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Developmental perspectives on SMEs on the borders of the European Union: The case of the Lublin region

ABSTRACT

The paper discusses determinants of development of SMEs in a border region in the recently-enlarged Europe. Based on a case study in the food sector in the Lublin region, Eastern Poland, the focus is on possibilities for the expansion of SMEs. This sector is compatible with the intellectual potential, the ecological strengths, and the potentials for tourism of this region and of the neighbouring Ukraine. The paper also argues that a change in mentality from state to private ownership can be a stimulating factor for economic development. As the region is relatively poor, its future economic and social progress will depend more on a rise of small and medium enterprises than on an expansion of large firms.

1. INTRODUCTION.

In addition to economic and socio-political factors, geographical location can be one of the crucial determinants of regional economic growth. Coastal and mountain regions may profit from tourism, while regions surrounding the capital cities benefit from the "centre effect,." But regions bordering neighbouring poor countries face special economic risks. Historical conditions may also be crucial.

2. REGION CHARACTERISTICS

The Lublin Region (LR) in Poland is one of the most eastern areas in the European Union, bordering on Ukraine and Belarus. During Poland's period of partition, 1791 – 1918, the territory around Lublin belonged to Austria. Even now, agriculture remains dominant. According to Eurostat, the Statistical Office of the European Communities, in 2002 it was the poorest region in the EU. GDP per capita, expressed in terms of purchasing power parity, was 32 per cent of the average of the EU25's 254 regions (EU News Release, 2005)[1]. As the third largest region (of 16) Lubelskie covers 8 per cent of Poland's surface with a population of 2,185, 000 inhabitants (5.7 per cent of the total). There are 213 communities, 19 of which are urban and 174, rural. About 47 per cent of its inhabitants live in towns. The mean number of people per square kilometre is 87 (as compared to 122 for Poland as a whole), but in Świdnik (close to Lublin) there are 155/km^2 and in Włodawa (on the Bug river) only 32/km^2.

Table 1. GDP in 2003.

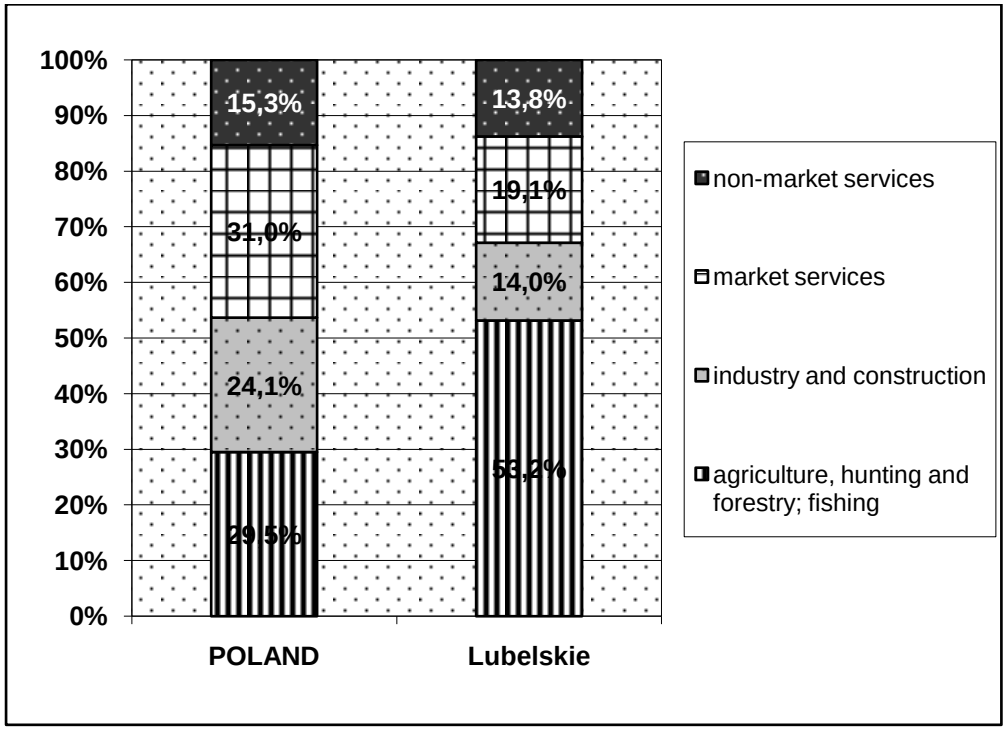
in PLN	POLAND	Lublin Region	position among of 16 regions
Gross Domestic Product	781,112,4	31,446,8	10
GDP per capita	20,431	14,300	16
Gross Nominal Disposable Income Per Capita	14,805	11,932	14
Average Monthly Gross Wages and Salaries	2,185	1,907	14
Registered Unemployment Rate	20%	18.7%	6

