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The Economic integration of the Central and Eastern European countries: the role of the small and medium enterprises

09/2004

ASSOCIAZIONE UNIVERSITARIA DI STUDI EUROPEI

AUSE

Associazione Universitaria di Studi Europei
ECSA-ITALY

These Working Papers collect the work of the European Communities Studies Association (ECSA) Research project *European Union Toward Enlargement: Integration Maturity and Adjustments of Acceding and non Acceding Countries of Central and Eastern Europe* (Agreement n. 2003-0249 with the EU Commission Directorate General of Education and Culture). The publication of work by Authors can be proposed by a researcher collaborating to a national ECSA involved in the project, provided that the paper has been presented in public. The name of the proponent is reported in a footnote. The views expressed in the Working Papers reflect the opinions of the Authors only, and not necessarily those of the national ECSA.

Printed with the contribution of the European Commission

Printed in Italy in December 2004
ASSOCIAZIONE UNIVERSITARIA
DI STUDI EUROPEI (AUSE)
Via San Felice, 5 – 27100 Pavia, Italy

The Economic integration of the Central and Eastern European countries: the role of the small and medium enterprises[α]

Antonio Majocchi[*]

1. Introduction

An analysis of the behaviour of economic factors in general and of business practice in particular is an important feature within the project of economic and social integration in Central and Eastern European countries (CEECs). Successful conclusion of the project to include eastern European countries depends, upon the one hand, on an interaction between policies taken up by the European Union and by nation states and, on the other, on the behaviour of economic and social agents, in which firms play a significant role. In June 1993 the European Council held in Copenhagen defined three fundamental criteria that candidate countries must satisfy in order to be integrated into the European Union. These principles, generally known as the 'Copenhagen Criteria', referred to the achievement of political stability, that is to the respect of civil and human rights and the implementation of democratic institutions, to the development of a healthy market economy in line with those of the EU and the realisation of acquis communautaire. The Copenhagen Criteria have provided important stimulus to those countries wishing to join the EU and, as has frequently occurred during the process of European integration, the definition of objectives has positively influenced the behaviour of both public and private agents, thus favouring eventual convergence.

Public operators in central and Eastern Europe have in fact had to start a vigorous update of legislature and institutions to satisfy Union demands. The success of this transitional phase, which will not end merely at the moment of accession but go on

[α] This paper has benefited from the support of the University of Insubria, Progetto d'eccellenza on "Internazionalizzazione ed innovazione d'impresa: evidenze dal sistema italiano e locale e prospettive d'evoluzione" The project is part of the AUSE Association and European Commission program (Directorate General for Education and Culture – Grant agreement 249/001). The author is grateful to the supporting institutions. The usual disclaimer apply.

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for years afterwards, is nevertheless also a function of the behaviour of private agents, these being firms, consumers, single individuals and political, social, cultural and religious groups. The study of this process of accession and its consequences thus cannot be limited to a simple analysis of public aspects but must also take the behaviour of private agents into account.
From an economic point of view it is possible to assert that only through the development of a solid network of companies in Central European countries can the objective of a market economy be achieved.
To this end, a substantial role is played by foreign businesses. The success of the South East Asian economy demonstrates just how the relatively open nature of these economies in association with a significant flow of foreign direct investments (FDI), was one of the fundamental ingredients, together with the right mix of economic policy, contributing to the important leap forward that these economies have realised in the course of the last twenty years.
If the role of foreign investment is thus relevant to the transition process of post communist economies it is appropriate to reveal how the presence and role of multinationals today, is called into discussion from different viewpoints and how various academics have brought a series of critical aspects to light, beyond the positive benefits that these firms convey.
The work in hand thus aims to evaluate what has been and what will, in the future, be the contribution of small and medium-size multinational companies to the process of convergence of the economies in transition. The article is organized in the following way: the next paragraph provides a concise illustration of the evolution of foreign investment in the candidate countries set to join the European union. Then follows a discussion of the arguments of those who uphold the positive role of multinationals and of those who present the negative aspects of their presence for their host countries. In particular we will try to illustrate how this ambiguous role can be interpreted in a different way when the firms making the investments are not large but instead small and medium-sized enterprises (SME). Finally the interesting case of firms in the Timisoara district of Romania is outlined with the express purpose of illuminating, with an empirical example, the difference between the presence of large and small enterprises. Some general conclusions end the article.

2. Direct foreign investment in Central and Eastern European Countries (CEECs)

Beginning in the mid nineties Central and Eastern European countries have been on the receiving end of an ever-increasing flow of direct investment, coming mostly from private companies. This process has contributed to the economic integration of these countries on a global scale, in general and in particular, within the European context. Between 1995 and 2001 the stock of investments in the region has quadrupled, going, according to UNCTAD estimates (World Investment Report, 2003, UN, Geneva) from about $40 billion to about $160 billion. This increase in the stock is the result of an ever increasing flow of investment that, as the following table illustrates, went from 12,2 in 1995 to 22,6 in 2001 then falling due to the unfavourable situation in 2002 to 11,5 billion US$.

