

THE GLOBAL CRISIS AND SMALL- AND MEDIUM-SIZED ENTERPRISES: THREAT OR CHALLENGE?

Simona Skorvagova, PhD

Janka Pasztorova, PhD

University of Economics in Bratislava, Slovakia

Abstract

SMEs play a significant role in all economies and are key drivers of employment, innovation and growth. SMEs have been especially hard hit by the global crisis. Due to their size and limited resources, in particular limited financial, managerial and information resources, they are more vulnerable to external shocks. With the economy facing the recession, companies are closing down and others are competing through spending cuts. Ongoing crisis has posed the significant challenge for small businesses and entrepreneurs. They need to take various measures against the economic shock to survive. This paper examines the possible changes in SMEs strategies that may be used to respond the unstable economic conditions in the world economy. The major attention is drawn especially to strategies based on the establishment of long-term relationships with stakeholders and on the strategies related to the cooperation between SMEs in order to innovate products/services or business processes.

Keywords: Small and medium enterprises, global crisis, adaptation, internationalisation, cooperation

Introduction

During the last decade, the world economy experienced deep recession and severe financial crisis. The policymakers together with managers are struggling to find ways how to manage current accelerating changes and how to answer this difficult situation. The behaviour of subjects has changed during the recession and has affected the economic climate everywhere in the world. Many economic subjects are fighting to avoid going bankrupt. Companies face the threats of declining sales and profits and are searching for new approaches towards their business activities.

The complexity of today's global economic environment has made it more important than ever to recognize and encourage the qualitative as well as the quantitative aspects of growth, integrating such concepts as social and environmental sustainability to provide a fuller picture of what is needed and what works. (Global Competitiveness Report 2012-2013, p. xiii)

The adaptation to new conditions is the prerequisite to survive. Not only companies need to address these circumstances. The crisis has highlighted the lack of confidence in the business and economic activity. Recessions are often periods of destruction in which old technologies, products and ideas meet their end, while new ones emerge. Recession impacts the business, poses major threats to, but also offers significant opportunities for, businesses. In order to survive all entities need to adapt. Destructive forces may not be a source of failure, but the inevitable pressure for necessary corrections of companies' philosophy. Every business in the world, regardless of size and type of business, cannot avoid the evolutionary

process, which is bringing incremental changes as a reaction on external environmental development.

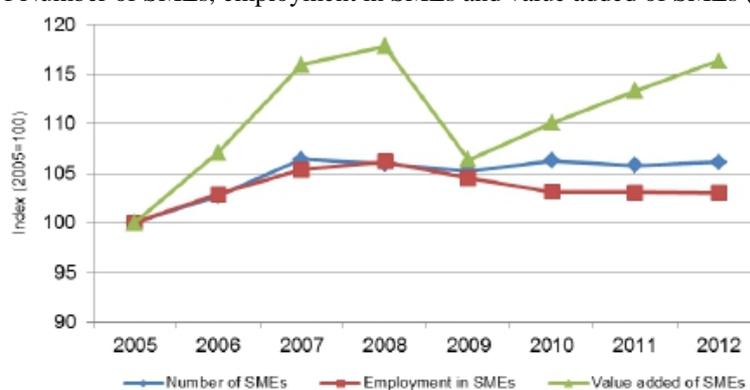
Crisis periods are more difficult especially for small and medium enterprises. SMEs are particularly vulnerable to external shocks, for the reason of limited resources, customers and product lines. Their small size restrains their adaptation strategies as downsizing or diversification of business activities. SMEs lack the resources, in particular financial and information resources, necessary to cope easier with the negative economic conditions in the economic environment. Nevertheless, they form the backbone of the national economy and can be crucial factor in the recovery from the global crisis. SMEs have been considered one of the driving forces of modern economies due to their contribution in terms of technological upgrading, product and process innovations, employment generation, export promotion, etc. (Annual report on SME in the EU, 2011/2012, 14).

This paper contributes to current issues about the business adaptation during recession and links with successful performance of SMEs in the future.

Small and medium enterprises in European Union

SMEs in the European Union are the key to the success of the European further development. SMEs account for 99,8 per cent of non-financial enterprises in 2012, which equates to 20,7 million business (Annual report on SME in the EU, 2011/2012, p. 15). They are significant employers, who contribute to the overall employment rate. Working conditions in SMEs could be characterised as a very favourable environment for employees. SMEs across the EU provided an estimated 67,4 per cent of jobs in the non-financial business economy in 2012 (Annual report on SME in the EU, 2011/2012, p. 15). This makes SMEs primarily responsible for wealth and economic growth in the EU. They also play a significant role in innovation and R&D, which predetermines them to be important carriers of innovation.