[1] Significantly, all five regions with the lowest GDP per capita were in Poland. These were four border regions: Lubelskie (32 per cent of the average), Podkarpackie (33 per cent), Warminsko-Mazurskie (34 per cent, and Podlaskie (35 per cent), and one interior region Swietokrzyskie (36 per cent). All sixteen Polish regions were below 75 per cent of the EU average regional GDP per capita. (EU News Release, 2005).

In 2003-04, the region's GDP grew by 1.3 per cent, while the national growth rate was 5.3 per cent. The region has only a 4.04 per cent share of national GDP, which locates it in tenth place in the rankings (see Table 1). GDP per capita is 70.17 per cent of the national mean, placing the region in last place right after two bordering eastern regions (one to the north, one to the south). The low contribution to GDP is caused by, among others factors, the employment structure - 38.3 per cent of the labour force work as small farmers in traditional agriculture. Approximately 57 per cent of the region's area is devoted to agriculture (arable land, orchards, meadows and pastures); important crops include potatoes, fruit, vegetables, tobacco and hops which in total account for 8.81 per cent of total national agricultural production, sugar beetroot (14.66 per cent), and soft fruits (strawberries, 5.83 per cent; raspberries, 73.98 per cent; and cherries, 14.22 per cent).

There are several reasons for the region's low contribution to GDP. First, Lubelskie is historically a rural region. Although the percentage of total area used for agriculture, 57.1 per cent, is higher than average for Poland (51,7 per cent) however the percentage of population living in Lublin rural districts is greater than the national average – 53.40 per cent in Lubelskie as compared to 38.84 per cent in whole country as a whole. Moreover, half of working population, 53.2 per cent, comprises individual farmers, which is much more than the average of 29.5 per cent for Poland at large (see Figure 1 for employment in 2003). The rate of unemployment is slightly smaller for Lubelskie than for the whole country, but there is high hidden unemployment in agriculture.