Table 1. Inward FDI of the CEE countries, joining the EU in 2004 and of pre-existing 15 state Europe (in billions US$)

Country	1995	1998	1999	2000	2001	2002	2003
CEEC-EU	12,2	16,7	18,6	20,3	18,4	22,6	11,5
Of which							
Czech Rep.	2,6	3,7	6,3	5,0	5,6	8,5	2,6
Hungary	5,1	3,8	3,3	2,8	3,9	2,8	2,5
Poland	3,7	6,4	7,3	9,3	5,7	4,1	4,2
Slovakia	0,3	0,7	0,4	1,9	1,6	4,1	0,6
Memorandum							
Worldwide	335,7	690,9	1.086,8	1.338,0	817,6	678,8	559,6
EU-15	114,6	249,9	479,4	671,4	357,4	374,0	295,2
Of which							
France	23,7	31,0	46,5	43,3	50,5	48,9	47,0
Germany	12,0	24,6	56,1	198,3	21,1	36,0	12,9
Ireland	1,4	8,6	18,2	25,8	9,7	24,5	25,5
Spain	6,3	11,8	15,8	37,5	28,0	35,9	25,6
FDI of acceding CEECs over total FDI EU-15 (%)	10,6	6,7	3,9	3,0	5,1	6,0	3,9

Source: UN, World Investment Report 2003, UN; Geneva, 2004, pg. 72

Investments in central European countries come largely from companies based within the pre-existing 15 European member states. This investment origin is due to various factors:
The proximity in geographical and cultural terms[1] - the good social and economic structures within CEECs.
The prospects of accession to the European Union regarding central European countries. In effect the prospect of joining the union seems to have been a deciding factor in the recent surge among western companies expanding their activities in the area. The quota of EU investment is 80% in the countries joining up in 2005 while for those with no fixed entry date yet defined the quota is less than 60%.

1 Meyer K. (1998), Direct Investment in Economies in Transition, Edward Elgar, Cheltenham, shows how the factor of cultural proximity is important in explaining the processes of internationalisation undertaken by European companies, in particular from Germany, towards other central and eastern European countries.

Nevertheless, as data on expansion to the east of western enterprises shows, this development is not to the detriment of the 15 pre-existing European member states, in fact the percentage of investments received by new entrant PECO countries compared to total investments received by the 15 pre-existing European countries has actually dropped from 1995 to 2001 going from 10,6% to 3,9%.

In order to analyse what motivates foreign companies to invest in countries new to Europe it is useful to refer to the classification of foreign investments usually adopted in economic literature2. On the basis of this classification the motivations for companies to invest abroad typically fall into four different categories:

'Market seeking' investment; or that is, investment which aims to position the company in a market with good growth prospects and the opportunity to attract important clients[3];
'Resource seeking' investment which aim to obtain resources (work, natural resources) at a lower price in real terms[4];
'Strategic assets seeking' investment with which companies intend to control strategic resources through their competitive position, maybe their sales network or their immaterial resources;
"efficiency seeking" investment through which companies concentrate activities in few locations abroad in order to create scale or scope economies.

With reference to direct foreign investment in central Europe, the majority of studies show that the principal motivation behind the company investment choices is that of market seeker[5]. Western European companies seem first and foremost to be attracted to the growth prospects of the market and thus have tried to position themselves in this market to take advantage of growth opportunities.
The search for low cost resources and, in particular, low cost of labour, only constitutes the second motivation in order of importance for companies. In this case it is opportune to note that if, as it is fitting to do, you correct the gross cost of work by the rate of productivity, gaining an indication, even if rather an imprecise one, of the real cost of work, it emerges that the gap between the cost of work in Western Europe and in associated countries or those in the process of joining up, is much lower compared to the gross difference. Setting the relationship between salary and productivity on average in western Europe to 100, it appears that investment in Poland already seems less tempting in terms of labour costs, even if only slightly, be-

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2 Dunning J. (1993), Multinational enterprises and the global economy, Addison Wesley, Harlow. England.
3 See Zhang K.H., and Markusen, J.R. (1999), Vertical multinationals and host country characteristics, in: Journal of Development Economics, (59), pp. 223-252
4 See for example Narula, R. e Dunning, J.H. (2000) Industrial development, globalization and multinational enterprises: new realities for developing countries, in: Oxford Development Studies, (28), pp. 141-167.
5 On this, see Lankes H.P. e Venebles A.J. (1996), Foreign Direct investment in Eastern Europe and the Former Soviet Union: Results from a Survey of Investors, Working paper, EBRD, London, and Resmini L. (2000), The Determinants of Foreign Direct Investments in the CEECs: New Evidence from Sectoral Pattern, in: The Economics of Transition, Vol. 8 n. 3, pg. 665-689 that illustrate how the market seeker motivation is the principal reason for foreign investment in central and eastern Europe.

ing equal to 99 while the situation in the Czech Republic and in Slovakia still seems favourable where the figures are respectively 144 and 157.

