

## **SME's Business Development: The Sector's Perspectives in the Czech – German Border Region**

Miroslav Pavlák

*Anotace: Malé a střední podniky hrají důležitou roli v národním hospodářství České republiky. Významným způsobem se podílejí na tvorbě nových pracovních příležitostí, investic a HDP. V tomto krátkém příspěvku jsou prezentovány některé dílčí výstupy obsáhlejšího výzkumu, který byl studenty Fakulty ekonomické Západočeské univerzity v Plzni realizován na jaře tohoto roku. Výzkum byl zaměřen na posouzení přínosu malých a středních podniků pro hospodářský rozvoj oblastí v česko – německém pohraničí.*

### **1. Definition of the SME sector**

Small and medium-sized enterprises distinguish themselves, in contrast with large enterprises, with some quantitative and qualitative characteristics.

Considering the characteristics, we consider in the first place the so-called „entrepreneurial“ personality of businessmen, which comprises independence and the ability to generate a profit and to lead personnel.

Considering the qualitative characteristics, we consider the number of employees, the profit, the turnover, and the market share. As maintained by the Statistical Office, enterprises have been classified in the Czech Republic according to the number of employees since 1. 1. 1997 as follows:

- **small companies** with up to 20 employees
- **mid-size companies** with up to 100 employees
- **large companies** with over 100 employees

The following criteria are used for the classification of enterprises in the EU:

- **micro-companies** with up to 9 employees
- **small companies** with 10 to 49 employees, annual turnover under 7m ECU or annual balance of trade under 5m ECU and not more than 25% of capital held by one or more enterprises which do not meet the criteria for SME.
- **mid-size companies** with up 50 to 249 employees, annual turnover under 40m ECU, annual balance of trade under 27m ECU; no more than 25 % of the capital held by one or more enterprises which do not meet the criteria for SME.
- **large companies** with more than 250 employees

**Table 1: Small and medium-sized enterprises in the Czech Republic**

National Economy Sector	SME (%)	Employees (%)
Industry	99.37	45.62
Construction industry	99.88	76.75
Trading	99.4	81.85
Hotels and restaurants	99.4	86.87
Transportation	99.9	22.87
Banking and finance	99.71	19.23
Services	99.93	83.75
Agriculture	99.83	82.76
TOTAL	99.80	59.12

(Source: Czech Statistical Office Report 1999)

## 2. The economic importance of the SME sector in the Czech Republic

Small and medium-sized enterprises make up a major settlement of the national economy. According to figures published by the Ministry of Industry and Trade, the share of small and medium-sized enterprises in the generation from GDP grew from 31.4 % in 1996, to 40.4 % in year 2000.

In 2000, SMEs made up 99.8 % of all going concerns (incorporated companies accounting for 13.4 % and self-employed individuals for 86.4 % of this).

The share of SMEs in total employment is 59.5 % (the share of incorporated companies being 43.2 % and that of self-employed individuals 16.3 %). In total output it is 52.8 % (corporations 39.1 %, individuals 13.7 %); in added value generated it is 52.6 % (corporations 39.2 %, individuals 13.4 %); and in wage costs (without OON) 54.7 % (corporations 44.2 %, individuals 0.5 %). The share of SMEs in total investments is 40.6 % (corporations 32.6 %, individuals 8.0 %).

**Table 2: The economic importance of the SME sector (share in percentage)**

	SMEs	Corporations	Individuals
Employment	59.5	43.2	16.3
Total Output	52.8	39.1	13.7
Added Value	52.6	39.2	13.4
Wage Costs	54.7	54.2	0.5
Total Investments	40.6	32.6	8.0

(Source: Czech Statistical Office Report 2000)

In terms of their share in total employment in 2000, it was largest in restaurants at 88.9 %, in agriculture at 84.6 %, in the service sector at 82.9 %, in trading at 79.9 %, and in the construction industry at 78.5%. Below average share of SMEs in employment was in the financial sector (18.7 %), in transportation (24.1 %), and in industry (46.6 %).



In terms of added value, 2000 was most significant for small and medium-sized enterprises in the service sector (85.1 %), in trading (86.5 %), in restaurants (76.3 %), in agriculture (82.6 %) and in the construction industry (73.6 %). Below average share of SMEs in added value was in the financial sector (11.9 %), in transportation (30.0 %), and in industry (36.2 %).