Figure1. Employment in 2003

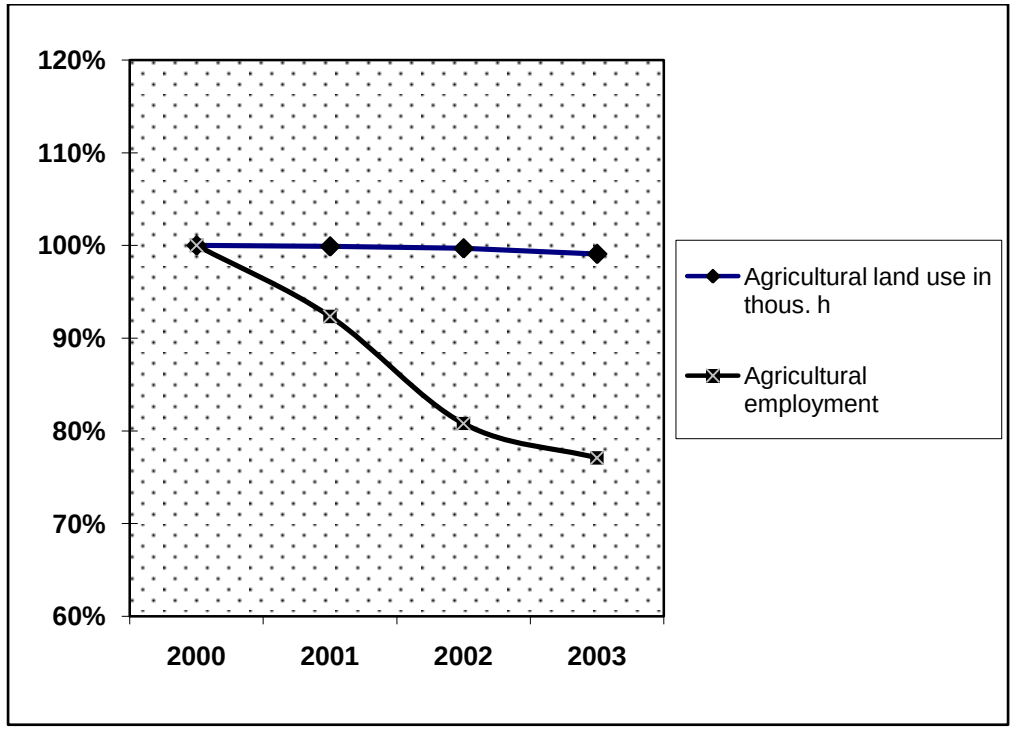


The region is underdeveloped with growing subregional disparities. Its transport infrastructure does not meet investors' expectations (see Table 2). Although important routes lead through the region to Belorussia, Russia and Ukraine, the main transport networks by-pass it and there is no local international airport. This results in a low level of investment attractiveness. According to the Institute of Research on Market Economy, Lubelskie's investment attractiveness is the lowest of all Polish regions (Swianiewicz & Dziemianowicz, 1999), with direct Direct Foreign Investments (DTI) accounting for only 1.2 per cent of the total. Improved transport facilities and other infrastructure should be the highest priority for local government efforts to enhance development.

Table 2. Transport and communication in Lubelskie in 2003.

	average in Poland	Lubelskie	position of 16 regions
Standard Railway lines per 100 km^2 in km	6.5	4.2	15
Hard surface public roads per 100 km^2 in km	79.6	71.2	11
Passenger cars registered per 1000 population	294	262	11
Telephone main lines per 1000 population	322.2	279.2	13

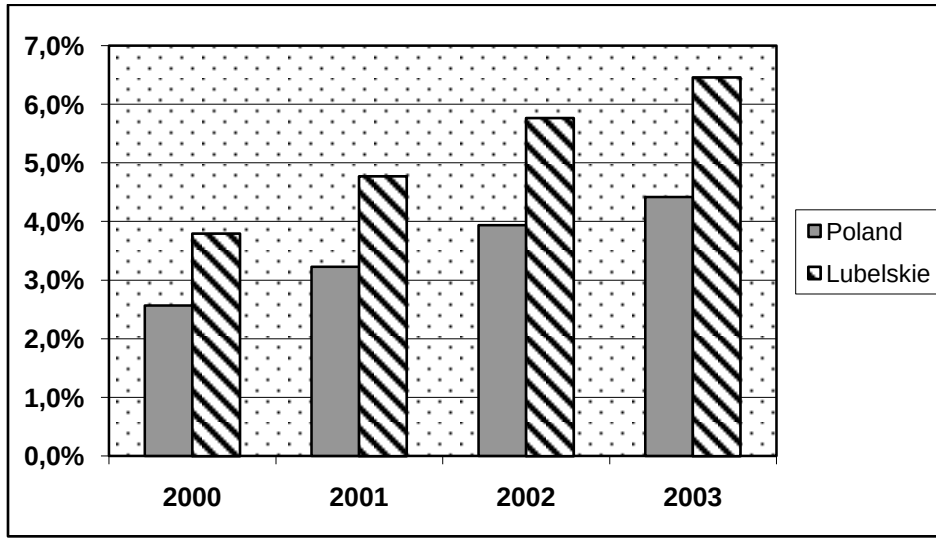
Figure 2. Agricultural land use and employment in Lubelskie



OECD research on cultivating regional development shows some medium term trends for rural regions. The most important tendency is declining employment opportunities in primary industries (OECD, Pezzini, p. 4) In Lubelskie over the last decade the number employed in agriculture has been decreasing, with 23 per cent fewer people in the sector in 2003 than in 2000 (see Figure 2).

