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THE INFLUENCE OF INNOVATIONS ON THE COMPETITIVENESS OF SMALL AND MEDIUM-SIZED ENTERPRISES IN POLAND WITHIN THE CONTEXT OF THE COMMON EUROPEAN MARKET

1. Introduction

When the European Union (EU) came into being in 1992 it was an enormous event. After many years of aspirations, it was finally possible to realise the dreams of several generations of Europeans about a 'common European home', which could ensure peace, stability, economic development and respect for human rights. Formally, the common European was a fact. Its main assumption is the implementation of four basic economic freedoms which concern the flow of commodities, people, services and capital. This has advanced European integration, especially by strengthening economic and political ties. Integration has created huge opportunities for development on one hand, but on the other hand, it has posed bigger challenges to all subjects, both macro- and microeconomic, under its influence. These opportunities are the result of the opening of national economies, which creates possibilities for growth in the volume of international exchange, or inflow of foreign direct investment. This should create a growth in the economy of the individual regions (countries) within the EU and an increase in the wealth of their citizens, which, however, creates the necessity of increasing economic competitiveness.

This issue was addressed by the Lisbon Strategy in 2000, which has the goal of changing the EU into the most competitive knowledge-based economy by 2010, capable of ensuring balanced development and a higher level of employment, as well as maintaining socio-economic cohesion. These aims were later supplemented in 2002 by the so-called Barcelona principles, according to

which an increase in expenditure on research and development to 3% of GDP and a significant increase in investment from the private sector are priorities. Poland faces a similar challenge. Having become a member of the EU in 2004, Poland committed itself to eliminate the differences between itself and the EU in many areas of socio-economic life.

Now, after two years of membership, despite certain economic successes, there is still much to do. One of the crucial tasks, which every successive government will face, is to increase the competitiveness of the Polish economy in Europe. Constantly increasing the level of innovation will make it possible to realise this goal. On a micro-scale, this means that companies should take actions to improve technical, technological and organisational solutions, in order to make their functioning more effective. The necessity of increasing competitiveness through innovations is the result of some important factors. The decrease in the meaning of geographical location and low labour costs, together with increased access to the majority of resources and European integration are among the most significant factors. In such a situation, Poland ought to seek a competitive advantage in areas closely connected with the development of an economy based on innovative knowledge. These are education, science, as well as research and development, together with promotion of industries based on advanced technologies and the development of a computerised society. European integration creates big opportunities.

However, one should remember that the transfer of knowledge does not occur automatically. There must be conditions which will enable this. At present, the most important condition seems to be the need for entrepreneurs and scientists to realise the importance of innovation. In consequence, the attitude towards innovation and its meaning in the process of the development of a company will change. Developing their belief in innovation as an important factor shaping the competitiveness of a company in both the domestic and international market is the most significant task for the near future. Small and medium-sized enterprises (SME) should play a big role in this process, because of the great number of such firms, as well as the share of GDP and employment they generate. They are more flexible in adapting to market conditions. However, they possess little capital, which may be insufficient to carry out (innovative) research and development. Hence, there is a need to support research and development by increasing access to external sources of funding. The structural funds for the years 2007–2013 offer quite big opportunities to SME. Their use depends on the companies themselves.

The main aim of this article is to analyse the level of innovation of SME in Poland in the context of the effect of the common European market on increasing the competitiveness of this sector.

2. Competitiveness as a source of the development of Polish SME in the common European market

Many entrepreneurs in the SME sector considered Polish accession to the European Union in 2004 as a serious danger to them. According to the survey conducted before accession, only 27.8% of businesses regarded it as a beneficial process [Starczewska-Krzysztozek, 2006]. The others thought that it was not very advantageous. This deep scepticism was a result of uncertainty and fear of increased competition in the common European market. However, their fears failed to materialize. Recent data taken in 2006 show that integration has not, in general, brought about negative changes in various economic measures *e.g.* receipts, profit or access to capital (see Figure 1).

