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Internationalisation and SME development in transition economies: An international comparison

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ABSTRACT

This paper is concerned with the effects of internationalisation on SMEs in countries that are becoming increasingly affected by market integration at a time when their economic structures are going through a process of radical transformation. Empirical data are drawn from recent surveys of SME managers in the food and clothing industries in Poland, Bulgaria and the Baltic States, which is compared with the results of similar surveys in the UK and Greece.

The results show that the ability of SMEs in transition countries to compete in foreign and domestic markets, varies between sectors. In food processing, although some SMEs have been able to penetrate foreign markets, the main effect so far has been to increase the level of competition in domestic markets. The evidence shows that foreign market penetration by food processing SMEs in transition countries is often focused on markets in other transition countries rather than in Western markets.

In the clothing industry, the effects of internationalisation are different because of the highly internationalised nature of the clothing market and the production system that supplies it. In this context, SMEs in countries such as Poland and Estonia particularly, have been able to attract subcontract type work from Western countries, based on their relatively low labour costs. However, as the Greek experience demonstrates, this type of production can be very volatile, disappearing almost as quickly as it is secured.

Despite detailed differences between countries and between sectors, the evidence shows that in all the Central and East European countries (CEECs) featuring in the study, some SMEs in the emerging private sector are responding to new foreign market opportunities and, in the short term at least, managing to achieve competitiveness. However, there is also evidence that their current basis of competitiveness in foreign markets contains weaknesses which may affect their ability to sustain their export effort in the longer term.

As far as SME managers in transition countries are concerned, the main priorities for government action to improve their ability to increase foreign market sales are assistance with export promotion and a reduction in the level of domestic taxation. The survey results show that although a significant minority of exporters in transition countries had been using external assistance to support their export effort, this was typically either on a fully paid for basis from consultants or informally from other firms or business associates rather than from trade organisations or formal business support organisations.

MANAGERIAL AND POLICY IMPLICATIONS

- The ability of SMEs in transition economies to compete internationally varies between sectors, as well as between countries.
- The volatility of subcontract work in the clothing industry is illustrated by the fact that in some CEECs (eg Poland), SMEs have already started to lose out to cheaper labour producers in other transition countries (eg Ukraine).
- Home market conditions can be an important

factor encouraging firms to look for foreign market sales: in Estonia, the small size of the domestic market and a liberal trade policy have been key factors; in Poland, the increasing competition in the domestic market is a key driver.

- An over-emphasis on price-based competition may be difficult for SMEs to sustain in the medium term.
- There is a consistently high level of demand from SME managers in the transition countries surveyed for assistance with export promotion.
- Increasing the marketing capability of SMEs in all countries surveyed is a priority as part of a strategy to make their export effort more sustainable.
- In the medium term, upgrading production technology and quality standards is central to the ability of food processing SMEs to compete.

KEY WORDS

Internationalisation, small and medium enterprises, transition economies, SME policy, competitiveness

INTRODUCTION

During the 1990s major changes have taken place in the external environment for European business. Increasing market integration in western Europe associated with the Single European Market combined with the effects of the transformation of Central and Eastern Europe (CEE), has potential implications for both east and west European firms. In addition, at a global level the gradual liberalisation of world trade expands the scope for an intensification of competition on a world scale.

For firms in Central and East European countries (CEECs), an additional problem has been the pace with which they have been exposed to market competition and the need to achieve a rapid re-orientation of markets to replace those lost in the former Soviet Union (Bradshaw et al., 1993). Moreover, in the early stages of transition particularly, the limited scale and scope of domestic demand is an additional push factor encouraging firms to look for foreign market opportunities. In the case of some CEECs (such as Poland and Estonia), the implications of increasing internationalisation is of particular policy significance in view of their likely accession to the EU in the future. Within this context, the development of a competitive export base is vital in order to eliminate old dependencies and to stimulate economic development in transition economies.

Although in theory all efficient businesses can take advantage of new opportunities and respond to threats from increasing internationalisation irrespective of their size, in practice there is concern that smaller businesses will lose out (Rosa and Scott, 1992). This is because of a number of size-related characteristics that may affect their ability to identify, cope with and respond to new sources of threat and opportunity. Smaller firms face a higher level of uncertainty in their external environment compared with larger firms. They have a more limited resource base, as well as a combination of ownership and management that often produces a distinctive set of behavioural characteristics in smaller companies.

The project on which this paper is based has been concerned with the effects of a variety of internationalisation processes on SMEs, as well as managers responses to them (Smallbone, 1998), although this particular paper focuses on the effects of the internationalisation of markets. While the main focus of the paper is on SME development in transition economies, the inclusion of survey data from the UK and Greece in the study, enables some comparisons to be made where appropriate.

In seeking to investigate the effects and implications of internationalisation on SMEs, the project has focused on two sectors: food processing and clothing. This provides a basis for comparison across a range of different national contexts, since it acts as a control for certain external environmental influences. The food processing and clothing sectors were selected because of the contrast in the existing levels of internationalisation in these industries, which has potential implications for the types of strategy that SMEs need to develop as internationalisation increases. This is because it is the structural characteristics and trends at the sectoral level that affect the potential sources of competitive advantage for SMEs, and thus the types of strategy that managers use to compete. Another reason is that in combination they represent a significant part of manufacturing employment and output in each of the transition countries surveyed.