Small and the medium-sized enterprises are directly involved in foreign trade. While the participation of self employed individuals is trifling since it amounts to some 0.1 % of the total foreign-trade turnover, the share of corporations is more significant. In 2000 the share of small enterprises (up to 49 employees) in exports was 14.3 % and the share of medium-sized enterprises (between 50 and 249 employees) accounted for 21.8 %. SMEs shared in 36,1 % of the total export turnover. The share of small enterprises in imports was higher, in comparison with exports, amounting to 26,4 % of the total. The share of medium-sized enterprises in imports amounted 22.9 %, a value comparable with their share in total exports. Taken as a whole, small and medium-sized enterprises shared in about one half (49.3 %) of the total imports.

**Table 3: The share of SMEs in foreign trade (share in percentage)**

	SMEs	Small Enterprises	Medium-Sized Enterprises
<b>Exports</b>	36,1	14,3	21,8
<b>Imports</b>	49,3	26,4	22,9

(Source: Czech Statistical Office Report 2000)

### 3. Description of the analysed border regions

The regions analysed in this study consist of 18 districts (NUTS IV) and are identical with the territory to which the EU's Phare – Cross-Border Co-operation (CBC) programmes have been applied since 1994.

#### Structure of the Analysed Territory

<b>NUTS II</b>	<b>Northeast</b> (only a part without the Region of Hradec Králové and the Region of Pardubice)
NUTS III	Region of Liberec
NUTS IV	Districts of Semily, Jablonec n. N., Liberec and Česká Lipa
<b>NUTS II</b>	<b>Northwest</b>
NUTS III	Region of Ústí nad Labem
NUTS IV	Districts of Děčín, Ústí n.L., Teplice, Most, Chomutov, Litoměřice and Louny
NUTS III	Region of Karlovy Vary
NUTS IV	Districts of Karlovy Vary, Sokolov and Cheb
<b>NUTS II</b>	<b>Southwest</b> (only parts of the Region of Plzeň and the Region of South Bohemia)
NUTS III	Region of Plzeň
NUTS IV	Districts of Tachov, Domažlice and Klatovy
NUTS III	Region of South Bohemia
NUTS IV	District of Prachatice

#### 4. Total contribution of SME sector to employment and income in the Czech - German border region

A dynamic development of the SME sector took place in the Czech Republic after 1989. The Czech entrepreneurs tend to set up small businesses, chiefly as services providers and the number of manufacturing companies is minimal. The growth of SMEs is thus a result of the border opening and foreign partners and investors discovering windows of opportunity here. As a final point, SMEs come into existence in consequence of large enterprises spinning off smaller firms. Such smaller firms then provide various services or supplies to larger enterprises in the region. A certain drawback is that is often their dependency on the parent company, which puts them at risk if the major buyer of their product or service experiences any difficulty.

These are also some enterprises founded as a result of the increased earnings of people commuting to work in Germany. Their high income (compared with the average for the Czech Republic) may well have been one of the impulses to set up smaller firms within the border area adjacent to Germany. Generally speaking, SMEs are concentrated in the urbanised areas (towns) and along the main roads.

We have analysed enterprises situated in the following Border Regions between Bohemia and Germany (Saxony and Bavaria):

##### a) NUTS III of Liberec

Major enterprises, at least from the employment point of view, are established by foreign investors (mostly German) in sectors such as engineering, manufacturing of car components, production of optics, textiles and glass, retail trading (large trading chains) and tourism (high capacity tourist facilities).

**Table 4: Structure of economic subjects according to number of employees in year 2001 in NUTS III of Liberec (in percentage)**

Number of employees of company	Semily	Jablonec n. Nisou	Liberec	Česká Lípa
0	65,0	45,0	64,7	60,6
1 – 5	11,3	26,2	11,6	11,5
6 – 19	2,8	2,3	3,0	3,1
20 – 99	1,2	1,1	1,2	1,2
100 and more	0,2	0,2	0,2	0,2

(In-house calculation from figures of the Czech Statistical Office as of 31. 12. 2001)

Almost 75% of all enterprises in the NUTS III of Liberec are represented by SMEs.