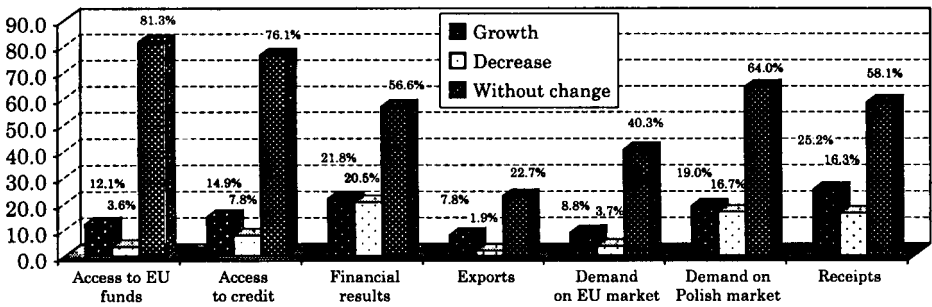


Fig. 1. The results of Polish accession to the European Union as of 2006

Source: based on: Starczewska-Krzysztozek, 2006.

These data clearly show that access to the EU has resulted in a growth in revenues and has had other positive financial effects within the SME sector, which was undoubtedly the consequence of a much higher demand, both in the EU and domestic markets, for produce manufactured by this sector. This is reflected in the fact that 53% of the Polish firms questioned exported to other EU countries. The only (according to the entrepreneurs) negative consequence of joining the EU is increased competition (30% of the companies questioned stated this). A decrease in prices (24.3%) and increase in business costs (44.7%) were causes [Starczewska-Krzysztozek, 2006]. The investments being undertaken show the level of competition and its structure. In 2005, 57.3% of the firms questioned made investments to develop their business, which was higher than in the previous year by about 17%. Gradually rising awareness among entrepreneurs, the significance of investments in the development of the company and an upturn in the economy, which lowered the level of investment risk, may be regarded as a cause of this growth. Expenses connected with acquiring capital goods are the most frequent investment activity (see Figure 2).

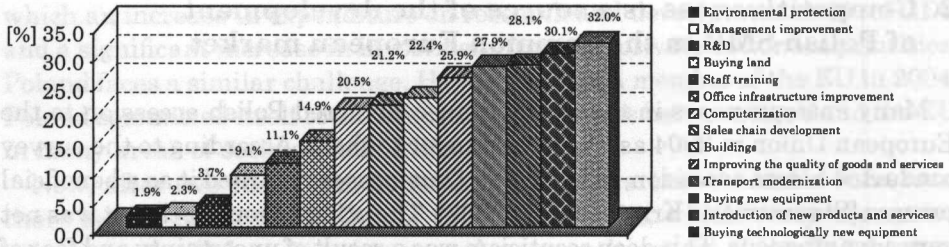


Fig. 2. Investments undertaken in the SME sector in 2005

Source: *Monitoring the Financial...*, 2006.

According to the data given above, investments in new technology were the most significant, accounting for about 30% of investments. The remainder includes modernization, staff training, computerization and sales chain development. It is worth mentioning that only a small minority of SME stated that they conducted R&D, 3.7%. Obviously no one should expect that this kind of activity will have a high share of investment in the SME sector. However, the small proportion of companies which decide to conduct research shows the small amount of interest in this area, due to the risk involved and the time required before results are achieved. Also, the lack of cooperation between scientists and industry, as well as the lack of state financing for research, is a reason for a lack of interest from the SME sector. Moreover, firms limit their costs and are not willing to create their own research centres, which seems justified. Unfortunately, the lack of appropriate financial sources and legal solutions does not support research which could lead to future profits. Data show that the majority of investment is spent on the direct purchase of innovations from external sources, mainly imported. In 2004, as much as 87% of all investment was based on the purchase of new technology and, depending on the region of Poland, between 18% and 49% of this expenditure was on goods that had to be imported. The rest was spent on goods of Polish origin, which may indicate that the majority of useful innovations already exist on the Polish market. Software, instructions or education connected with the introduction of innovations account for the smallest share in investment, 2% respectively. This may indicate a low level of awareness of entrepreneurs, who think that new machines and equipment are sufficient to be competitive [Żołnierski, 2006].

Here, it seems necessary to show clearly which factors are most frequently emphasized by entrepreneurs as determinants of competitiveness. The first is price. Its meaning has increased greatly in recent times and it appears that this will not change over the next few years (see Figure 3).

