

Impact of EU Enlargement on Business Environment of Small and Medium-Sized Enterprises in Slovakia

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SUMMARY

The paper discusses the impact of EU enlargement on business environment in the Slovak Republic. Integration of Slovakia into EU has significantly influenced operating conditions for small and medium enterprises. Prosperity of small and medium enterprises depends mainly on their ability to adapt themselves to these new conditions.

INTRODUCTION¹

One of the goals of Slovakia in the current period should be a full adaptation to EU economic standards. Basic assumptions of the successful integration of the Slovak economy into the EU are increase of competitiveness and productivity, decreasing the rate of unemployment, decreasing the state budget deficit and balance of payments deficit. This all is possible only under the condition of successful development of small and medium-sized enterprises (SMEs).

Globalisation and global economic competition with the USA, Japan, and China requires increasing the competitiveness of all EU member states and all entrepreneurial subjects. If we compare the US and Japan economics to the EU economics, the basic assumption of EU competitiveness increase is its integration into a compact economic complex with internally harmonised business environment. In order to achieve it, the EU has to take many important actions in the area of taxes, financial market, labour market, public administration, and agriculture.

SME ABILITY TO ADAPT TO ON-GOING CHANGES

If Slovak SMEs are to succeed in this competition, they must adapt to this business environment and respond quickly to constant changes. EU accession influences SMEs in various areas of their activities. Especially the following challenges should be pointed out:

- requirement to adapt to on-going changes,
- increase of the competitive pressure on SMEs,

- constant need to increase the human capital quality,
- efficient use of available EU funds,
- investment conditions and opportunities.

The pressure on SME's ability to adapt and flexibly react to changes in entrepreneurial environment and competition after the EU accession will keep growing. Research results of the pre-accession expectations CAPE (Corporate Readiness for Enlargement in Central Europe) carried out by EUROCHAMBERS based on comparison of results from the new EU member states, had been positive for the Slovak entrepreneurial subjects (see Chart 1).

The Slovak firms expected positive impacts mainly in the area of foreign investment inflow and more transparent entrepreneurial practices. SMEs also expected better access to the joint EU market of goods and services and to EU capital market.

Slovak SMEs had different expectations before the EU accession and besides of positive aspects of integration, entrepreneurs were afraid of several risks and threats. Slovak entrepreneurial subjects pointed out the following negative aspects of integration as the most serious:

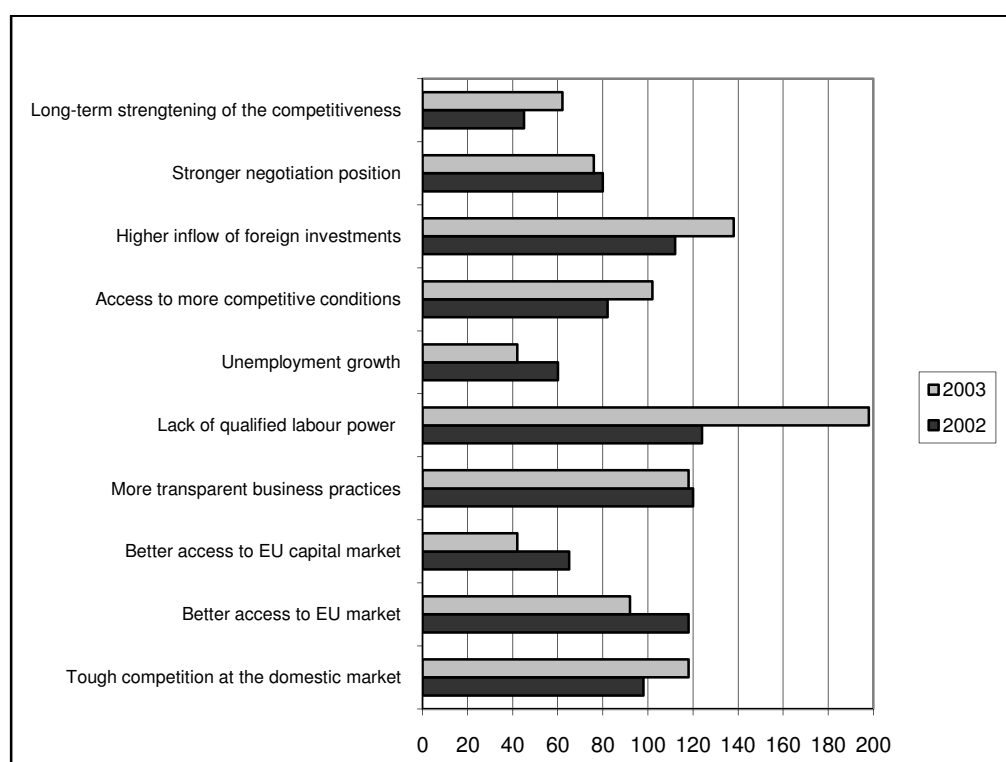
1. Fast price adjustment that can have negative impact on competitiveness of Slovak SMEs because of losing competitive advantages such as lower energy prices, lower labour costs etc.
2. Growth of number of foreign competitors that would push domestic SMEs out of the market because of some important competitive advantages such as high production quality, high innovative capability, sufficient own capital etc.
3. Inefficient use of European funds that are expected to contribute to development of the member states'