Another tendency is an out-migration of young people caused by lack of employment opportunities. Lubelskie is hardly unique in this respect. Nevertheless, in 2003 the region's population decreased by 0.7 per cent while total population in Poland decreased only by 0.2 per cent. Lubelskie is second among Polish regions in its high negative net internal and international migration for permanent residence, with a rate of -2.1 persons per one thousand of population. Although Lubelskie provides satisfactory access to facilities in higher education, there is not enough demand in the local labour

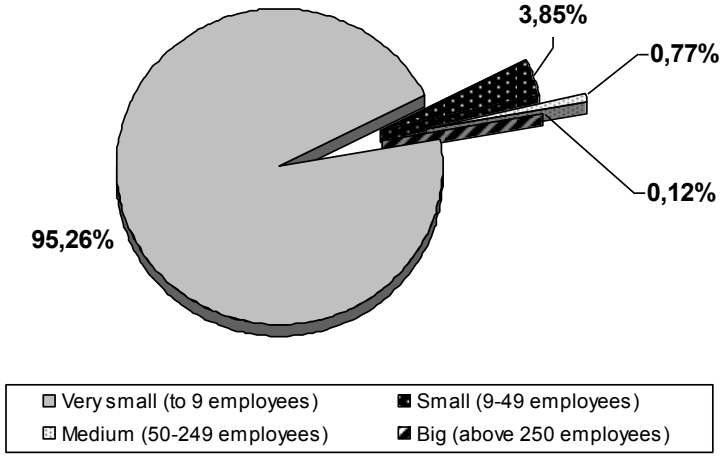
Figure 3. Percentage of unemployed postgraduates in total unemployed number



market for graduates. It is ranked sixth in comparison to other regions in respect to the number of students, with 457.5 students in higher education institutions per 10 thousand population. However the share of unemployed graduates is growing faster in Lubelskie than in Poland as a whole (see Figure 3)

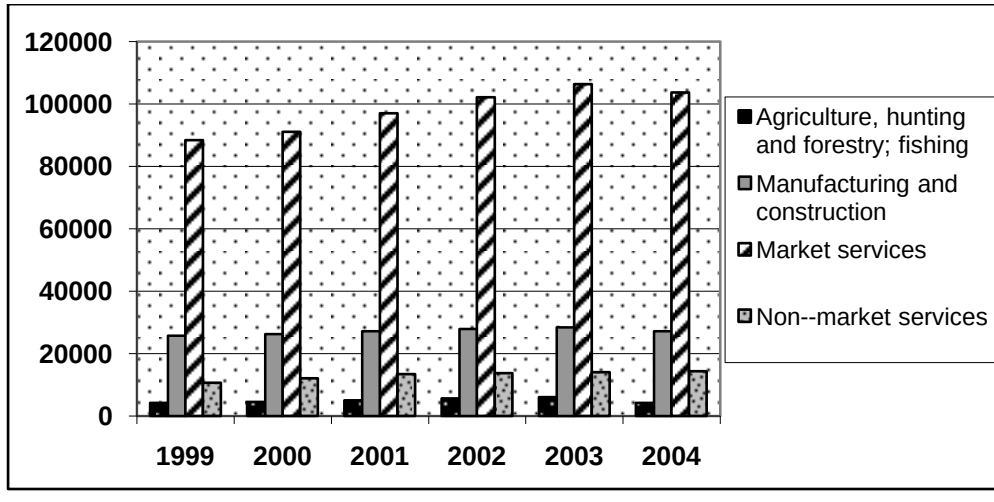
In 2004 there were 149,478 registered enterprises, that is, 4.18% of the country's total. Most of them (116,849) were small, privately-owned enterprises, but the rest (32,629) were state owned firms, cooperatives, commercial companies with foreign capital participation, and joint stock firms with limited liability. 142,400 firms in Lubelskie employed less than 9 workers, 5,757 were small companies, and 1,148 medium-sized. Enterprises employing more than 250 workers constituted 12 per cent of the total (see Figure 4).