Such an attitude may arise for various important reasons. Firstly, entrepreneurs are forced to sell their products in the EU at low prices, because of the low level of their innovative development. Secondly, the process of the

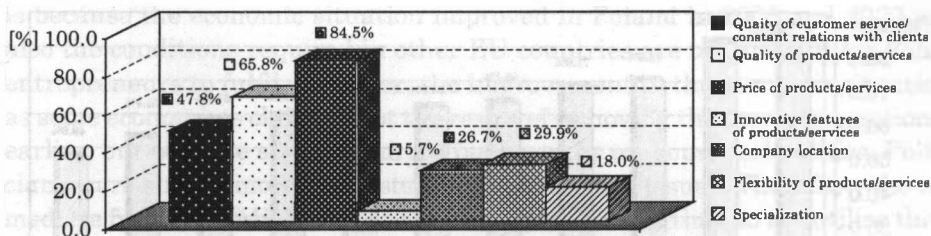


Fig. 3. Factors that influenced the competitiveness of Polish business in 2005

Source: based on: Starczewska-Krzysztozek, 2006.

diffusion of innovations into Polish companies is too slow. Therefore, price becomes the most important argument to attract clients. Thirdly, expansion into developed EU markets forces Polish manufacturers to use indirect channels of distribution. In practice, this means that the price must include the middleman's margin. Very often big companies play this role selling their own products in their own countries under their brand names. Thus, they dictate prices. Although this factor appears to be significant, companies should be encouraged to be innovative, because a strategy based on low prices is short-term as Asian companies, especially from China and India, have a growing advantage. Other factors that increase competitiveness are also important and their meaning should rise in the near future. These are the quality of customer service, the quality of products, specialization and flexibility. In practice, this requires changes in the style of management, oriented at a deep reformation of working practices and the introduction of new systems.

Having presented the main determinants of competitiveness, it seems necessary to consider the factors which decrease the level of competitiveness in Poland (Figure 4).

Among these factors, high labour costs and taxes are the greatest problem for Polish companies. Both these factors have a negative impact on the competitiveness of SME and restrict their opportunities and access to credit. These high costs of functioning make entrepreneurs less willing to invest in, for example, innovations. According to studies it seems necessary to pay attention to the fact that some companies are not treated fairly. This means that there is a chosen group of companies which are favoured by the authorities. Moreover, there also exists a so-called 'grey' market in Poland, which is competitive, due to the high financial burdens placed on companies by the government. It is possible to increase the competitiveness of Polish businesses in the course of a few years by decreasing taxes, making labour laws more flexible and imposing restrictions on the "grey" sector. Most respondents considered the political situation to be a huge obstacle in the development of their company, as well as its competitiveness. More than 49% of respondents emphasized the

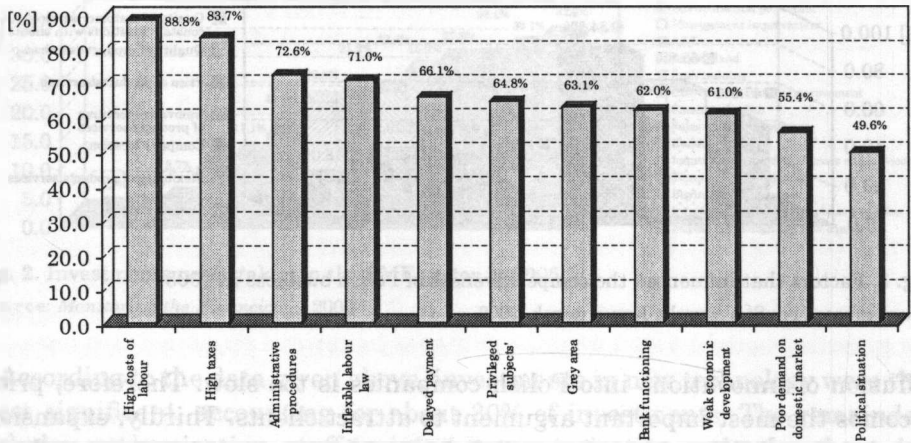


Fig. 4. Factors that weaken the competitiveness of the SME sector in Poland

Source: based on *Monitoring the Sector...*, 2006.

lack of political stability, which may be a serious impediment in the decision making process. This is the result of uncertainty in predicting the economic future. Therefore, entrepreneurs are not willing to invest, because of growing expenses. The political situation makes SME consider the possibility of locating their business in another EU country. About 6% of the companies surveyed take this possibility into account and 19.3% say that the main reason for a lack of competitiveness is the lack of political stability in Poland (Figure 5).