Table 2. Gross salary and productivity in certain European countries

	Average monthly gross salary					Productivity	Productivity /salary (EU=100)
Country	**1998**	**1999**	**2000**	**2001**	**2002**	**2000**	**2000**
Average UE-15	1.845	1.923	2.127	2.191	==	42,5	100
Of which							
Greece	1.101	1.160	1.227	1.286	1.357	19,4	79
Portugal	==	==	1.052	1.112	==	10	48
Spain	==	1.297	1.326	1.372	1.425	26,1	98
New Members Peco	==	381	410	460	==	11,7	117
Of which							
Czech Rep.	==	343	379	430	510	10,9	144
Estonia	==	282	303	328	==	8,3	137
Hungary	307	314	348	408	489	11,1	160
Latonia	==	257	277	280	==	==	==
Lithuania	233	251	270	300	==	==	==
Poland	346	442	471	626	598	9,3	99
Slovakia	274	260	299	320	382	9,2	154
Slovenia	==	895	935	988	1.041	21,3	114
New candidate countries							
If which							
Romania	=	120	144	165	174	==	==
Bulgaria	101	111	120	127	132	==	==

Source: UN (2004), World Investment Report, UN, Geneva

With growth of foreign investment and economic development taking hold in CEEC countries it is obvious that differences in salary between European countries will tend to gradually decrease. From this perspective labour seeking investment at the basis of FDI is destined to slip into further decline over time, being replaced by efficiency and strategic assets seeking motivations. The fact that low labour costs are not the only factor attracting the flow of investments towards the area should be considered as positive. Indeed, companies that seek to take advantage purely of low labour costs tend to make modest investments that are typically low on new technology. In addition, labour seeking investments, precisely because they are characterised by low capital intensity, tend to transfer rapidly to new locations when the labour cost rises. This may happen due to the fact that this type of largely insignificant investment is easily transferred or that as soon as the economic and productive fortunes of the investment take an up turn salaries tend to rise too. In conclusion it has to be noted that regarding labour costs, competition with other areas in the world is strong and in order to maintain a good competitive level, strategy adopted would necessarily focus on trying to limit salary growth. This strategy of economic policy would not only be undesirable from a social viewpoint but would also compromise the attractiveness of the area to those companies who sought new markets and who, as illustrated, seem to represent the largest quota of investment in the region.

3. Effects of FDI in the CEEC countries

Debate surrounding the effects of foreign business presence in the receiving economy has swelled over recent years following the boom in foreign direct investment on a global scale. If, on the one hand, FDI has been seen as a powerful development force by the majority of scholars[6]; it should be noted that a string of authors[7] have instead underlined how these investments bring with them a series of negative effects for the economies receiving the investment.

Foreign direct investments constitute a significant contribution, to the countries of Central and Eastern Europe, in the creation of capital. The percentage of investments that have their origin in foreign capital is in fact in the region of 13,9%, in the two year period spanning 2001-2003, compared to the worldwide average of 9,8%. In some countries, such as Bulgaria, Slovakia and Estonia the percentage is around 30%.

In the debate on the effects of foreign direct investment in general, and in particular that realised in transitional economies, many studies have highlighted how Multinationals played a fundamental role in providing capital for transitional economies at a time, like in the early nineties, when these economies were short on funds and had difficulties obtaining resources on the financial markets[8]. It is plain that this positive effect was thoroughly developed during the initial years of transition, and is still an important feature in some countries like Bulgaria and Romania, who remain behind in the modernisation process; it seems to be less relevant a function in those countries, such as the Czech Republic or Poland, who have demonstrated greater integration with the global economy and reliability in world financial markets[9].