Figure 4. Structure of economic actors in the region (based on Central Statistical Office)



Accordingly to ECC regional data, trade and repair enterprises comprised 36.17 per cent of the total; real estate, renting and business, 12.1 per cent; construction, 9.3 per cent; industry, 8.90 per cent; and transport and storage and communication, 7.52 per cent. Slightly over sixty percent of enterprises are located around Lublin.

Figure 5. Structure of Economic Entities by Activity in Lubelskie



The number of enterprises decreased by 3.5 per cent in 2003-04. Moreover, the pace of establishing new companies has fallen. There were 12,079 new companies established in 2003 and only 10,052 in 2004. On the other hand the number of companies liquidated has increased dramatically from 6623 in 2003 to 9960 in 2004, that is by 50 per cent. These numbers suggest hard conditions for entrepreneurs in the region.

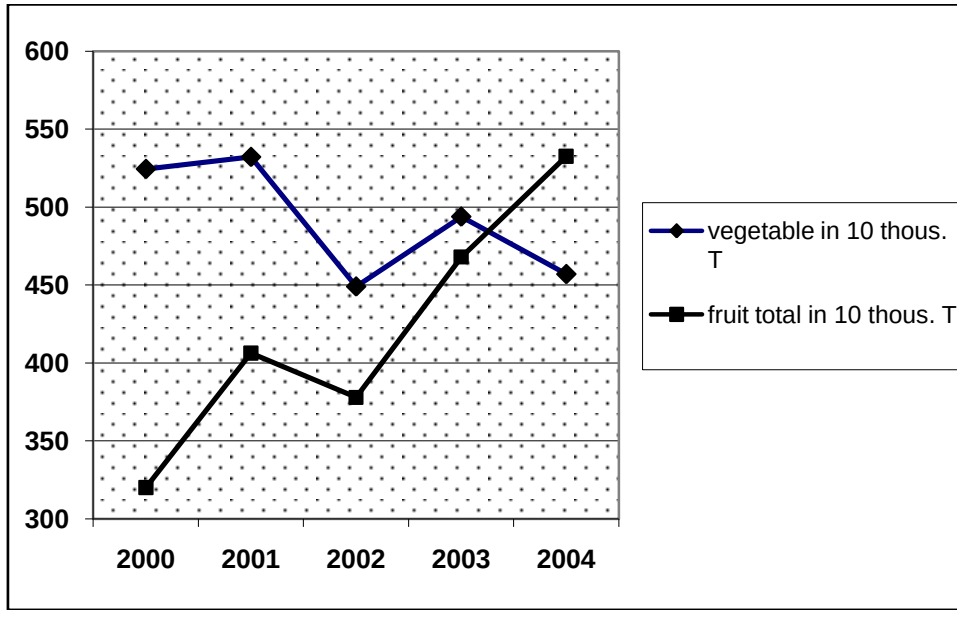
3. DEVELOPMENT PERSPECTIVES

What are the odds that Lubelskie will develop economically in the new Europesn economic environment? Is it agriculture, tourism, industry, SMEs,

scientific activity or some other economic domain that could contribute to the region's prosperity? Successful opportunities for the region's development are concentrated in areas providing competitive advantages in factors such as an ecologically clean natural environment, education and low labour costs.

The main regional competitive advantage is based on climate and soil conditions and Lubelskie's clean natural environment which are perfect for cultivating some kinds of crops and for ecologically sound agriculture in general (Figure 6 and Table 3).

Figure 6. Vegetable and fruit crops in Lubelskie



Furthermore, there agricultural technology is improving. There are already recognized factories of milk and fruit products of high quality, although this sector is not yet fully exploited. The traditional pasta plant described by Zaleski in the PILOT reports provides an example of joining

traditional with modern technology[2]. The simple products appeal to people's taste and gusto whereas new technological solutions have also been introduced. The food processing development in the Agriacademy could offer new products to the market, keeping in mind that the region is a granary and a source of various fruits and vegetables. In addition, underground potable water is of the highest quality. The wholesale market in Elizówka is a meeting place for agriproducers and merchants. It could also serve as basis of novel ideas for food production. The European market and subsidiary policy for less developed regions plus proper use of local capabilities (e.g. human and natural resources) can be a fruitful scene for development.