These data indicate the significance of economic stability. It should be emphasized that there is a close link between the political situation and the economy. One might expect that a political improvement would positively influence economic stability, which will make entrepreneurs stay in Poland. At present the number of companies wishing to relocate is decreasing fast. This

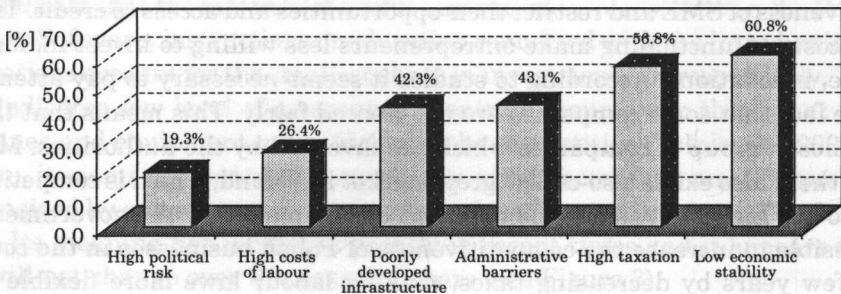


Fig. 5. The most common reasons for wishing to relocate a company from Poland to another EU country in 2006

Source: based on: Starczewska-Krzeszotoszek, 2006.

is because the economic situation improved in Poland in 2006 and 2007 and also the conditions required in other EU countries are too difficult for Polish entrepreneurs to fulfil. However, the improvement in the economic situation, as some economists claim, is not the result of removing the barriers mentioned earlier, but because a split occurred between the economy and politics. Politicians were simply more interested in non-economic issues. Therefore, the immediate future of SME belongs to the entrepreneurs. If they do not utilize these favourable conditions for development before 2013, they might squander their opportunity of make their position in the EU market stronger. In the process, the meaning of such an important sector for the economy will decrease, making the general economic situation in Poland worse.

3. Innovations as a source of development of the Polish SME sector in the common European market

Data and numerous reports prepared by international organizations show a significant difference between the levels of economic innovation in Poland and in the most highly developed EU countries. The innovation indicator for Poland in 2005 was 23% and clearly below the EU mean. This gives Poland 25th place in Europe (Figure 6).

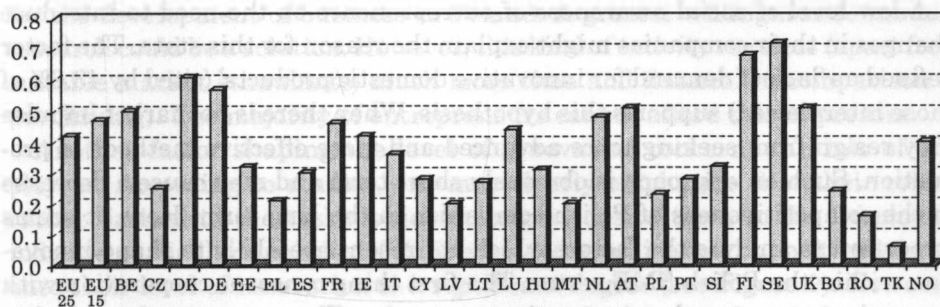


Fig. 6. Poland's innovation indicator in comparison with selected European countries

Source: based on: *European Innovation Scoreboard...*, 2005.

A lack of means, difficult access to external sources of financing, high costs of innovations, a lack of need to innovate, uncertain demand and rising competitiveness, difficulties in seeking suitable partners for cooperation, a lack of information about technology, the market and new methods of management are all factors, which limit the development of innovations in Poland to a large extent. Of these factors, one should pay attention to a lack of information about new methods of management. In practice, this means that a large number of

entrepreneurs do not know anything about innovations on the Polish market. The reason for this might be a weak flow of information between those who take an active part in the process of introducing new solutions into the economy within the SME sector (Figure 7).