6 for a review of the vast amount of relating literature and a concise overview of the principal results see for example UNCTAD (2001), World Investments Report, UN, Geneva

7 for a critical view of the role of mulinationals see for example: Anderson S.e Cavanagh J. (2000), The Rise of Corporate Global Power, Institute for Policy Studies, December. Klein N. (2001), No Logo, Flamingo, London, Hertz, N. (2001), The Silent Take-Over, William Heineman, London

8 For an analysis of the role of the multinationals as relevant financial source for investment projects see for example:: Falcetti E., Sanfey P and Taci A. Giugno (2003) Bridging the gaps? Private sector development, capital flows and the investment climate in south-eastern Europe, WP Giugno 2003, EBRD, London; S. Manzocchi (1997), External Finance and Foreign Debt in Eastern and Central European Countries, IMF Working paper, n. 174, IMF, Washington. For a critical view of the role of foreign direct investment as a source of funding finance see instead: Lipsey R.E. (2000), Interpreting Developed Countries' Foreign Direct Investment, NBER working paper, n. 7810, NBER, Washington

9 With reference to the Czech Republic see for example: J. Soukup and A. Majocchi, Italian direct investment in the Czech Republic: the results of a fields analysis, (

Besides the positive effects in financial terms, foreign direct investment, especially in transition economies, brings a general economic stability in terms of the balance of payments, export promotion, currency value stability and, in the absence of significant investment promotion policy, a beneficial effect on the public budget[10].

Last but by no means least is the effect generated by foreign business presence in terms of technological impact[11]. The effects of technology transfer (spillover effects) are induced through various different economic mechanisms that range from imitation on the part of local firms of the new technologies adopted by more advanced foreign firms, to positive effects in terms of better productivity of the work force, to the realisation of joint projects with local companies or institutions with the result of improving competition in the areas in which the companies are active. With reference to Central and Eastern Europe many studies have shown how the presence of foreign companies has significantly raised the average level of work productivity[12].

While these effects are, with differing degrees of enthusiasm, considered positive; the presence of foreign firms in transition countries has also brought about effects that cannot be considered so beneficial to their host. The negative effects of foreign business presence can be placed in three major categories.

The first aspect refers to the displacing effect of foreign investment on domestic investment. This effect is in turn the result of the greater competitiveness and economic force that the foreign company usually has compared to the local one. The local competitors see their market shrink due to the presence of the more efficient foreign company. It should be noted that this aspect is nothing more than the flip side of technological transfer. Depending on how competitive they are; foreign companies tend to increase their market share to the detriment of local companies who are then forced into technological updating in order not to be squeezed out of the market by their competition[13]. In practice this alternative depends largely upon

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http://eco.uninsubria.it/dipeco/Quaderni/files/QF2004_33.pdf) and also: Král, P. Identification and Measurement of the Relationships Concerning Inflow of FDI: The Case of the Czech Republic. Working Paper Series No. 5, Czech National Bank, Prague 2004; Mišun J. - Tomšík V.: Foreign Direct Investment in Central Europe Does It Crowd in Domestic Investment? Journal Prague Economic Papers No. 1, Prague 2002; Vintrová, R.: Savings and Investments in Transitional Countries. Journal Prague Economic Papers No. 4, Prague 1996, Zemplinerová, A. e Benáček, V.: FDI in the Czech Manufacturing Sector. Journal Prague Economic Papers No. 2, Prague 1997

10 On this point see for example: Krkoska L. (2001), Foreign Direct Investment Financing of Capital Formation in Central and Eastern Europe. WP no.67, December, EBRD, London

11 Lipsey R.E. (2000), Interpreting Developed Countries' Foreign Direct Investment, NBER working paper, n. 7810, NBER, Washington on this matter expresses the following idea (pg. 23): "Since much of FDI consists of offsetting two-way flows, we suggest that the main role FDI plays is that of transferring assets from less efficient to more efficient owners". On the effects of spillovers see also the wealth literature: Kokko A. (1994). Technology, market characteristics and spillovers, Journal of Development, Economics, 43, pp. 279-293 e Blomström, M. Kokko A. e Zejan M. (2000). Foreign Direct Investment: Firm and Host Country Strategies, Macmillan Press London

12 With reference to Central and Eastern European countries the positive impact of technological transfer due to the presence of foreign companies is highlighted by, amongst others, the following authors: Kogut B.(1996), Direct Investments; Experimentation, and Corporate Governance in Transition Economies, in C.W. Gray and A. Rapazynski (eds.), Corporate Governence in Central Europe and in Russia, vol.1, Central European University Press, Budapest, pg. 293-332; Estrin S., Hughes K. E Todd S. (1997), Foreign Direct Investment in Central and Eastern Europe: Multinational in transition, Pinter, London.