Table 3 Structure of Market Agricultural Output in 2002 (Percentage's)

	Poland	**Lubelskie**	**Difference**
Grand total	100	100	
Crop output			
total	36.1	44	7,9
cereals	12	11.7	-0.3
industrial	6.3	10.6	4.3
potatoes	2.9	2.3	-0.6
vegetables	7.1	8	0.9
fruit	6	10.3	4.3
Animal output			
total	63,9	56	-7,9
cattle for slaughter	3,7	3,2	-0,5
pigs for slaughter	25,9	20,8	-5,1
poultry for slaughter	9,7	5	-4,7
eggs	4,5	3,2	-1,3
milk	18,1	21,8	3,7

Development also requires a mentality change among local entrepreneurs, who should collaborate more with the university institutions and with the YOUNG research institute in Puławy than at present. The merger of tacit,

[2] http://www.pilot-project.org

practical knowledge with theoretical advancement at the universities may lead to novel solutions.

Another chance dwells in tourism and more specifically in the agricultural tourism. The region is still ecologically clean with many accessible lakes, forests rich in undergrowth including areas overgrown with blueberries. More initiative could be undertaken to build collaboration with Ukraine across the Bug river, one of the most important naturally preserved treasures. The big lakes on the Ukrainian side could attract tourists, once a cross-border recreation summer area has been developed and advertised. The possibility to meet two distinct cultures, sample the local folklore, and eat "ecologically-sound" fresh water fish is attractive to many people from highly urbanized areas.

4. THE DEVELOPMENTAL ROLE OF SMES

As heavy industry is unlikely to settle here, greater stress needs to be put on services such as transport, building, carpentry, medical help, and computer programming provided that the services could be marketed locally and in nearby regions. In contrast to its economic situation and agricultural character, Lubelskie possesses some strong features, one of which is intellectual potential. There are five university level schools with approximately 100,000 students per annum, 60 per cent of whom are female. The Academy of Agriculture, Polytechnics, a Medical School and two universities provide educated people in various domains, even though many of the graduates currently leave the region in search of better work opportunities. The recent idea of building a Scientific Technological Park could absorb some of the graduates and be source of new technological solutions in food production and technology, aviation or telecommunication.

In Świdnik the helicopter plant has a chance to develop within the so called Eastern Aviation Valley extending from Dęblin to Rzeszów and Mielec in the South.

Small firms, flexible in production and location and focused on export products, have a chance to develop with benefit to the whole region. It is puzzling that so few satellite SMEs have grown around large enterprises in coal mining, nitrogen fertilizer production and cement. Recently, a new wood furniture company emerged in Biłgoraj. Not only is the local market well covered by its products but exportation to other European countries is also growing at a reasonable rate. New designs and new materials (e.g. melamine from a Puławy factory) make the furniture attractive to customers.

The growth of SMEs is also dependent on more general policies included in the National Development Programme. These firms need a decentralized system of financial support and greater financial help – for example, access to cheap credit. Better technical infrastructure (roads, the Internet) is needed, and more power should be given to regional authorities. Other improvements would include simplifying the legal basis for private entrepreneurship, increasing financial support for education and training, support in purchasing new technologies, rewarding the introduction of novel technologies, assistance in investment (e.g. converting agricultural terrain into industrial properties by building roads and terminals). Central and local policy should consider all the main factors contributing to an entrepreneurial atmosphere.

As a substantial proportion of unemployed people have secondary and tertiary educations, assistance in properly channelling these resources is crucial. These people are well equipped to acquire "know how" and if motivated and supported may take the challenge of setting up their own businesses. Entrepreneurship need not happen by accident; it can be

intentionally fostered on both sides – on that of the government as well as on the level of individual potential entrepreneurs.

With relatively large number of students, there is strong human potential in the region. At the end of 2004, around 993,000 people were employed, of whom 84,764 were in industry, 29,326 in trade and services, 12,365 in building, 6,956 in real estate and company service firms, and 1,630 in hotels and restaurants.