The empirical data on which the project is based consist of 377 face-to-face interviews in Poland (120), Bulgaria (135) and the Baltic States (122), plus a further 50 in Greece and 101 telephone interviews in the UK. The interviews were conducted in the summer of 1997 using a harmonised survey instrument, although the use of telephone methods in the UK meant that not all questions could be included. Nevertheless, it is possible to make a direct comparison between these countries, based on recent survey data. As well as conducting surveys of SME managers, secondary data sources and key informant interviews were also conducted in each country. These were used to identify the existing levels of internationalisation in the two sectors, any evidence of change that is occurring in this respect, the role of SMEs within the sectors and the main elements in the business support infrastructure, particularly those concerned with providing export support.

To be eligible for inclusion in the study, firms needed to be at least 51 per cent private and domestically owned, trading for at least one year, and employing 100 or less, at the time of the survey. Firms were selected for inclusion in the survey using a two-stage methodology. A short filter questionnaire was administered initially in order to establish eligibility for inclusion in the second stage survey. As well as meeting the specified eligibility criteria, firms that were interviewed in the main survey needed to be affected by, and/or involved in, one or more of the main dimensions of internationalisation included in the study. These were: exporting; experiencing competition from imports in the domestic markets; foreign capital involved in ownership and/or foreign direct investment by the firm itself; a joint venture or collaboration with foreign partners; and having managers with experience of management either abroad or in a foreign company. In order to facilitate comparison with the other national samples, in each country we aimed to include a similar proportion of firms in each of three size groups (ie 1–20, 21–51, and 51–100) and also a similar proportion of firms in the two sectors.

The rest of the paper is structured around three key questions, which are answered with data drawn from different sources:

(i) To what extent have SMEs in the food and clothing industries in Poland, Bulgaria and the Baltic States been able to compete successfully (a) in foreign markets and (b) with imported goods in the domestic market?
(ii) What is the basis of the competitiveness of surveyed firms in foreign and domestic markets? How does this compare with similar SMEs in the UK and Greece? To what extent are the strategies being employed by managers sustainable?
(iii) What are the main implications that emerge from the analysis (a) for public policy and (b) for management strategies at the micro level?

Each of these questions is considered in a separate section below.

COMPETING IN FOREIGN AND DOMESTIC MARKETS

Foreign markets

At the micro level, competitiveness can be assessed by examining the performance of firms over a period of time, to see to what extent they have been able to preserve or enlarge their market

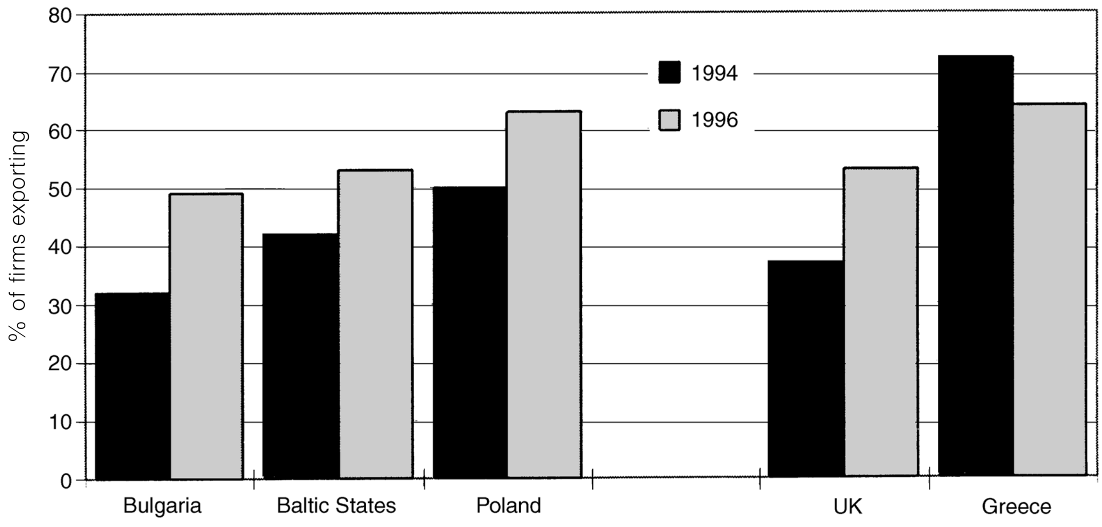

Figure 1: Proportion of surveyed firms that were exporting in 1994 and 1996: food sector