13 See for example: Barnes J. Kaplinsky (2000), Globalization and the death of the local firms: the automobile components *sector in South Africa*, Regional Studies, Vol. 34 (9), pg. 797-812

the capability of the local policy making authority that should, on the one hand, allow local businesses a period of transition to start the process of technological upgrading. On the other hand the opening up of markets is essential because without this prospect it is unlikely that the positive effects of competition would reach the domestic economy[14].
With reference to foreign companies in CEECs it clearly emerges how the level and speed of opening up the market is very different from country to country, bringing diverse results in terms of foreign company presence and effects caused by the market opening.
Indeed, the weighting of foreign direct investment is equal to 43,3% of the GDP in Hungary and 42,6% in the Czech Republic, two countries who started the process of opening up their economies right from the start of the transition period, while the figure is about half this for countries like Bulgaria and Romania who adopted a much slower and gradual approach to market transition.
The second critical aspect due to the presence of foreign companies is related to the effective capability of the foreign businesses to transfer their technological know-how to local firms. According to some authors[15] foreign companies present in CEECs have realised only a low level of technological transfer[16]. In fact, in some cases, multinational companies do not seem to have made any significant impact on the local economy, either due to scarce exchange with local business or to the monopolistic power that large multinationals can wield before local suppliers. In some cases, particularly in countries undergoing the process of transition and development, the major disequilibrium in the market, between multinationals and the network of suppliers has frequently lead to anti- competitive practice on the part of the foreign company with the consequence of transferring the competitive price pressure to the network of local producers[17].
Finally, the presence of large companies in transition countries has been critical due to the significant effect that these large multinationals, with their own well defined strategy, can have on the macroeconomic policy of transition countries, especially the smaller ones[18]. It is clear that, considering the dimensions of some large multinationals, their decision to invest or disinvest can have a significant impact on the unemployment levels and wealth of the countries involved. This factor has, without

14 See: Stiglitz, J. E. (2002),. La globalizzazione e i suoi oppositori, Einaudi, Torino
15 Cross ref. G. Hunya (2002) Recent Impacts of Foreign Direct Investment on Growth and Restructuring in Central European Transition Countries, WIIR Series: Research Reports, No. 284, WIIR, Vienna.
16 For a review of the technological impact of the presence of foreign multinational companies see: UN (2002), World Investment Report, UN Ginevra.
17 On the perverse effects of the presence of strong multinational companies on the network of local suppliers see for example: Altenburg (2000), Linkages and spillovers between transnational corporations and small and medium-sized *enterprises in developing countries: opportunities and policies*, in: UNCTAD, "TNC_SME Linkages development: Issues Experiences-Best Practices", UN, New York and Harrison (1994). *Lean and Mean. The Changing Landscape of Corporate Power in the Age of Flexibility*, Basic Books, New York.
18 De Grauwe P. e F. Camerman (2002), How Big are Multinationals?, in: http://www.econ.kuleuven.ac.be/ew/academic/intecon/Degrauwe/PaulDeGrauwe.htm effectively sheds light on the role and the dimension of multinational companies. Comparing the PIL of the main world countries and the added value generated by the most important multinationals it emerges, for example, how companies such as Wal-Mart Storse, Exxon and General Motors generate an added value higher than the PIL of countries such as Hungary or the Czech republic. Nevertheless, authors conclude that (pg. 15): "…there is little evidence that the economic and political power of multinationals has increased in the last few decades".

doubt prompted some states to propose policy expressly to attract such investment, lowering levels of taxation on company utilities, creating special tax privileges for foreign companies and increasing work flexibility to attract investment.

4. The role of small and medium sized multinational companies

If the role of large multinational companies has been studied ever more closely with reference both to their worldwide impact on the economy and to their role in the process of Central and Eastern European integration, the same cannot be said for small and medium sized businesses. It is by now a well known fact that smaller scale business has made significant investment in the process of globalisation[19]. Scarce attention has however been dedicated to the role they play in the process of integration regarding Central and Eastern Europe. On the one hand this gap can in part be blamed on the lack of data and the difficult task of subsequently searching it out, on the other this lack of enquiry is particularly grave considering the important role these companies have both in developed and transitional countries. Numerous studies exist on the role of smaller firms in the various different national economies, however the role of small and medium sized enterprise in the internationalisation process between the pre-existing European states and new European member countries, has scarcely been touched upon. In actual fact the role of small and medium sized enterprises in the European economic context is fundamental, both from the point of view of economic weighting in general and with respect to the more limited function SMEs carry out as catalysts for change in transition countries and as an element of positive integration between old and new member states of the Union.

SMEs are in fact the primary source of new employment opportunities within all European countries, covering between 60 and 70% of total employment and representing about 95% of all firms present in the OCSE countries.

Regarding SMEs it is pertinent to note that an ever-increasing number of firms from this category are pursuing internationalisation processes and as highlighted in some recent empirical studies[20], this process is also currently underway between smaller firms from the pre-existing 15 European nations towards CEECs.

This process of internationalisation towards the East coming from smaller firms, presents numerous interesting angles from which to analyse economic impact and to discover, in the case that the impact was considered positive, which are the tools of economic policy that potentially favour and encourage the process.