Figure 1 Number of SMEs, employment in SMEs and value added of SMEs (2005=100)



Note: 2011 and 2012 figures are estimates

Source: Ecorys Macro & Sector Policies: EU SMEs in 2012: at the crossroad. Annual report on small and medium-sized enterprises in the EU, 2011/2012. Rotterdam : ECORYS Nederland BV, 2012, p. 16.

Figure 1 illustrates the position of SMEs in European economy during the crisis period. SMEs were hit hard by the economic crisis in 2009. In 2010 the decline in the number of SMEs was halted, but employment in SMEs continued to decline. Since 2009 there has been a strong recovery in value added of SMEs. For 2012, an overall increase in value added and fragile development in number of enterprises were expected, while employment in SMEs remained unchanged.

European economy in general shows low levels of business and consumer sentiment and increasing unemployment limiting consumption, which has all led to an insufficient GDP growth. The crucial factors, which might boost competitiveness of the European economy,

are driven by productivity enhancements, in which innovation and new skills are important elements. SMEs have been considered one of the driving forces of economy due to their relative small size and close relationships with stakeholders. These enable them to react promptly to any changes in external environment as they are vulnerable to external shocks. SME's competitiveness depends on their ability to innovate and to promptly address to changes in business environment. SME's innovativeness not only enhances their own competitiveness, but also through their networks with other firms, they improve competitiveness of the entire economy.

SMEs adaptation

SMEs are conducted and managed by their owners or a manager. Their relative small size and favourable working environment facilitate the cooperation between owner and employees that may often lead to mutual agreement on further development of the company. However, owners always have the responsibility regarding the strategies they adopt, although their choice is often affected or constrained by resources and relations with other stakeholders. The nature of SMEs makes them very vulnerable to any changes in environment or in relations with stakeholders. They depend on trustworthiness and loyalty of their business partners, customers, suppliers or employees. Any business and strategic decisions may drain or deploy resources that are crucial for their future survival. There is no guarantee, that particular strategic decision will bring required results. Success or failure of any business activity strongly depends on the important stakeholders such as suppliers or customers as well as small business owner. Product innovation, for example, may increase sales and have positive effects on customers and their loyalty to small business, but there is also a possibility that innovation may have opposite effects and will not produce the intended outcomes. Failure of changed strategy is especially for small and medium enterprises extremely dangerous. Limited resources, in particular financial and information resources, give them not as many chances to adjust the strategy as to their larger counterparts. Small size and limited resources as well as the smaller customers' base and product lines restrict a firm's capacity to cope with competitive pressures that are strengthen during the crisis period.

Impacts of recession on small business may be analysed from two sets of view. These may be termed the *vulnerability* and *resilience* view (KITCHING, 2011, p. 3). Vulnerability is connected to the external shocks in business environment. Difficult conditions and unstable situation affect the ability of small business to address the changes adequately and find appropriate reaction. The lack of resources cause that there are many influences in external environment beyond their control. Thereby, small business performance is highly volatile in short-, medium- and also long-run. Resilience means the ability to quickly return to previous favourable conditions. This is a positive side of their small size. Flexibility of SMEs in adjusting resources, processes or products has made them able to survive during difficult times. Their links with stakeholders enable them to exploit existing market opportunities or to create new or innovative way of business processes. Recession has posed major threats to small businesses, but their flexibility and small size are offering interesting opportunities for them. Thereby, small businesses face to a major dilemma: to cut cost or to invest to innovate.

Two major decisions related to adaptation of small business on external shocks in economic environment are costs cuts or product/process innovation. Cost cuts may produce required outcome in order to maintain survival in short-run. On the other hand, investing in order to invent new products or processes may create opportunities for long-term value creation. Recession has compelled firms to rethink their business strategies. It is difficult to decide whether to cut costs or the converse, to invest financial resources into innovation processes. Reducing staff, for instance, might reduce the firm's capacity to mobilise human resources when necessary, or it might cause the loss of the trust of employees toward the

employer. Likewise, the firm might have not enough human capital to undergo crucial changes during recovery, as well as recession. Investment in the innovation processes might drain firm's resources and might fail to generate sufficient sales to cover costs. Studies of small enterprises demonstrate the importance of both cost-cutting activity and revenue-generation practices (KITCHING, 2011, p. 4). Performance of SMEs is closely linked with the actions taken during the recession period. The particular form of adaptation is contingent upon the circumstances and depends on the individual firm's situation and possibilities. There is no golden rule that will guarantee the success of the adaptation.