##### b) NUTS II of Northwest Bohemia

The level of business activities in the mining areas, with concentrations of heavy industry and in the Sokolov district (with a similar industrial structure), is still significantly lower than the average of the Czech Republic, and than the other parts of the region. This is one of the causes of the local problems, which consist in insufficient diversification and high unemployment.



The interests of SMEs are promoted and defended by the district chambers of commerce and agriculture set up by the regional chambers. Business centres also support SMEs, as well as business incubators and economic parks, which are under development. They have a very limited effect for the moment, however, because of their low number and quality. SMEs have considerable reserves for co-operation with research and development facilities, including the use of information services in support of business (for example Euro Info Centres and RPICs).

**Table 5: Structure of economic subjects according to number of employees in year 2001 in NUTS II – Northwest (in absolute figures)**

Number of employees of company	Decin	Ústí nad Labem	Litoměřice	Teplice	Most	Lozany	Chomutov	Karlovy Vary	Sokolov	Cheb	Region
0 - 9	4 210	3 152	3 855	4 493	2 118	2 700	2 876	5 448	2 462	4 200	37 514
10 - 24	460	428	444	500	393	305	422	421	254	306	3 933
25 - 99	262	238	235	216	209	161	230	187	150	174	2 062
100 - 199	76	71	51	57	59	24	57	31	24	41	501
200 - 499	27	23	17	19	18	13	20	30	12	14	175
500 - 999	11	14	4	7	12	2	10	9	3	4	76
1000-1999	4	5	1	2	2	0	2	0	0	0	16
2 000 and more	0	1	0	1	2	0	2	1	1	0	8

(In-house calculation from figures of the Czech Statistical Office as of 31. 12. 2001)

### c) NUTS III of Plzeň

Small and medium-sized enterprises were vital at the beginning of the 1990s for NUTS III - Plzeň to meet the market opportunities and to absorb the jobless. The decline of the key manufacturing sectors (engineering and agriculture) led to gradual long-running growth in unemployment, which further intensified in 1998 and 1999. Most small and medium-sized enterprises operate in the service sector as a result of the decline of the manufacturing sectors. The importance of small and medium-sized enterprises in NUTS III of Plzeň lies in the expected diversification of the manufacturing sector, forestalling economic recession resulting from the structural changes, linked to the continuous stagnation of industrial and agricultural production in the region and subsequent rise in unemployment. Although they make up most of the enterprises in the region, small and medium-sized enterprises are not yet a critical stabilising factor if the structural changes continue.

The key factor for the stability and development of small and medium-sized enterprises is their competitiveness in the local and foreign markets. This is limited by their difficult access to financial resources and by high overheads, in particular when they start up and stabilise their business or if they implement costly development projects. The standard of their management, the use of advanced technologies, the ability to expand to foreign markets, inter-company co-operation, and the use of professional associations to uphold their interests, all these are inferior to advanced foreign economies.

The description of small and medium-sized enterprises in NUTS III of Plzeň is based on the available sources, such as the records of the Czech Statistical Office, strategic materials prepared to date, and studies prepared at the local and national level. Analytical work is



hampered by the deficient company registration system, the main problem being keeping track of economically inactive enterprises.

Small and medium-sized enterprises in NUTS III of Plzeň provide approximately 50 % of the total number of jobs. To the total exports from the region they contribute less than third. The estimated share of small and medium-sized enterprises in the total regional GDP is also approximately about one third. Small and medium-sized enterprises employ in the regional industry fewer workers than the nationwide average, which is estimated at 42 %.

With respect to the nationwide average of the participation of small and medium-sized enterprises in the creation of jobs in industry, which is estimated at 40 % (Ministry of Industry and Commerce annual survey), the share of regional enterprises is smaller thanks to the existence of large industrial enterprises. In the service sector, small and medium-sized enterprises share in the total number of jobs with almost 90 %. Small enterprises are for the most part micro-enterprises with up to five employees. Small and medium-sized enterprises mostly practise a trade, work in the construction industry, provide business and technical services, and do repair work. Approximately one third of them are engaged in trading, repairs of consumer goods, restaurants and accommodation services.

For the largest part, small and medium-sized enterprises are based in the regional centres and along the developmental axes, whose attractiveness for the establishment of a business is due primarily to easy accessibility and the closeness of target markets and source capacities, including subcontractors. This trend is further strengthened by new manufacturing investments, which could bring to small and medium-sized enterprises and cooperative capacities.