It is interesting to evaluate, in this respect, to what extent the consequences of the presence of these small and medium sized multinational firms on their host countries differ from those generated by large-scale multinationals.

It is opportune at this juncture to underline how many of the negative aspects blamed on the presence of large multinationals are not applicable to smaller firms.

19 M. Fujita, Small- and Medium-Sized Transnational Corporations: Trends and Patterns of Foreign Direct Investment, Small Business Economics No.3, Vol.7, 1995

20 Majocchi A. (2004), *Developing a Favourable Business Environment: Lessons from the experience of Italian Firms in The Region of Timisoara*, Romania, http://www.oecd.org/dataoecd/36/9/31798578.pdf

These smaller firms have the double advantage of low level market power and, consequently, low impact on the macro-economic policy of their host country while being at the same time noted for their significant contribution in the creation of new jobs and high level of integration, thoroughly embedding themselves into the local economic situation[21]. This integration at local level is shown by an elevated number of links with local suppliers, competitors and clients. A high intensity of economic relations with local partners, demonstrated by supply and secondary supply links, information exchange and technological agreements, typically has two main results. Firstly, the SME often represents a significant level of technology transfer. While they may remain less technology intensive than the large firms, small and medium sized operations, for limits intrinsic to their very activity, are more prone to sharing their technological expertise with local partners. Secondly, SMEs, expressly due to their greater local integration tend to be more careful regarding the impact of their own policy in a local context[22] thus demonstrating a high level of social responsibility.

Finally, it can be noted how embedding in the local context produces positive consequences in the medium and long term. If the local network of partners proves especially beneficial and becomes important to the firm, it tends to maintain the investment even faced with new investment opportunities elsewhere in the world.

5. Small and medium-sized enterprise in CEECs: the case of the Timisoara region.

If the flow of investment in CEECs is analysed it emerges that for the whole of the nineties investment was mainly realised by large-scale firms. This is easily explained by the high level of uncertainty that still surrounded such investment; due to doubts over economic conditions, the state of institutions and the legal system and last but not least the eventual date for these countries to join the European Union.

Only afterwards did an ever increasing number of small and medium-sized firms, mostly orientated towards export, move their investments towards these countries, choosing those closest to the European Union, such as Hungary, Poland and the Czech, Slovak and Romanian republics. Regarding the impact of SMEs in CEECs a particularly interesting case is that of Romania which has recently received an ever more significant flow of investment from Italy, realised mainly by firms of extremely limited dimension. Analysis of this case allows some relevant aspects of the effects and limits of the presence of these small and medium-sized firms in Eastern Europe to be brought to light.

On the basis of official data, Italy is the sixth largest investor in Romania in terms

21 For an analysis if the concept of local embedding on the part of multinational firms see: Andersson U. Forsgren M., Holm U. (2002), The strategic impact of external networks: subsidiary performance and competence development in the multinational corporation, Strategic Management Journal, Vol. 23, n. 11, page. 979-996.

22 Such a conclusions are reached for example by: Majocchi A., Mayhofer U., Secchi D. and Urban S., Corporate Governance and Social Responsibility: an Analysis of French and Italian SMEs, 29th Annual EIBA (European International Business Academy) Conference, Copenhagen Business School, Dec. 11-13, 2003

of capital invested but the first in terms of the number of firms present[23], from this data it can be deduced that the most part of these investments are modest, in line with typical SME schemes. Further to this, a large slice of these investments tend to be concentrated in the North West region, closest to the European Market[24]. The flow of investments has brought capital and new technology into the region rendering it the most dynamic in Romania. To analyse the reasons behind this influx of investment on the part of small and medium-sized firms two types of motivation can be considered: those prompting Italian firms to de-localize production phases (push factors) and the motivations that attracted them to the area in question (pull factors).

Regarding 'push' factors it is useful to consider that the major part of the investments in the area are vertical in nature, or that is, concentrated in the backward phase, typically more labour intensive and subject to elevated pressure of price competition.

The choices made by these Italian firms are the result of a series of contextual factors. In fact, these firms, which typically act in traditional sectors positioned in the mature stage of the cycle, are therefore highly susceptible to price competition and in particular face competition from South East Asian producers who, adopting very aggressive policies, have put European producers in difficulty.

Besides this increased foreign competition, with the advent of the single currency, Italian firms have also had to put aside the competitive devaluation policies, which allowed firms to maintain and improve international competitiveness at the beginning of the nineties, even in the absence of any processes of innovation.