Internationalisation and cooperation of SMEs

Cost-cutting activities might only have just short-run effects on firm's performance very often. Revenue-generating practises include various actions that are generating revenue through investment, innovation and diversification. Implementing revenue generating approaches may require far-reaching decisions about resources and their mobilisation and the effects of this strategic reorientation might bring intended performance in the long-run only. Creation of cooperation among SMEs is a possible way how to save time, use synergies and even achieve cost reduction. Cooperation, especially with foreign business partner, provides opportunities to gain extensive experience of new environments. Firms learn how to deal with unpredictable changes in unknown markets and how to adapt to changes. They might also benefit from the learning effects of the cooperation with a foreign partner.

There are many possibilities, how to improve competitive position of European SMEs. Nowadays, the global economy is characterised by the accelerating globalisation processes that are enhancing the need for fast decisions and innovations. Generally, firm gains its strength when it learns from competitors or in cooperation with business partners. As already mentioned, there are two sets of adaptation strategies that might be used during recession period. To cut the cost or to innovate products/business processes. Desired strategy is the implementation of both options according to firm's possibilities and capabilities. Firms involved in the internationalisation might benefit from the learning effects of international expansion. The cooperation with a foreign partner or the necessary adjustment of products or strategies to foreign market environment support the ability of firm to innovate or to react to changing circumstances in a flexible manner. Many studies have confirmed that internationally active firms introduce product or process innovation more often than their non-internationally active counterparts. Innovation is very often an outcome of product development necessary to enter foreign market as well as the consequence of the firm's foreign market activities. Internationally active firms are forced to innovate in order to build competitive advantage in foreign markets and development of new product/service is often a consequence of competition from foreign enterprises on the domestic market.

Ongoing globalisation processes together with the impacts of global crisis are highlighting the need to address changes in international environment promptly and to recognise new opportunities that may improve firm's competitive position. Foreign market activities provide firms with access to knowledge, technologies and especially to experience that are new or different in comparison with domestic information base. This allows the firm to utilise learning effect originated in the export/internationalisation processes and decisions. There is a link between the innovation and internationalisation at least in the sense that firms need to innovate in order to gain and maintain competitive advantage in foreign markets. SMEs also have to deal with foreign competitors effectively not only in foreign markets, but they increasingly face with foreign spill over effects that may take place from foreign competitors in the domestic market.

Internationalisation of SMEs business activities has many benefits not only for their economic performance but it also may help to improve their market position both in national

and foreign market. Foreign market activities may reduce market risk and help to exploit different economic level and economic development of countries in the world. Internationalisation supports innovation of product or processes and reduces dependence on any particular market. Notwithstanding, many SMEs do not even plan to become internationally active, as they are not able to overcome many barriers associated with internationalisation. There are two main types of these barriers. Internal barriers are related to firm's capabilities and external barriers are related to the firm's business environment. SMEs have a tendency to underestimate or converse to overestimate barriers of internationalisation. These differences in firm's perception of foreign market barriers are connected to experience with foreign market activities. Many SMEs give barriers higher importance than it is in reality. Information and experience with international business activities may play a crucial role in starting foreign markets activities. Internal barriers are related to firm's capabilities to operate abroad. Internal barriers result from limited financial, managerial and information resources, and are typically smaller than in case of large firms. Internal barriers in perception of SMEs are related to lower level of efficiency of the firms, high cost of internationalisation or the lack of sufficiently qualified personnel. External barriers are related to the business environment and range from lack of capital necessary for starting foreign operations, lack of adequate information on cultural differences of foreign markets.

According to the study of European Commission on Opportunities for the Internationalisation of European SMEs there are the three most important barriers that may affect SME's business activities in markets beyond the Internal Market: (EC: Opportunities for the Internationalisation of European SME, p.48)

- payment risks,
- difficult paperwork, i.e. bureaucratic procedures,
- lack of finance.

Figure 2 provides more detailed answers of SME's perceived barriers of internationalisation. It shows the list of 15 main barriers perceived by SMEs that may affect their foreign market activities or may prevent SMEs to enter these markets. The list presents both, external and internal barriers of internationalisation. Tariffs or quotas and political risks belong to the less important perceived barriers. The list reveals that the most important perceived barriers are associated with financial limits, lower efficiency regarding the price or quality of product, or insufficient knowledge of internationalisation processes.