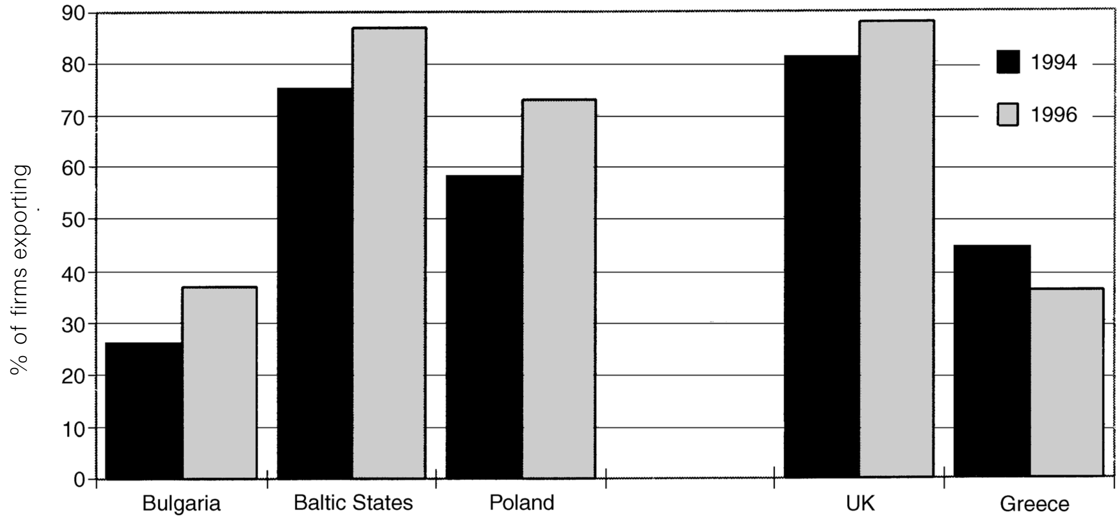

Figure 2: Proportion of surveyed firms that were exporting in 1994 and 1996: clothing sector

shares and, in the case of export markets, by their ability to increase their foreign market sales. Referring to the SMEs surveyed in the transition countries in 1997, the proportion of exporting firms increased from 48 per cent in 1994 to 60 per cent in 1996; or from 54 per cent to 67 per cent in Poland; 59 per cent to 70 per cent in the Baltic countries; and from 28 per cent to 42 per cent in Bulgaria. Figures 1 and 2 show a more detailed pattern of change during this period at the sectoral level.

While the sampling procedure used to include firms in the survey means that the proportion of exporting firms is higher than would be found in a random sample from the SME population, the results show that an increasing proportion of surveyed firms had been able to generate some foreign market sales during the study period. This suggests that, in the short term at least, these firms had been able to achieve competitiveness in foreign markets. While a similar pattern is apparent among UK firms, the proportion of Greek firms that were exporting actually decreased between 1994–96, from 58 per cent to 50 per cent.

However, while the proportion of surveyed firms engaged in foreign markets typically increased between 1994–96, the extent of foreign market involvement by individual exporters was more variable (both between countries and between sectors), although as far as firms in transition countries were concerned it more commonly decreased than increased. In the clothing industry for example, the median proportion of total sales generated abroad decreased in Poland from 55 per cent in 1994 to 40 per cent in 1996, and from 70 per cent to 55 per cent in Bulgaria. However, in the Baltic States the median proportion of total sales generated abroad remained steady at 90 per cent, reflecting the limited size of the domestic market and the high level of subcontract-type relationships between Baltic SMEs and foreign companies in this industry. By contrast, UK clothing exporters were typically generating a much lower proportion of their total sales abroad in 1996 than their counterparts in the other countries featuring in the study (median of 27 per cent), although their penetration of foreign markets typically increased between 1994–96.

The explanation is that clothing SMEs in all surveyed countries during the 1994–96 period (particularly those involved in foreign subcontracting) experienced considerable fluctuations in demand, reflecting the highly competitive and international nature of the clothing market. The emphasis placed on price competition in this market means that contractors are continually looking for cheaper sources of supply. While this has affected some of the countries featuring in the study (eg Poland, Greece) more than others, SMEs in all countries have been affected (including the UK). However, the UK sample of clothing SMEs is different to those in the other countries in that they show a higher propensity to have their own products, rather than producing on a subcontract basis for other companies, and to be emphasising non-price factors in the way in which they attempt to compete. Moreover, where UK firms were engaged in international subcontracting, it typically represented a smaller percentage of total sales than in their counterparts in CEECs.

Food processing exporters in the transition countries were typically less dependent on foreign market sales than their counterparts in clothing, with only small variations between the transition countries surveyed. However, whereas Polish food exporters had typically increased their penetration of foreign markets during this period, in Bulgaria and the Baltic States there was a sharp fall in the median sales generated abroad. Of those countries featuring in the study, Greek food processing exporters were the most highly orientated towards foreign markets, which mainly reflects the inclusion of firms in the sample exporting tinned fruit and olives to traditional European markets (such as to Germany and the UK) and to the USA. By contrast, UK exporters in the food processing sector typically exported a very small proportion of their total sales (median 5 per cent), although a small minority of UK firms were generating a majority of their sales abroad.