economies such as the Structural funds and the Cohesion fund.

4. Lack of qualified and well trained entrepreneurs, managers and employees who would be able to respond to new conditions.

Success of Slovak SMEs on the EU market depends mainly on their capability to adapt to market changes and changes in the business environment that are going on a continuous basis. After the EU accession pressure on ability of SMEs to adapt and flexibly react to changes will grow steadily. Flexibility and adaptability have to be inseparable parts of the entrepreneurial activity.

The ability to react to the changes is proportional to the quality of SMEs management. The entrepreneurial subject can succeed on the market only if it manages to cope not only with standard changes but also with changes related to the integration process. After the EU accession the entrepreneurial subjects in Slovakia have to comply with the joint EU legislation including strong pressure to increase transparency and strengthening a company's goodwill in the public.



Source: CAPE Corporate Readiness for Enlargement in Central Europe. A Company Survey on the States of Preparations for Single Market 2003. Summary Report. Brussels: Eurochambers and SBRA, 2003.

*Figure 1 Evaluation of effects of the joint market by Slovak firms
(Average per 10 new EU member states = 100)*

INCREASE OF THE COMPETITIVE PRESSURE ON SMEs

Another impact of EU accession is increase of the competitive pressure on SMEs in Slovakia. International comparisons and studies show that the competitiveness of SMEs in Slovakia is low (European Innovation Scoreboard, 2004). According to the enterprise efficiency in the area of innovation, profitability and trustworthiness Slovakia ranked 37th out of 49 evaluated countries, Hungary ranked 28th, the Czech Republic improved from 43rd to 31st and Poland ranked 46th in 2003 (NARMSP, 2004).

One of the most important sources of the competitive position increase of the Slovak SMEs is their innovation and investments to the research & development (R&D). Innovation is regarded as one of the key drivers of the economic welfare. As the Community Innovation Survey offered a Summary Innovation Index in 2004, Slovakia ranked in the "Catching-up" pattern for Acceding countries and currently is at the seventh position from bottom of all EU countries, USA and Japan. The Index uses only the twelve most widely available indicators such as human resources for innovation, creation of new knowledge, transmission and application of knowledge, and innovation finance, output and markets. It covers all EU countries. Nevertheless, the position of Acceding countries like Slovakia should not hide the existence of