Figure 2 Barriers perceived to be most important by internationalised EU SMEs, index of importance of barriers for third markets



Source: European Commission: Opportunities for the internationalisation of European SMEs, Final Report. Brussels: Business Cooperation and Support Network Unit, 2011, p. 48

Entering foreign markets offers new opportunities and challenges for SMEs. Regardless the constraints of international activities, operating abroad provides various learning effects affecting firm's ability to compete in the world market. Competitive

advantage, which is gained from the foreign market business activity, is very unique. It is linked to knowledge, experience of different business environment, and higher potential to innovate. Especially nowadays, when global financial crisis has plunged most of the national economies into a severe recession, internationalisation of business activities might be crucial for further survival of firms. SMEs are more vulnerable to external shocks due to their size and dependency on national market. Foreign markets provide them a chance to adapt to new circumstances. However, the current level of SME’s internationalisation is insufficient. SMEs involved in international activities prefer entry modes with minimal investment and lower degree of foreign market commitment. These modes require no equity investment and thus have a low risk, but also low rate of return and little control. Higher potential for learning effect and related effectiveness of business operations arise from cooperation among SMEs from different countries. Cooperation generally involves the transfer of technology, processes, human skills or knowledge. The benefits of such cooperation are long-lasting and hard to imitate. However, only a small percentage of European SMEs is involved in internationalisation beyond the Internal Market.

Following data demonstrate small international commitment of European SMEs. The two most common modes of internationalisation are exports and imports: (EC: Internationalisation of European SMEs, p.5)

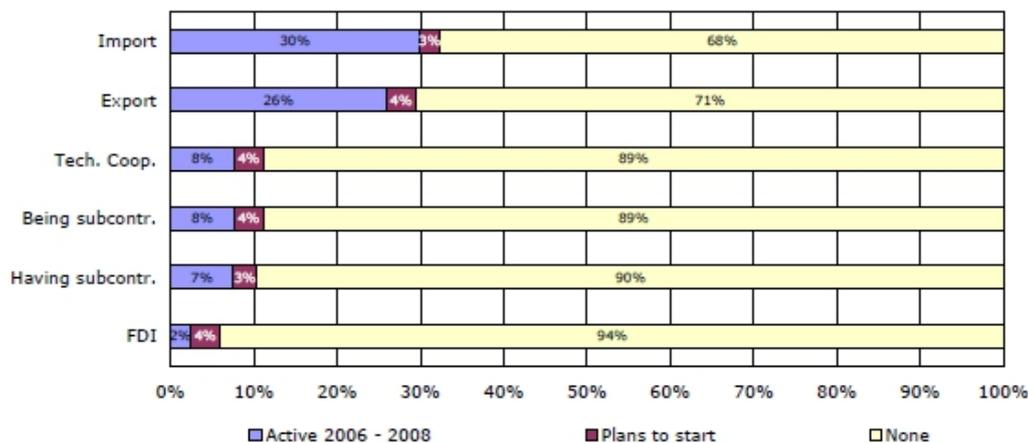
- 25% of SMEs within the EU27 export, of which about 50% also go beyond the Internal Market (13%).
- 29% of SMEs within the EU27 import, again 50% import from countries outside the Internal Market (14%).

In addition:

- 7% of SMEs within the EU27 are involved in technological co-operation with a foreign partner.
- 7% are a subcontractor to a foreign partner.
- 7% have foreign subcontractors
- 2% of SMEs are active in foreign direct investment.

Figure 3 presents an overview of different types of internationalisation according to the foreign market commitment. The highest share of SMEs is engaged in importing (30%). About one quarter of European SMEs are engaged in exporting. The share of FDI is just about 2% of SMEs foreign operations. Relatively sufficient is the share of technical cooperation among firms, 8% of SMEs has already had technical cooperation with foreign partner.