In terms of export destinations, markets in Russia and CIS countries remain important for exporting SMEs in the CEECs featuring in the study, particularly in the case of food processing firms. At the same time, there were detailed variations between countries which mainly reflected a tendency to trade with neighbouring countries, such as Germany in the case of Poland, or Nordic countries in the case of the Baltic States. In clothing, SMEs were more involved in Western markets than in the case of the food industry, although this often involved highly dependent subcontract type relationships. Not surprisingly, surveyed firms in Greece and the UK were more orientated towards Western markets than their counterparts in CEECs, particularly to markets in other EU Member States.

We have also specifically examined the extent to which SMEs in transition economies have been able to access non-CEE markets. In food processing, the proportion of SMEs in transition countries that were exporting to Western markets in 1996 was less than half the proportion that were exporting to all markets (24 per cent compared with 56 per cent). In clothing, comparable figures were 48 per cent and 64 per cent, indicating the greater difficulties which food processing SMEs from transition countries have had in penetrating Western markets, compared with their clothing counterparts.

Domestic markets

Although the proportion of firms involved in foreign markets may have been increasing during the study period, domestic market conditions continued to be a major factor influencing the overall performance of surveyed firms. For example, in the transition countries, 40 per cent of surveyed firms were completely dependent on their domestic markets for sales in 1996, although this varied from 58 per cent in Bulgaria to 33 per cent in Poland and 30 per cent in the Baltic States. In Greece, half the surveyed firms were entirely domestic-market orientated and in the UK the equivalent proportion was 30 per cent.

When the SME managers in the transition countries were asked to describe the pattern of demand trends between 1994 and 1996 and the level of competition in domestic markets, their responses revealed a considerable variety of market environments that reflected variations in local/regional and national market conditions, as well as differences between sectors. As far as the food industry is concerned, Polish and Bulgarian food-processing SMEs appear to have faced particularly difficult domestic demand conditions during this period, whereas Baltic SMEs in this sector typically rated their domestic demand trends more positively. This reflected a growth in the food market in Baltic countries in the study period, particularly in Estonia. However, competition appears to have been particularly strong in the domestic market in the food processing sector in Poland and the Baltic countries, although rather less so in Bulgaria where the pace of privatisation and SME development has been slower than in some of the other countries (particularly in Poland).

In the clothing sector, domestic demand trends were typically seen as more difficult than in food processing, although competition in the domestic market appears to have been less intense in this sector by SMEs across the transition countries. At the same time, there were some variations between countries. Bulgarian clothing SMEs appear to have had very limited opportunities for sales growth in the domestic market, although strong competition was less commonly reported than in the other countries surveyed. Polish clothing firms also faced limited opportunities for domestic sales growth although in this case, intense competition, was an additional factor. Baltic clothing SMEs appear to have faced the most encouraging domestic demand conditions during the study period since almost half the managers surveyed described domestic demand as 'growing' and a majority described competition as 'moderate' or 'weak'. However, more detailed analysis showed that this was almost entirely a result of the recent buoyancy in the Estonian market.

On the basis of these results, the depressed state of domestic demand conditions would appear to be one of the drivers encouraging Bulgarian firms in both sectors to look to develop foreign markets. Polish firms would also appear to have considerable incentive to seek foreign markets because of domestic demand trends, although in this case the level of competition in the domestic market was an additional driver. The more open nature of the Polish and Baltic economies compared with Bulgaria, combined with the more rapid pace of SME development in Poland and Estonia, has contributed to a high level of competition for domestic sales in these markets.

Managers were also asked about the main sources of competition that they face in their domestic markets (Table 1). As far as the transition economies are concerned, while other private domestic firms were the most commonly mentioned source of competition in the home market, imports were one of the three most commonly mentioned sources in both sectors. In fact, in the Baltic States, imports were mentioned as a source of competition by the vast majority of SMEs in both sectors, reflecting the relatively open nature of the small Baltic economies.

The highly internationalised nature of clothing markets is illustrated by the fact that in all transition countries surveyed, imports were a more frequently mentioned main source of competition than they were in the food industry. Indeed, in Poland imported goods were the most commonly mentioned source of competition by clothing SMEs and in the Baltic States four out of five firms in this sector reported competition from this source. The pattern is even more pronounced in Greece where imports were mentioned as one of the three main sources of competition by 90 per cent of clothing SMEs. In the UK, imports were the second most commonly mentioned source of competition by clothing SMEs after other small domestic firms.

Managers of firms that had identified imports as one of the three main sources of competition in domestic markets were asked about the main sources of this (Table 2). In the food processing industry, Germany was one of the most consistently mentioned sources of competition in all the transition countries surveyed, although in Estonia, other Nordic countries were also prominent. Competition from other CEECs did not appear to be significant in the domestic markets of transition countries surveyed in this sector, with the excep-

Table 1: Managers' assessment of the main sources of competition in domestic markets

	Food						*Clothing*					
Sources of competition	*UK* %	*Gr.* %	*CEEC* %	*Bu.* %	*BS* %	*P* %	*UK* %	*Gr.* %	*CEEC* %	*Bu.* %	*BS* %	*P* %
Small firms	44	32	72	78	75	64	63	42	64	58	82	58
Large firms	60	68	56	41	64	61	41	58	45	42	43	54
New entrants	2	0	17	16	3	31	2	5	8	9	9	6
Unregistered firms	0	0	14	6	24	13	0	5	29	21	25	48
State-owned firms	0	0	15	33	9	8	0	0	13	18	7	8
Imports	21	36	46	22	70	41	45	90	62	52	80	62
Other	21	0	2	10	0	0	14	0	1	1	0	0
Total no. respondents	48	22	169	49	59	61	49	19	170	77	44	48

(i) managers were asked to identify up to three main sources of competition.
(ii) Gr. = Greece; CEEC = Central and East European Countries; Bu. = Bulgaria; BS = Baltic States; P = Poland.

