain international issues may be very important, it might be very difficult to raise the interest of SME-entrepreneurs. A good example is the introduction of the euro. Although SBOs have intensively debated on the implementation scenarios (i.e. front loading yes or no; scenario's of bringing into circulation the new euro notes and coins), the issue was dominated by the political elite and the multinationals.

With the internationalisation (or regionalisation) of the economy, more important issues are at stake at a transnational level. Examples of these issues are the enlargement of the European Union, trade regulations at WTO-level and banking regulations at the BIS in Basel. But, due to a lack of resources and a weak participation in the relevant networks, SBOs seem to have little influence on these issues and more international co-operation becomes a necessity. The same holds true for activities in the field of international business support.

5.4 The role of small business organisations in the new economic environment

The new economic environment adds an international dimension to the activities of SBOs. They not only have to cope with the “traditional” issues of institution building (membership, lobbying, business support), but on top of that they have to deal with the internationalisation of the economy and the policy making process. SBOs, as well as their members, have to adapt to the new economic and political situation. The developments in ICT can be a tool in this adaptation process.

ISBC 2002 suggestions

SBOs and the new economic environment

- At what level can and do SBOs operate in this new environment?
- In what way can SBOs assist SMEs in order to adapt to the new economic environment (impact on business support activities)?
- To what extent can the strategies of SMEs as outlined in the previous sections be helpful for SBOs?

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http://www.isbc2001.org	ISBC 2001 Congress Website
http://www.mkb.nl	Royal Dutch Association for Small and Medium-sized Enterprises (Koninklijke Vereniging MKB-Nederland)
http://www.eim.nl	EIM Business & Policy Research
http://www.eim.nl/uk/uk/eim_partners.html	ENSR, European Network for SME Research
http://www.isbc.or.jp/	ISBC, International Small Business Congress
http://www.europa.eu.int	European Commission
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http://www.ecb.int	ECB, European Central Bank
http://www.ueapme.com	UEAPME, European Association of Craft, Small and Medium-Sized Enterprises
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http://www.conferenzabologna.ipi.it/Eng/index.html	The Bologna Conference on Enhancing the Competitiveness of SMEs in the Global Economy: Strategies and Policies, June 2000
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http://www.wasmeinfo.org/	WASME, World Association for Small and Medium Enterprises
http://www.icsb.org/	ICSB, International Council for Small Business
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