serious problems: though these countries show a stronger growth performance than the EU, a large part of this growth is due to the fact that these countries have started from very slow starting values for several indicators. Moreover, public and private R&D spending is falling (European Innovation Scoreboard, 2004). Slovakia currently depends on foreign direct investments (FDI) for growth that will eventually reach an upper limit, unless there is an improvement in the innovative capabilities of domestic firms. Slovakia ranked among the trend leaders within the Acceding countries only in two indicators: Employment in med/high-tech manufacturing and ICT expenditures / GDP. In all other indicators Slovakia lies far behind not only all EU countries, but the Acceding countries as well. According to the European Innovation Scoreboard 2004, the major relative strengths of Slovakia are (1) trend for science and engineering (S&E) graduates, (2) trend for European Patent Office (EPO) high-tech patents, and (3) innovation expenditures. The major relative weaknesses are: (1) trend for public R&D, (2) current US Patent and Trademark Office (USPTO) patents, and (3) current and trend USPTO patents (European Innovation Scoreboard, 2004). Slovakia is doing better on diffusion than on the creation of innovation. Even 80% of Slovak firms are non-innovators, 8% are technology adopters, 4% are technology modifiers, 5% are intermittent innovators, and only 3% are strategic innovators (European Innovation Scoreboard, 2004).

Management of all SMEs must be aware of fact that after the EU accession they are under increased competitive pressure. Increasing the number of competitors and free movement of goods and services within the EU are the driving forces of this. Entrepreneurial subjects, if they want to succeed, must be prepared for such a trend. Slovakia ranked 40th most competitive country out of 60 measured by The World Competitiveness Scoreboard 2004 what meant the advancement from the 46th position. Slovakia ranked even better than the Czech Republic, Hungary, Slovenia or Italy.

The basic requirements of the business subject's competitiveness, as viewed by financial institutions and foreign investors, are:

- financial power of SMEs and ability to raise the financial resources,
- credibility of SMEs,
- innovation capability and constant increase of expenditures on R&D,
- lifelong education and training of both SME managers and employees,
- creation and application of new knowledge inside the companies, and much more that are also of critical importance.

On the other hand, SMEs expected that after the EU accession accessibility to banking and non-banking financial resources would improve.

IMPACTS OF THE EU ACCESSION ON SMEs IN THE REGION OF KOŠICE

It is difficult to evaluate the impacts of EU accession on SMEs because of small period from the accession. As opinion polling survey on impacts of EU integration showed, opinions of entrepreneurs from the region of Košice differ. The research was realized on a sample of 30 SMEs in December 2004. This research is not representative, but still it gives a basic indicative overview of SMEs opinions from the region of Košice on impacts of the EU accession.

Thirty SME managers from the region of Košice were asked to respond in a questionnaire-based survey. Companies from different sectors were involved in the following sample: retail trade – 9, catering services – 7, craftsmen – 5, clothing industry – 5, information technologies – 4.

SMEs' managers were requested to answer a simple question with seven possible responds. They were asked to choose the one that mostly corresponds with their perception of the impact of EU accession on their entrepreneurial subject.

Question: What is the main impact of the Slovak EU accession on your company?

1. Without significant changes.
2. Liberalization of the input prices.
3. Increase of the competition pressure.
4. Better access to EU market.
5. Better access to financial means.
6. Simpler EU funds raising.
7. Other impacts.

Table 1. Impacts of Slovak accession on SMEs within the region of Košice

Impacts of Slovak accession on SMEs within the region of Košice	No. of SMEs	Share (%)
Without significant changes	12	40 %
Liberalization of the input prices	6	20 %
Increase of the competition pressure	4	13 %
Better access to EU market	3	10 %
Better access to financial means	2	7 %
Simpler EU funds raising	3	10 %
Other impacts	0	0 %
TOTAL	30	100 %

Source: Own research

Though the research is not representative it allows getting the subjective opinions of the entrepreneurs within the region of Košice on the impact of the EU accession on their business activities. The results show that in the first months after the EU accession by Slovakia 40% of small

and medium entrepreneurs have not experienced significant impact on their entrepreneurial activities. This result is influenced by the regional performance of SMEs. We can suppose that in the case of big companies the share of enterprises which were not affected by integration would be much lower.

Significant is a share of SMEs (20%) that perceive the liberalization of input prices as a cause of the EU integration. The discussions are going on in the area of energy and gas markets' liberalization that would significantly affect SMEs. They have to calculate with further increase of the electric energy prices by 15-20%. The EU energy capacity is considered to be insufficient and with respect of a consumption pressure its price can increase. Entrepreneurs have to calculate with similar trends also in a gas industry (NARMSP, 2004).