Table 2: The most frequently mentioned sources of competition from imported goods

Country	*Food*	*Clothing*
Poland	Germany	China Turkey Italy S. Korea Thailand
Bulgaria	Greece Turkey Germany	Turkey Greece China
Estonia	Finland Denmark Latvia Sweden Germany	China Finland Italy
Latvia	Germany Netherlands	Turkey Finland Germany Lithuania
Lithuania	Germany Poland Netherlands	Germany Italy
Greece	Northern Europe (UK, Germany, Norway, Denmark, Switzerland) Mediterranean countries	China Taiwan Italy UK Bulgaria Poland Czech Republic
UK	Other EU states (particularly Netherlands)	Bangladesh India China Hong Kong

Each manager was asked to name up to 3 countries as sources of the strongest competition in domestic markets.

tion of Lithuania, where Polish food products were seen as a source of competition by a significant number of domestic SMEs, and Estonia, where Latvian products were mentioned by a significant minority of domestic producers. Indeed, one of the consistent trends in this sector was the tendency for imports from neighbouring countries to be seen as a source of competition by domestic firms, reflecting the tendency for consumer tastes in food to show 'regional' variations.

However, there was a different pattern of response in the case of the clothing industry where low labour cost countries in the Far East and Turkey were frequently mentioned by SMEs in transition countries, alongside competition from firms in EU Member States, such as Germany and Italy for higher value added products. Indeed, the highly internationalised nature of the clothing market meant that the pattern of response by UK and Greek clothing SMEs was not significantly different from that of SMEs in transition countries. However, in Greece particularly, SMEs from CEECs (particularly Bulgaria and the Czech Republic) are clearly becoming a growing source of competition in the domestic clothing market. While few UK managers viewed firms in CEECs as a major source of competition currently, approximately one in four identified them as a source of potential threat.

Our results show that while there are similarities between the transition countries in the nature and extent of the competition that SMEs face in the two sectors, differences in the pace of transformation together with factors such as market size, macro-economic stability and trade policy combine to produce some differences between countries in the nature and extent to which SMEs are currently being affected by internationalisation forces in their domestic markets. Nevertheless, competition from Western producers is clearly an important feature of domestic market conditions in all CEECs, contributing to the increase in competition that is a feature of advancing transformation.

THE BASIS OF COMPETITIVENESS

In this section, the strategies used by managers to compete in foreign and domestic markets are examined. It should be emphasised that use of the term 'strategy' is based on a characterisation of management behaviour (views, decisions and actions) which may be planned but more often is not. In other words, it is an interpretation of 'strategy' based on the views and actions that managers report rather than necessarily representing an explicit or formal strategy on the part of the managers themselves.

While in the short term a firm's ability to compete may be measured by performance criteria such as market share, sales growth and profitability, it can be argued that its ability to maintain competitiveness in the longer term depends on the basis of its competitive advantage. In this respect, Michael Porter (1990) refers to a hierarchy of sources of competitive advantage based on their sustainability. Whereas lower order advantages such as low labour costs or cheap materials are

Table 3: Managers' assessment of the most important competitive advantage of their products in foreign markets

	Food						*Clothing*					
Competitive advantage	*UK* %	*Gr.* %	*CEEC* %	*Bu.* %	*BS* %	*P* %	*UK* %	*Gr.* %	*CEEC* %	*Bu.* %	*BS* %	*P* %
Lower price	0	25	44	46	40	45	10	22	49	48	55	35
Unique product	9	13	7	5	10	5	0	0	4	0	4	7
Superior product	0	6	2	0	7	0	5	0	8	10	13	0
Reliable quality	46	44	24	36	23	17	34	33	22	29	17	20
Speed of delivery	5	0	7	0	0	15	12	33	3	0	2	5
Quality of service	0	0	4	0	3	7	17	11	4	0	0	12
Customer relationships	5	13	7	0	10	7	0	0	4	0	8	2
Specific market segment	14	0	2	2	7	0	5	0	1	0	2	0
Effective advertising	0	0	0	0	0	0	0	0	2	0	0	5
Packaging	0	0	1	5	0	0	0	0	0	0	0	0
Other	23	0	2	9	0	2	16	0	3	0	0	0
Total number of respondents	22	16	92	22	30	40	41	9	119	13	53	40

(i) This table shows the competitive advantage which managers rated as the most important.
(ii) Gr. = Greece, CEEC = Central and East European Countries, Bu. = Bulgaria, BS = Baltic States, P = Poland.

often readily duplicated by competitors, higher order advantages are less easily replicated. Examples include product differentiation based on unique products or services, and types of customer relationships which may be protected by the high costs for customers of switching vendors. These are the types of competitive advantage which in theory SMEs are well equipped to develop, in that they offer scope for firms to use the flexibility which their small scale offers, to their own and their customers' advantage.