In the new context of international competition the SMEs have had to come up with innovative policies both from a production and market contact viewpoint. Faced with the necessity of pursuing delocalisation processes, to areas with direct access to the European Marketplace, small and medium sized Italian firms found themselves having to get to grips with a new development direction, they had to operate in a new and relatively unknown context. The modest size of these firms in this case, acted as a limiting factor in that, due to financial and managerial restriction, most did not have the resources to start up the process of internationalisation autonomously. Thus Italian firms replicated the industrial district model that had been the point of reference over the previous thirty years in Italy, on an international scale. When the first firms invested in the area they marked the beginning of a process that in time has seen an ever-increasing number of businesses make the move to the area. The experience gained by these first pioneer firms was passed on the others and the growing presence of Italian companies in the area created a fa-

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23 Recent estimates by the Centro Estero Veneto in, (2003), Indagine sulla presenza imprenditoriale veneta in Romania, Centro estero Veneto, Antenna veneto Romania, estimated the number of Italian firms present in Romania to be 12.366.

24 For a more indepth analysis of the experiences of these Italian firms in Romania see: Majocchi A. (2004), Developing a Favourable *Business Environment: Lessons from the experience of Italian Firms in The Region of Timisoara*, *Romania*, http://www.oecd.org/dataoecd/36/9/31798578.pdf

vourable context in turn acting as a force of attraction to still more firms[25].
Apart from the reasons pushing Italian firms to start delocalisation processes it is pertinent to examine what the motivations were which lead to such a high concentration of businesses moving to the specific region of North West Romania.
The figure below illustrates the pattern of registration of firms in Romania and the counties of Timis and Arad, that is the two counties in the North West that have received consistent Italian investment.

Table 3. Italian firms in Romania and the counties of Timis and Arad

Year	Italian Firms registered in Romania (influx)		Italian Firms registered in Timis (End of year stock)		Italian Firms registered in Arad (influx)	
	Nr.	%	Nr.	%	Nr.	%
1991	524	4,2%	262	==	26	2,6%
1992	1124	9,1%	411	==	42	4,2%
1993	1285	10,4%	433	==	55	5,5%
1994	1353	10,9%	754	==	93	9,2%
1995	312	2,5%	192	==	31	3,1%
1996	353	2,9%	197	==	27	2,7%
1997	568	4,6%	277	==	37	3,7%
1998	1017	8,2%	394	==	80	8,0%
1999	1119	9,0%	364	==	99	9,8%
2000	1422	11,5%	460	==	148	14,7%
2001	1564	12,6%	487	==	148	14,7%
2002	1566	12,7%	555	==	157	15,6%
2003**	159	1,3%	556	==	63	6,3%
Total	12366	100%	1638*	0,00	1006	100%

(*) = at the end of 2003 (**)= provisory data relative only to part of the year. Source: Majocchi (2004).

The evolution of the presence of Italian forms in the area shows it is possible to discern two different periods: An initial boom in investment at the start of the nineties and after a period of stasis the reanimation of investment activity starting from 1999. The influx of investments in the area seems due to structural features rather than short-term factors. To identify the success factors relating to this area

25 For an economic explaination of the process of agglomeration of the firms see for example: Krugman, P.R. (1991). *Geography and trade*, MIT press,. Cambridge, Mass; Porter M. E., (1990), *The Competitive Advantage of the Nations*, Macmillan Press, Basingstoke. For an analysis with specific reference to the Italian Realty see: Becattini, G. (1990), *The Marshallian Industrial District as Socio-Economic Notion*, in Pyke, Becattini, and Sengenberger (1990). Pyke, F., G. Becattini, and W. Sengenberger (1990), *Industrial Districts and Inter-firm Cooperation in Italy*, Geneva, International Institute for Labour Studies For an analysis applied to the PECO countries: Manrai A. L., Manrai A. K., Lascu D.N (2001), *A country-cluster analysis of the distribution and promotion infrastructure in Central and Eastern Europe,* International Business Review (10) 517–549

the method interpretation proposed by Porter[26] can be adopted, this method groups factors explaining the success of certain areas in attracting and encouraging economic development into four broad categories. The factors are:

- The availability of production factors
- Demand conditions
- The existence of services and support sectors
- Strategies and level of competition in the area.

In this context the promotion policies regarding local economic development can contribute to or hinder the success of the area.

With reference to the Timisoara area the availability of production factors, the basic labour required in primis, constituted without doubt a factor of attraction, at least in the first phase of development in the area. Nevertheless the cost of work does not explain by itself the success of this district, for the simple reason that, on average it is superior to that of all the other regions of Romania and many other Balkan regions, with the exception of the capital.

Besides low labour costs other elements seem to have played a more important role. In the first place, the quality of the work force: the high level of education, the presence of numerous universities and technical schools and the pre-existence of a manufacturing culture before the fall of the regime provided the area with a highly qualified work force that guaranteed high levels of productivity. Cultural aspects also seem to be just as important: the international outlook of the area, the mix of cultures and ethnic groups as well as the high number of small and medium sized enterprises in the area which had already created a context that eased the path for Italian firms adapting to the new situation and reinforced the attractiveness of the locality.