Only 13% of responders perceive increase of the competition pressure as an impact of integration. Entrepreneurs were already under the competition pressure and that is why they do not perceive it as a major impact of the integration.

There is only 7% of SMEs perceiving a better access to financial means and 10% of entrepreneurs feeling a chance for an easier draw of financial means from the EU funds. This result is rather disappointing because the entrepreneurs expected from integration an improvement of opportunities to fasten and simplify the process of access to financial sources.

Imbalance of financial relations is a barrier for the Slovak SME competitiveness within the EU market. The liability maturity is in most Slovak SMEs approximately twice higher than the claim maturity. The insolvency has negative impact on the competitiveness of entrepreneurial subjects on the EU market.

One of the weaknesses of many SMEs is their inability to compete with financial services that are connected with the sale of goods and services. If SMEs want to succeed on the EU market, they have to eliminate this drawback. Almost every business subject can produce a product of good quality or offer a good service, the question is how to place them at the EU market and sell to customers.

USAGE OF EU FUNDS

After the EU accession the key funds are Structural EU funds and the Cohesion fund. The PHARE, ISPA and

SAPARD projects will be finished in the period 2004-2006 and since 2004 the structural funds and the Cohesion fund are available for the Slovak SMEs.

A basic difference between pre-accession and the Structural funds is in project approval. A pre-accession aid operated in the ex ante regime of approval, it means that every project was submitted to a Committee for approval (besides SAPARD). On the other hand, the Structural funds are operating in a decentralized ex post regime, i.e. approval of the project by the European Commission (EC) is not required. Responsibility for selection of the projects is on every state itself, the EC has only a monitoring function.

The EU contribution is 75 % from public expenditures for pre-accession funds, the sum of contributions by the Structural funds varies from 25 % to 80 %. The advantage for Slovak SMEs is that the level of each contribution depends on the development rate of given region measured by GDP per capita. Especially entrepreneurs from underdeveloped regions have a chance to obtain sources; in the Slovak Republic these are all regions except Bratislava. Difference between pre-accession financing and post-accession financing from EU funds is in the volume of provided financial resources. The pre-accession aid for all candidate countries was around 3 billion EUR per year, since the EU accession the member states are allowed to spend 4 – 14 billion EUR. (Drahosová-Fáberová-Gazdová, 2003)

It is necessary to use all financial sources from the EU funds in order to sustain fast development of Slovak SMEs. Many entrepreneurial subjects obtain a capital needed for the establishment or development of the entrepreneurial activities by using these funds.

STRUCTURAL FUNDS

The Structural funds focus on poor regions of the EU member states. Poor regions are classified using the criterion the GDP per capita that has to be below 75 % of EU average. The Structural funds are as follows:

1. European Regional Development Fund (ERDF),
2. European Agriculture Guidance and Guarantee Fund (EAGGF),
3. European Social Fund (ESF),
4. Financial Instrument for Fisheries Guidance (FIFG).

Table 2. Structural funds according to targets.

	TARGET 1	TARGET 2	TARGET 3
What does it finance?	Underdeveloped regions	Regions with structural difficulties	Regions requiring an aid in the area of education, scientific preparation, and labor skill
Structural funds	ERDF, ESF, EAGGF, FIFG	ERDF, ESF	ESF
Financial means for 2000-2006 (bill. EUR)	135,9	22,5	24,05
Share on structural funds' budget	69,7 %	11,5 %	12,3 %

Source: Action of the EU Council No. 1260/1999 about the Structural funds.

COHESION FUND

Financial resources from the Cohesion fund are available after the EU accession. This fund does not belong to the Structural funds, it was established in order to help economically weaker EU states. The basic difference is that the Cohesion fund is aimed for states, while the Structural funds are for the regions. Countries with GDP per capita below 90 % of EU average are eligible for this fund.