Managers of exporting firms were asked to assess on what basis their products competed against those of their competitors in foreign markets. In transition countries in both sectors, it was price rather than product distinctiveness or product innovation that the managers of SMEs emphasised as their *main* competitive advantage, followed by product quality, particularly by Bulgarian SMEs (Table 3). Although a small number of exporters perceived that they had competitive advantages with respect to characteristics such as speed of delivery (particularly Polish food firms), quality of service (particularly Polish firms), established customer relationships (particularly Baltic food firms) and unique products, non-price advantages appear much less prominent than price in the way in which SMEs attempt to compete in foreign markets. While there were some minor variations between sectors and countries, the underlying pattern was fairly consistent in the surveys conducted in the CEECs.

However, comparison between the responses of SME managers in transition economies with those of their British and Greek counterparts revealed some very clear differences. As Table 3 demonstrates, in the food sector, both Greek and UK SMEs emphasised the reliability of their products. While a significant minority of Greek food-processing firms placed price as their first competitive advantage, none of the UK firms did so. For them, it was non-price competitive advantages that were emphasised, including product quality and market focus. Similarly, in the clothing sector, Greek and UK SMEs placed more emphasis on non-price than price advantages. In the Greek case, it was a combination of product reliability and speed of delivery that were emphasised; in UK clothing firms, it was product reliability, speed of delivery, quality of service and design characteristics that were stressed. Certainly, the survey evidence suggests that SMEs in Greece and the UK place a higher emphasis on non-price competitive advantages in foreign markets than their counterparts in transition economies.

However, in the case of transition countries, certain differences in the relative importance of price and non-price advantages are apparent when managers' assessment of the basis of their competitiveness in foreign markets is compared with that in the home market. In the food processing sector, 'reliable product quality' is the most frequently mentioned *main* competitive advantage in the home market (by 32 per cent of firms), followed by lower price (27 per cent); in fact, no other factor was mentioned by more than 8 per cent of firms. In clothing, the most frequently mentioned main advantages were 'reliable product quality' (29 per cent), lower price (27 per cent) and 'a unique product' (16 per cent). In Poland, 'service quality' was mentioned as the main competitive advantage by 15 per cent of firms. It would appear therefore, that based on managers' assessment of the most important single competitive advantage of their products, price-focused competitive tactics were less dominant at home than they were abroad, with product and service quality more frequently mentioned as competitive advantages in the domestic market than they were in foreign markets by exporting firms.

Managers were also asked what they considered to be the main advantage of their strongest competitor in foreign and domestic markets. In foreign markets, the most frequently mentioned main advantage of competitors by SME managers in transition countries, in both sectors, was lower costs. In the food industry, competitor cost advantages were typically associated with greater scale economies whereas in the clothing sector both scale economies and lower labour costs were prominent. This underlines the potential weakness of competitiveness that is overly focused on price, because of the possibility of losing out, either to larger firms that are able to exploit scale economies, or to lower wage cost producers. Among transition countries, it is Baltic SME managers that perceive the biggest threat from larger competitors with lower production costs in foreign markets, particularly in the food sector. As far as price competition based on lower wage costs is concerned, it was Polish firms that most frequently viewed this as the most important advantage of their main competitor in foreign markets, reflecting the fact that rising domestic wage costs are exposing them to greater price competition from lower cost producers, particularly in the clothing industry. Bulgarian clothing firms have also been experiencing the latter phenomenon, reflecting their position in the market and their role in the international division of labour.

The second most commonly mentioned advantage of competitors in foreign markets was with respect to marketing and distribution, where better advertising and promotion by competitors was managers' main concern (particularly by Polish SME managers in both sectors). The managers of Baltic food-processing firms placed particular emphasis on the more efficient distribution systems of competitors in foreign markets, which in the case of the food sector is an area where economies of scale are potentially important. Other competitor advantages that were mentioned by managers included: better financing (particularly by Baltic and Bulgarian clothing firms); more modern production equipment (particularly Baltic clothing firms) and better product quality (particularly Bulgarian firms in both sectors).

The answers of Greek and UK managers showed both similarities and differences compared with those given by their counterparts in transition countries. In the clothing industry, the highly competitive nature of international market conditions is illustrated by the fact that 'lower costs' were viewed as the most important advantage of main competitors by more than half the UK firms surveyed and four out of five of the Greek SMEs. Moreover, in both cases, this was almost entirely seen to be a result of lower wage costs in an industry where there is considerable scope for relatively labour intensive production. Not surprisingly perhaps, advantages based on more modern equipment, better financing or superior product quality were of less concern to Western managers than their counterparts in the CEECs.