Figure 3 Percentage of European SMEs involved in international business activities, having concrete plans to start such activities or none at all. For various modes of internationalisation



Source: European Commission: Opportunities for the internationalisation of European SMEs, Final Report. Brussels: Business Cooperation and Support Network Unit, 2011. p. 12

Most of the European SMEs are active only within Europe. Emerging markets such as Brazil, Russia, India and China are served only by 7% to 10% of exporting SMEs. Only in transport and communication is this percentage much higher (EC: Internationalisation of European SMEs, p.6). While the European Union countries are facing financial difficulties, increasing unemployment and decreasing demand, emerging countries such as BRIC countries continue to show robust growth rates. The prospects for economic recovery look encouraging with the IMF projecting substantial economic growth by 2014, ranging from nearly 3,8 % in Russia, 4% in Brazil to close to 6,4% in India and 8,5% in China (IMF, World Economic Outlook Update 2013).

Emerging countries provide a range of opportunities for European SMEs. These opportunities arise from the fact that some sectors of their economy are under-developed, but their internal market has significant size with increasing domestic consumption. Consumer's power is increasing and their wealth has created promising opportunities to manufacture consumer goods and to provide consumer services. The need to modernise and upgrade technology base or rapidly growing consumer markets are offering opportunities for SMEs foreign markets commitment. Fragile economic environment in Europe and weak recovery with adverse consequences for sales, investment and financial stability have highlighted the need for searching new markets providing better opportunities and growing potential. Promising emerging markets according to their demographic and economic potential are BRIC countries. However, there are many barriers related to business activities in these markets. The most significant or crucial for SMEs refer to bureaucracy, rigid labour markets, cultural differences or trade barriers. With such unfamiliar legal and cultural barriers, preferred mode of entry is to establish long-term cooperation with local partner. Local partners may provide SME with help in understanding cultural differences and may contribute to lessening political and economic risks. Cooperation with local partners can be attractive especially when it enables SMEs to utilise the specialised skills of local workers, when it allows the firm to gain access to local market, or when the firm lacks the financial resources or personnel capabilities to expand internationally. Cooperation with foreign partner can be successful market entry strategy, particularly for SMEs with limited resources and knowledge of these local markets.

Conclusion

Global crisis has triggered many economies into severe recession. Business climate has changed rapidly since 2009 and European economies are still struggling to find way out to pre-crisis growth levels. Most developed countries are experiencing just modest recovery from crisis which is discouraging business activities of firms. European economy shows insufficient GDP growth which has led to limited production, increasing unemployment and lower consumption. Improvement of productivity levels that will arise from innovation and new skills can enhance European competitiveness. SMEs have been considered one of the driving forces of economic growth due to their important role in job creation and flexibility. However, SMEs are more vulnerable to external shocks and to volatile development. Unstable economic environment forces them to adapt their strategies in order to survive current inauspicious pressures.

Small business adaptation and performance depend similarly as in case of large companies on their owners or managers and also on other stakeholders (customers, suppliers, competitors, government and others). Their ability to implement adaptation strategies is constrained by limited financial, managerial and human resources. From this point of view, the SMEs find it easier to cut the costs than to invest in order to innovate. However, adaptation decisions are contingent upon various factors, particularly upon the type of industry and product features. The possible actions during the recession period are related to

adjustments in product strategies, access to capital or labour market conditions and cost optimisation. Studies have demonstrated that both, cost cutting and revenue-generating strategies, might have positive effects on SME's performance. Gaining and maintaining of competitive advantage during recession shape the future ability of the firm to adapt in post-crisis period. There are many possibilities how to improve competitiveness of the European SMEs. Cooperation among SMEs or cooperation with foreign partners can offer the opportunity to learn how to cope with diversity and changes affecting international business environment and business climate. Cooperation generally involves the transfer of technology, processes, human skills or knowledge. The benefits of such cooperation are long-lasting and hard to imitate.

The current economic situation in Europe has underscored the need to look for new sources of growth. Third country markets, which have favourable conditions and prospects for economic recovery, can provide attractive opportunity for the EU SMEs. Emerging markets provide opportunities that range from underdeveloped sectors to significant size of their internal markets. Notwithstanding, expansion into these markets is associated with various barriers such as bureaucracy or cultural differences, their demographic and economic potential provide invaluable environment, making it possible to formulate and implement advantageous business strategy producing the desired levels of performance in the future.

To conclude, recession represents a threat and an opportunity for firms and their ability to adapt. SMEs are especially vulnerable to external shocks such as recession and are affected by many restraints due to their limited financial, managerial and information resources. One possible way how to cope with the current unstable situation might be to establish new cooperation among the SMEs or with a foreign partner. It is impossible to deal with all the issues in such a short article, but future efforts should focus on a closer examination of internationalisation processes of the SMEs and their impact on SMEs performance and their ability to adapt.

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