The Cohesion fund focuses on projects in the area of life environment protection, traffic infrastructure development, it finances also studies that are related to project realization. The level of co-financing is 80-85 % of total public expenditures.

Table 3. Commitments of EU towards Slovakia within the structural operations according to each year of shortened program financing in 2004-2006 in constant prices in 1999 in mil. EUR.

	Structural funds	Cohesion fund	Structural measurements together
2004	261.50	174.40	435.90
2005	351.50	143.60	495.10
2006	437.30	191.70	629.00
Total	1 050.30	509.70	1 560.00

Source: www.finance.gov.sk

Table 4. Commitments of EU towards Slovakia within the structural operations according to each year of shortened program financing in 2004-2006 in common prices in 1999 in mil. EUR.

	Structural funds	Cohesion fund	Structural measurements together
2004	288.72	193.11	481.83
2005	396.56	162.66	559.22
2006	502.33	221.49	723.82
Total	1 187.61	577.26	1 764.87

Source: www.finance.gov.sk

Decision of the Slovak government on division of financial resources among all structural funds resulted from the reaction to lower level of direct payments into agriculture, which on the basis of negotiations in June 2002 were at the level of 25 %, 30 % and 35 % in 2004, 2005, and 2006. Increasing of the EAGGF and FIFG share had to secure enough means in the agriculture. The Slovak government approved the following division of financial means of the structural funds:

- EU initiative: 5,38 %,
- ERDF: 46,62 %,
- ESF: 28 %,
- EAGGF, FIFG: 20 %.

WHAT WILL BE THE IMPACT OF EU ACCESSION?

According to the study carried out by the National Agency for the Small and Medium Enterprises Development the EU accession will have both positive and negative effects. Here are some of the examples:

- more opportunities for the cooperation with firms within the EU,
- more opportunities to succeed at the EU markets,
- threatening the firm activity by the competitors from EU countries,
- widening and improving the purchase conditions for the Slovak SMEs,
- equal legislative environment for all entrepreneurs within the EU,
- development of cooperative contracts with EU firms,
- regional and branch cooperation,
- easier access to financial sources,
- increasing export to EU,
- increase of competition on the domestic market,
- drain of the qualified working power,
- increasing of the requirements for the qualitative production.

In the area of economic and financial conditions it is necessary to secure an easier and simpler access to bank loans. This requirement has a permanent priority. It is necessary to eliminate risks at every level and to use offered opportunities.

CONCLUSIONS

SMEs create a basis of the Slovak and the whole EU economy and therefore it is necessary to create such conditions that would allow them more effective functioning and prosperity. It is important to take following actions in order to secure a prosperous position for SMEs:

- legislative norms of good quality such as fast and inexpensive set up of a company, employment of workers, economic and accounting agenda (implementation of the International Accounting Standards),
- advancement in the area of finances, e.g. by obtaining of financial resources, in taxation load (implementation of the flat income tax rate 19 % and one value added tax rate at the level of 19 %),
- education system of good quality producing good quality human resources, well educated students with entrepreneurial spirit,
- good preparation of entrepreneurial ideas and projects that would classify for financial resources from the EU funds,
- strengthening of innovative and technological SMEs capacities, such as implementation of e-business,
- creation of effective representation of SMEs at the regional, national, and EU level.

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Összefoglaló

A cikk az EU bővítésének a Szlovák Köztársaság üzleti környezetére gyakorolt hatását vizsgálja. Szlovákia Unióhoz való csatlakozása jelentős mértékben befolyásolja a kis és közép vállalkozások működési feltételeit. A kis és közepes vállalkozások jóléte főképp azon képességük függvénye, hogy mennyire tudnak ezekhez az új feltételekhez alkalmazkodni.

Резюме

Статья рассматривает как расширение Европейского Союза повлияло на предпринимательское окружение в Словацкой Республике. Присоединение Словакии к Европейскому Союзу в большой степени повлияло на условия функционирования малых и средних предприятий. Благополучие малых и средних предприятий та функция, которая показывает, как эти субъекты могут адаптироваться к новым условиям.