However, the responses given by the managers of food processing SMEs in the UK and Greece revealed a different emphasis. Although a majority of Greek firms in this sector were concerned about their competitors' price advantages, this was more a result of their larger scale than cheaper labour costs. The importance of marketing to competitiveness in this sector is demonstrated by the fact that 38 per cent of Greek food processing firms viewed superior advertising and promotion as the most important advantage of their main competitor. The pattern of response by UK managers in this sector was even more striking. Lower cost was only mentioned as the most important competitor advantage by 10 per cent of UK food-processing firms compared with 34 per cent who referred to aspects of marketing and distribution and a further 29 per cent who referred to other competitor advantages such as 'being established in the market already', 'better access' or 'cheaper materials'. This is associated with the fact that one of the distinguishing characteristics of food-exporting SMEs in the UK was the possession of a branded product. Unlike their counterparts in transition countries, none of the UK or Greek food-processing firms felt disadvantaged in foreign markets with respect to the age of their production equipment or product quality.

CONCLUSIONS

Current and future competitiveness

To summarise, the results show that the ability of SMEs in transition countries to compete in foreign and domestic markets varied between the sectors. In food processing, although some SMEs have been able to penetrate foreign markets, the main effect so far has been to increase the level of competition in domestic markets, as competition from imported goods has grown. A far as export opportunities are concerned, our evidence shows that foreign market penetration by food processing SMEs in transition countries is often focused on markets in other transition countries rather than in Western markets. Although some food processing SMEs from the CEECs surveyed have also been able to penetrate Western markets, these tend to be in neighbouring countries (such as Germany in the case of Poland).

In the clothing industry, the effects of internationalisation are different because of the highly internationalised nature of the clothing market and the production system that supplies it. Countries where labour costs are relatively low have been able to attract the more labour intensive parts of the production of low or medium-quality products, typically on a subcontract or outward processing basis. In this context, SMEs in countries such as Poland and Estonia particularly, have been able to attract subcontract-type work and outward processing traffic during the first half of the 1990s, based on their relatively low labour costs. However, as the experience of Greece demonstrates, this type of production can be very volatile, disappearing almost as quickly as it is secured. Indeed, there is evidence that by the mid-1990s, clothing SMEs in Poland and Estonia were beginning to lose out to lower labour cost producers elsewhere in CEE (such as Ukraine and Belarus) as a result of implementing this type of strategy.

There are also differences in the effects of an increasing internationalisation of markets between transition countries which, to a considerable extent, reflect differences in the pace of transformation. However, even in Bulgaria, where SMEs started from a lower export base in 1994 than their counterparts in Poland and the Baltic States, the number of firms selling abroad increased during our survey period, as the small size of the domestic market, combined with low purchasing power encouraged firms to look abroad. More generally, home market conditions can be an important influence on the propensity of firms to look abroad for sales. In Estonia for example, small market size, combined with the effects of a relatively liberal trade policy on the level of competition in the domestic market, has made it necessary for many firms to look outside the national market in order to grow (Smallbone et al., 1997). Interestingly in Poland, the effect of the rapid growth in the number of small firms on the level of competition in the domestic market, has been one of the factors encouraging SME managers to look outside their national markets for sales. However, Polish SME managers in both sectors also showed the highest propensity to identify increased competition from imports as a major source of future threat, reflecting their assessment of the effects of EU membership and increasing market integration on the domestic market.

Despite these detailed differences between countries and between sectors, the survey evidence shows that in all the CEECs featuring in the study, some SMEs in the emerging private sector are responding to the opportunities presented by new foreign market opportunities and, in the short term at least, managing to achieve competitiveness. However, there is also evidence that the current basis of competitiveness of SMEs in transition countries in foreign markets contains certain weaknesses which may affect their ability to sustain their export effort in the longer term. The survey evidence revealed that price was the most common way that managers sought competitive advantage in foreign markets in both sectors which, in the case of clothing, was typically associated with subcontracting-type relationships with foreign customers. In food processing, price focused competitive advantages were more typically associated with the penetration of markets elsewhere in CEE and the former Soviet Union, rather than in the West.

Implications for policy

In this final section of the paper, the role for policy in influencing the ability of SMEs to exploit foreign market opportunities and respond to the threat of competition from imported goods in the domestic market is considered. As in the rest of the paper, the emphasis is on the transition countries although references are made to the UK and Greece where appropriate.

As part of the survey in transition countries, managers were asked what their priorities were for government action to improve their ability to sell in foreign markets. While detailed variations exist between countries, there is a consistently high level of demand for assistance with export promotion from firms in both sectors. Bulgarian managers demonstrated the highest level of interest in assistance with export marketing, reflecting the fact that the level of effective export support in Bulgaria is weaker than in the other countries. The other main priority for action as far as managers are concerned is a reduction in the level of domestic taxation, which was of particular concern to Polish managers.