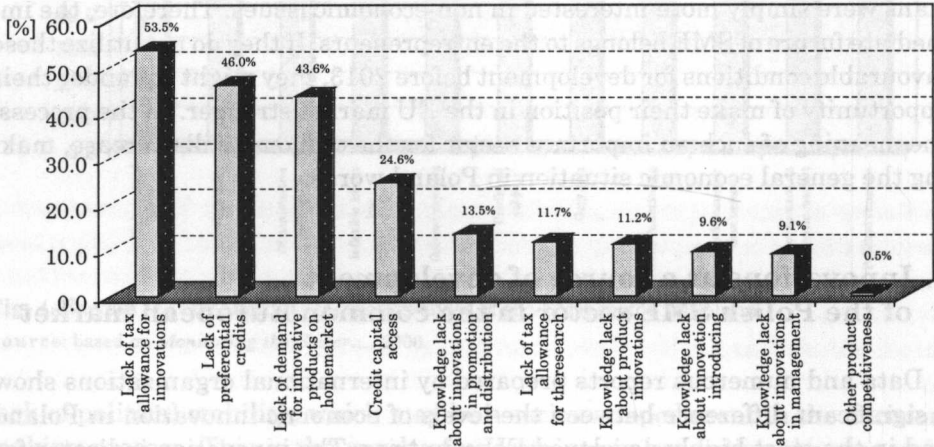


Fig. 7. The factors that weaken innovation within the SME sector in Poland

Source: Based on: *Monitoring of the Small...*, 2006.

A low level of social awareness of entrepreneurs on the need to introduce changes in their companies might explain the reason for this state. The factor defined as 'lack of demand for innovative domestic products' (cited by 43.6% of those interviewed) supports this hypothesis. When there is no market impulse they resign from seeking more advanced and more effective methods of production. Such an approach is obviously short-term and may cause a decrease in the competitiveness of Polish companies in the long term. Here, it seems important to analyse the factors which at present are likely to shape innovation within the Polish SME sector. The first thing concerns cooperation with research centres or other innovative companies. The survey conducted after Polish accession to the EU (at the turn of 2004 and 2005) shows that only 36.7% of companies cooperated with other companies from the same sector. Between 1.4% and 6.4% companies cooperated with companies from various other sectors. The level of exchange of experience between Polish companies and those from EU was lower (between 0.2 and 5.0%, Figure 8).

The leading cooperators are those connected with education (6.2%), financial mediation (8.1%), or the construction industry (8.8%). This is due to the fact that they have to purchase foreign technologies, which are often sold later on the Polish market to other companies, not within the SME sector. But this kind of cooperation does not serve to improve their level of innovation. It has

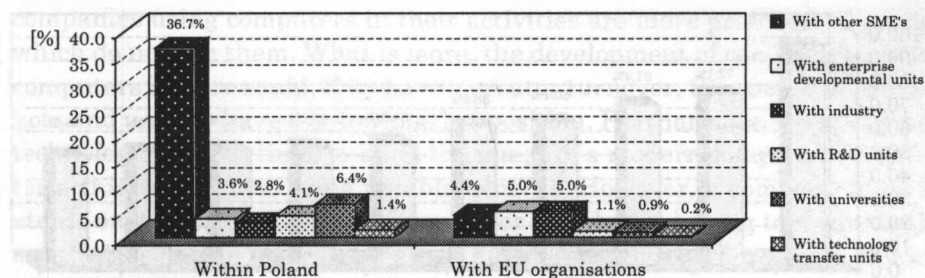


Fig. 8. Cooperation of Polish SME with innovative units

Source: Based on Żolnierski, 2005.

only a commercial goal (they mediate in sales) and is short-term, which is not very developmental.

Because external sources, *e.g.* universities, that transfer innovative solutions are over-exploited (companies carry out a low level of research), an analysis of their usefulness was conducted. Again in this case, many companies presented unwillingness to cooperate (approx. 75%), while others emphasized the need for education (approx. 18%). The following were the next most common: purchase of equipment (1.3%) and technology transfer (buying licences and patents – 0.05%). This data indicates the lack of interest in introducing technical, management and product innovations, as well as in their meaning for the development of business in Poland. A greater willingness to conduct research could be a solution. However, this kind of activity requires (apart from suitable market stimulants) much more time and finance (in comparison to purchasing). The majority of entrepreneurs cannot afford this at present.

Another factor shaping the level of innovation concerns the role of employees. According to studies, one may clearly emphasize that their role is rather limited to the tasks which managers desire them to do. Employers indicate particular qualities of their employees, which might positively influence their level of innovation to a significant degree (see Figure 9). However, this research also shows that the percentage of employees fitting the image of a modern company does not exceed 8%.

The conclusion is that the meaning of employees in the implementation of innovative projects is irrelevant. This approach is definitely wrong, since placing emphasis on profitability and the level of economic risk without considering the possibilities of the effective engagement of human resources in the process of realizing a project (connected with a suitable system of motivation) may not guarantee market success.