The establishment and development of small and medium-sized enterprises is institutionally underpinned by a network of chambers of commerce, the Business and Innovation Centre in Plzeň (BIC), Regional Advice and Information Centres (RPICs). These institutions offer advice for the process of financial, marketing and human-resource management. Exports are supported with information channelled through the network of chambers of commerce and the Euro Info Centre, hosted by the organisation BIC in Plzeň.

**Table 6: Structure of economic subjects according to number of employees in year 2001 in NUTS III – Plzeň (in absolute figures)**

Number of employees of company	Tachov	Domažlice	Klatovy
1 - 5	5 010	1 222	1 645
6 - 19	223	317	429
20 - 49	97	114	157
50 - 99	35	51	58
100 - 499	38	33	43
500 and more	1	0	3

(In-house calculation from figures of the Czech Statistical Office as of 31. 12. 2001)

#### d) NUTS III of South Bohemia

Major enterprises, at least from the employment point of view, are established by foreign investors (mostly German) in sectors such as engineering, retail trading (large trading chains) and tourism (high capacity tourist facilities).

**Table 7: Structure of economic subjects according to number of employees in year 2001 in District of Prachatice (in absolute figures)**

Number of employees of company	Prachatice
1 – 5	1 030
6 – 19	286
20 – 49	108
50 – 99	39
100 – 499	23
500 and more	0

(In-house calculation from figures of the Czech Statistical Office as of 31. 12. 2001)

#### 5. Conclusion and Recommendations

Results of the performed survey indicate that it is useful to divide this matter into two parts.

The firms are aware of their weaknesses or opportunities and are ready to use them.

It may be therefore expected that the incurred EU funds will be used effectively and may bring along rapid effects.

These areas include the use of foreign markets. In addition to the development of the existing forms organised by CzechTrade, we recommend providing support to study stays of entrepreneurs abroad, formation of new trade missions and language training.

Another area in which the entrepreneurs are ready is the employee training. Employers are well aware of the important role played by skills of their workers, have a good knowledge of their employees and of the needs of their further professional growth, and are ready to get involved in this respect. The existing support gives priority to the education of managers. Therefore, it would be useful to provide specific support to the education of workers, organised directly by the employers.

The firms have seen good results of mutual co-operation and are ready to further develop such co-operation. There is room for special support to SME networking focused on the resolution of specific business plans.

The firms are aware of lack of capital and are not excessively indebted. This makes room for supporting further business activities of SME by simplifying access to further financial sources.

The firms are unaware of their own weaknesses and are thus not interested in support provided in this respect.

Direct EU support has and will have little effect in such cases. Therefore, we recommend focusing, concurrently with the support, also on the promotion of expected conduct of firms.

This area includes insufficient managerial education of entrepreneurs, lack of interest in innovations, lack of interest in research and development, problems with implementation of



marketing conduct of the firms, lack of interest in new places of business or in the improvement of work organisation, giving priority to current needs over long-term needs, insufficient interest in the development of human resources, lack of trust in consulting or in specialisation, and underestimating preparation for admission to EU.

We recommend creating a model of a successful SME and effectively promoting such model as a way to prosperity. Such model should be based on demonstrating that the high level of education of managers, sustained HR development, paying attention to innovations, improvement of work organisation, developing specialisation, orientation on the future, etc., are a way to business success. It could be a training program on a demonstration enterprise prepared in collaboration with universities and Chambers of Commerce and Industry in the border regions. The cross border collaboration in this project is expected. One of the output of this activity could be a handbook.

Stimulating the interest of Czech businesses in the operation in industrial zones requires the preparation of a package of support measures.

A certain specific feature in this respect is the interest of firms in the certification of their quality systems and in cross-border co-operation. The firms are interested in certification but are not aware of the connection between quality management and quality of work organisation – their interest in this aspect is minimal. Provision of further support to the introduction of quality systems may play the role of a bridge between the needs of which SME are aware and the objective needs of which they are not aware. The emphasise on the quality system is based on considering of the importance of quality products producing for their competitiveness on the European market.

The development of foreign and cross-border co-operation requires seeking other models and motives than the existing ones. It is certainly not in the interest of the Czech Republic to further base such co-operation on its cheap work force, due to which there is a number of enterprises involved in hired labour.