The demand for assistance with export marketing is supported by the fact that when asked to assess the main barriers to increasing foreign market sales, a 'lack of finance to support the marketing effort' was the most consistently mentioned barrier by managers in all transition countries. While a shortage of finance may not be the only constraint in this respect, there is a need to increase the marketing capability of firms, particularly if they are to begin to place more emphasis on non-price factors in seeking competitiveness. Moreover, this is an area where individual SMEs often need help because of their internal resource base in terms of finance and management resources. As many Western governments recognise, there is a potential role for the state in contributing to the development of an infrastructure to support the export marketing effort of SMEs.

The demand for government action to support export marketing from managers in transition countries is also supported by the fact that a significant minority of current exporters had been seeking assistance with their export effort. In fact, the proportion of current exporters in transition countries that had received some form of external assistance with export marketing during the two years prior to the interviews (29 per cent) was significantly above that of their counterparts in either Greece (12 per cent) or the UK (6 per cent). The most common types of assistance received in all transition countries were information about foreign markets, followed by advice with respect to marketing strategies and pricing policies. In almost all cases, export assistance came from consultants (8 per cent), particularly in Poland (13 per cent); or from other firms (7 per cent). In very few cases had assistance been received from trade organisations or public/quasi-public agencies. Significantly, only 2 per cent of current exporters in CEECs had received any form of financial assistance with respect to export marketing. In the UK by contrast, where fewer exporters had received any form of export assistance, two-thirds of those that had, received some form of financial benefit, either in the form of subsidised attendance at a trade fair or exhibition or a subsidised consultancy. In most cases, where surveyed firms in transition countries reported receiving assistance with export marketing, this was obtained either on a 'paid for' basis from private consultants or informally from other firms or business associates.

The specific needs of SMEs in transition countries in this respect include: increasing access to information about foreign market opportunities; increasing access to advice concerning the organisation of distribution in foreign markets, including the identification and vetting of agents and distributors; increasing access to advice concerning the organisation of export promotion; the targeted use of grants or soft loans to contribute to the cost of developing export marketing plans, market feasibility studies and attending foreign trade exhibitions/fairs; facilitating the provision of short courses and seminars in export marketing in local business centres; supporting the development of sector-based organisations to offer specialist export assistance to SMEs. While examples of export support programmes exist in each of the surveyed transition countries, the evidence here suggests that their penetration is negligible.

As transformation proceeds in the CEECs, developing and strengthening appropriate sector-based organisations is an important part of developing a business support infrastructure. SMEs in countries that are at a relatively early stage of transformation, such as Bulgaria, face particular disadvantages in this respect, as the survey results indicate. One way of contributing to the development of such bodies would be to provide an opportunity for sector-based organisations, or groups of firms, to bid for funds to organise collaborative export marketing initiatives.

The constraining influence of the tax burden (social taxation as well as enterprise income tax) is a recurrent feature of studies concerned with small businesses in transition economies (eg Levitsky, 1996; Smallbone et al., 1997). While there may be some tendency for managers to point to external rather than internal constraints, the view is too consistently expressed to be dismissed by policy makers. A combination of the fact that employers carry most of the burden of social insurance rather than sharing it with employees, combined with the disproportionate effect of payroll taxes on firms that are relatively labour intensive, contribute to this pattern of response. Although the problem may be a general one rather than being specifically related to exporting, one of the reasons why firms place such emphasis on the effect of domestic taxation levels on their international competitiveness may be because of their over-reliance on price as the main basis of their competitive advantage.

While increased support for export marketing and a review of the effects of the tax burden may be the most immediate priorities for policy attention in the minds of managers, there was also a consistent recognition by managers across the CEEC samples of the need to modernise and upgrade production technology in order to improve business performance. Clearly, the ability of SMEs to compete in foreign (particularly Western) markets in the longer term is likely to be affected by the production equipment that they are using. The evidence from this study is that the technology gap may be widening between East and West, since in food processing, where technology can be an important competitiveness factor, SMEs in the CEEC were investing significantly less during the 1994–96 period than their counterparts in the two EU Member States.

A related issue in this respect is the need to upgrade quality standards, particularly in sectors such as the food industry. The importance of assisting firms that both recognise the need to raise standards and also have a potential capability for doing so, can be justified on two bases. The first is that it will help them to generate sales in Western markets where, in the food sector particularly, consumers are becoming increasingly demanding. The second is that it will increase the chances of SMEs securing future supply opportunities in the domestic market as foreign firms increasingly invest in sectors such as retail, hotels and catering.

Although managers themselves typically have other short-term priorities, many SME managers (in Poland and the Baltic States particularly) recognise the potential future business opportunities that may result from inward investment. In both sectors, foreign investment is likely to grow in the future in retailing and, in the case of the food industry, in the hotel and catering sector also. However, the experience in mature market economies (such as the UK) is that such customers typically have very demanding quality standards that often exceed the legislative requirements. Results from other CEEDR research in Portugal, demonstrate the threat to domestic SMEs in the food sector that were unable to meet the standards of the French and Spanish hypermarket chains that grew rapidly in the Portuguese market after Portugal's entry to the EU in 1990 (Smallbone et al., 1999). There is an important lesson here for countries such as Poland that aspire to join the EU in the near future.

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