Apart from the wealth of positive factors elements relative to demand were also important. The regions of Timisoara and Arad are found close to the EU markets and this coupled with the geographical concentration of numerous firms specialised in traditional mechanics and clothing and materials in the area has created a significant level of demand.

Finally, the rich pattern of local production increasing internal competition has prompted firms in the area to develop innovative processes and improve competitiveness thus maintaining the high level of competition in an area where it is already extremely strong. As a consequence productivity in the area has, over time, become particularly high, demonstrating how the positioning of businesses in industrial estates tends to improve the competitiveness of the firms operating there[27].

In addition to these strictly economic factors another factor has been highlighted by Italian literature as a fundamental element in explaining the competitive nature of industrial districts: social cohesion[28]. As frequently occurs in economic proc-

26 Porter M. E., (1990), *The Competitive Advantage of the Nations*, Macmillan Press, Basingstoke
27 Banca d'Italia (1999), Relazione annuale 1998, Banca d'Italia, Roma.
28 Cfr. Beccattini G. Distretti industriali e made in Italy: le basi socioculturali del nostro sviluppo economico, Bollati Boringhieri, Torino

esses, social and economic evolution go hand in hand. On the one hand, good social conditions in the area have favored the development of a vibrant system of production: a wealth of small and medium-sized firms, on the other hand economic success has contributed to strengthening social cohesion, intensifying international commitment and value of the area. Today the Timis and Arad region (Banato Crisana) presents itself as a central European area with every potential of becoming a leading light for the whole region both from a cultural and economic standpoint. The experience of the Banato Crisana region seems to confirm how the influx of investment from small and medium-sized firms has, in the first instance, a lesser impact on local economies but how, at the same time, this impact is more lasting and beneficial for the economies receiving the investment. Small and medium-sized enterprises tend to benefit from a 'cascade' effect in taking processes forward: the presence of pioneer firms attracts others which in turn causes new firms to set up and thus the social climate improves, unemployment falls and the general local economic situation picks up. From this point of view then, it could be said that small and medium-sized firms offer all the benefits associated with the presence of large scale firms- with the sole exception, in most cases, of technological excellence- without any of the negative aspects connected to the presence of the big multinationals.

6. Conclusions

This work has tried to demonstrate how the role of small and medium sized enterprise is today fundamental to the process of European integration and the shift towards market economies. SMEs are not only important for their impact on local economies but also because having created the right conditions they can become powerful catalysts both for economic development and economic and social integration between the 15 pre-existing European countries and the transition countries in Central and Eastern Europe. The particular case of the region in North West Romania shows how the policy of SMIs are important and how, in tandem with Federalist principals and more specifically that of subsidiarity, various levels of government can be important in promoting firms and industrial districts. Two levels of government in particular seem to play a crucial role in promoting competition and development among the SMEs: Local government and European Policy.
The task of local government is that of creating and promoting the right conditions for development and embedding of SMEs in the local context[29], promoting cooperation between all actors on the local economic scene: university, schools, firms and associations; favoring those institutions involved in research and education while preserving and improving social and environmental conditions.

29 For a detailed analysis of local policy for the development of SMEs and clusters see: Enright T. (2002), *Regional clusters: What we know and what we should know*, Paper prepared for the Kiel Institute International Workshop on Innovation Clusters and Interregional Competition, 12-13 November 2001 e OECD (2001), Balestri A. and Cavalieri A., *Promoting the internationalisation of clusters: lessons from Italy*, in: Devolution and Globalisation. Implication for local decision-makers, OECD, Paris, pp. 123-158

European policy is just as important to the process, not only because the prospect of new member states joining up has been a powerful catalyst in the development of SMEs but also for the impact of the direction it offers in industrial policy, guidelines for progress that it is both in the position to and should generate. In the first place, choices taken regarding major infrastructural networks will constitute the bones of the new European economy in such a way that they are already significantly influencing the location decisions taken by firms, especially in PECO countries. Secondly, the EU has a responsibility to promote policy for technological innovation on an international scale that will also involve small and medium sized firms in such a way that objectives for competition, set at the European Council of Lisbon, can be met; objectives that would be difficult to realize without the involvement of SMEs.

In order to fully realize these objectives it would however be necessary for the EU to take on greater autonomy in realizing tax policy, in the first instance through an increase in budget so as to promote research and development on a European level and to realize a more efficient network of infrastructure in Transport, energy and telecommunications sectors. Only then would it be possible to create the right contextual conditions in Europe to effectively promote competition between firms, both large and small placing the virtues of monetary stability, gained through the advent of the Euro side by side with those of economic growth that only a fully developed fiscal policy can guarantee.

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