The last (analysed) factor which shapes the level of innovation in business is the use of information and telecommunication technology. The state of the SME sector is not good in this area either. Considering the meaning of

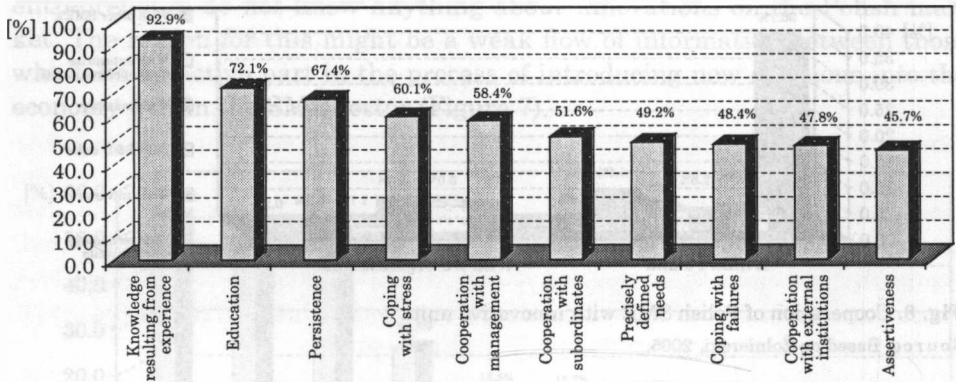


Fig. 9. Employee traits which affect the level of innovation

Source: based on: Żolnierski, 2005.

computers in the management process, not only the number of computers in a company, but also their utilization is important. This requires appropriate software and access to the Internet.

Micro businesses most commonly do not use the Internet in their activities (17%). The number of companies which utilized computers in their work was 93% in 2005 and in comparison with 2004 it had increased slightly by about 1%. Also in 2004 the number of companies using the Internet was 87% and compared to the previous year it had grown by about 2 percentage points [Żolnierski, 2005].

Although the percentage of Polish companies using computers and the Internet to carry out their business activities is high, big companies are the most common users (41%). For small and medium-sized enterprises this figure equals 26%-28. As far as different economic sectors are concerned, the Internet is most commonly used by the financial mediation and computer science sectors (96% and 95%, respectively). In the remaining sectors this percentage equals approximately 47% [Operation Programme..., 2006]. A higher level of utilization of computers in business may create new models of companies based on the Internet. Such companies do not have warehouses or registered offices, which explains their diverse nature and the common lack of a defined structure. They are based on connections between the place where a contract is signed and the place where goods or services are produced. This cuts costs and makes a company more competitive. A relatively small number of firms in the SME sector are able to use computers. A lack of funds and external sources of finance may well explain this phenomenon. A company's fixed capital and profit often does not allow it to invest in available computer technologies. Moreover, such companies do not employ enough employees able to value the usefulness of e-business and introduce its latest solutions. Studies reveal that

companies using computers in their activities are more profitable than those which do not use them. What is more, the development of companies utilizing computers is more rapid, they have a greater turnover, they act in bigger markets and usually have a better market position. Furthermore, using computer technologies allows them to build the image of a modern company. In the long term this should also bring notable benefits. However, a company must create its own website. The greatest number of websites belong to medium-sized enterprises and in the case of small businesses, those where there are well-educated managers. It seems that education has a great impact in increasing their awareness as far as innovative management solutions are concerned.

4. Conclusions

Obviously, because of limited space, it was not possible to discuss all aspects concerning the competitiveness and level of innovation in the Polish SME sector. However, the studies conducted reveal that this sector is not very innovative. There are many explanations of this fact. Firstly, there is a lack of finance. Secondly, entrepreneurs are unwilling to finance innovations which seem specific to the Polish market. But since the economy has opened up to external impulses and, moreover, the situation in Poland is improving, Polish firms may change their attitudes towards innovations. We can only hope that innovative development will not start too late and Poland will be able to catch up. Also, the Polish government's awareness of the business environment seems important. Apart from good intentions, the government is expected to introduce all the necessary decisions resulting from the plans and programmes concerning the strategy for developing innovation in Poland included in 'Ways of increasing innovation in the economy in 2007-2013'. The main task of the government is to subordinate all economic and social policies to promote innovation. Hence, on one hand, the document coordinates all these areas and, on the other hand, it ensures accordance with all the crucial strategies of the national government and the EU. New instruments serving the development of innovation were introduced in this document, as there exists the necessity of coordinating actions and it is known that enterprise should be the final beneficiary. There is hope that the main goals of this document will be accomplished thanks to the structural funds available to Poland up to 2013.

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