As 38.39 per cent of the population live in rural areas, rapid migration to towns could be risky. Instead, establishing new activities in the countryside is more natural, even when the environment is agricultural. People have to know that SMEs are a powerful locomotive in economic development (Grant Thorton, 2002). The Central Statistical Office has reported that in 2001 SMEs contributed 48 per cent of GDP. The cost of employing a person in an SME is 3.6 times lower than in a large enterprise. This suggests that investments by SMEs could employ proportionally more people than the same level of investment by larger firms (See Glikman, 2002, 2001).

Among the barriers handicapping the development of SMEs are low capital, low financial and legal stability, strong competition, and lack of cooperation. After the socialist period, there was obviously a low rate of accumulation of capital in private enterprises. Without the sufficient capital, prospective investment will not happen. People need to feel solid ground under their feet to undertake risky investment. The shortage of financial resources evokes psychological barriers that act as handicaps to economic activities.

Taking these disadvantages into account, is it feasible to base development policy on the growth of SMEs? We say YES. Much also depends on the efficient use of human factors operating in a market context.

We see this emerging in creativity, for example in new products satisfying people's needs and tastes in the food sector. Not only the local but also the Western and Eastern markets can be challenged. The eastern border is the entry to big markets in post-soviet countries. Single investors and entrepreneurs should create small consortia leading to greater efficiency in the value chain. This could be realized in cooperation with the planned Technological Park to be built in next few years. The academic centre should itself play the role of an inventor as it once did with fiber-optic telephone lines, when they had been disgracefully hindered by the communist regime[3]. The constant creation and accumulation of knowledge that is occurring should be transferred into the production sector.

5. WHAT DO SMES REQUIRE FOR DEVELOPMENT?

The growth of national and regional economies and the encouragement of employment requires stimulation of entrepreneurship on national, regional and enterprise levels. External influences via state policy or scientific institutes can either facilitate or hinder individual initiative. There have to be clear and readable rules and a legal basis for opening and running a firm. The state has to simplify and stabilize the taxation system, minimize the bureaucratic burden related to concessions and simplify the opening or establishment of a new firm. Non-directly visible but important are the level of public sector deficits and the state of the public debt as these affect interest rates on bank loans.

More direct support is possible on the national level. For example, the government could forgive or postpone health service and retirement taxes for

[3] The state authorities had imposed cooperation with the Soviet Union rather than with Sweden, the technological leader in the field.

newly opened firms, as in France where new firms pay social fees for their first year of activity only after they have been in business for five years. Other forms of assistance would be to facilitate access to seed or venture capital, depending on the development stage of a firm, and to encourage R&D. Basic research that at first glance does not seem to be very useful often finds eventual application and becomes crucial for innovative solutions.

Due to strong differentiation among Polish regions, the assistance instruments should be specifically designed for each region. For instance, our region with its agricultural profile requires different financial and material help than the Gdańsk area. Initially, the Lublin region did not participate in RITTS programme (Regional Innovation and Technology Transfer Strategy) which came into operation in 1994, or in RIS (Regional Innovation Strategies), which was inaugurated in 2001/02 for new member states of EU. The Lublin region was only included in a new edition of RIS in 2003 (Szultka, 2005).

These broader policies do affect the development of SMEs. To start a firm and become competitive does not happen in vacuum. The presence of a healthy state and local "nest" is a requirement as exemplified by the presence of relevant scientific and research centres. As Lublin is a university city, there are moves by the firms from the metal and food sectors to get support from academics. The case study of the metal sector reported to PILOT by Z. Zaleski can serve as an example. STALMET often is challenged by a major Italian customer with strict demands for precision parts. The manager has signed an agreement with the appropriate institute of Lublin Polytechnic and asks them for assistance whenever a technological problem arises. "They do it much faster than we could have done and find a solution which my employees would not find under the time pressure," says the firm's owner.

Regional authorities and business organizations should foster the creation of clusters in which similar problems can be handled at lower cost. The professional training of the labour force can be cheaper. It is also possible at the regional level to determine which sectors offer the prospect of success and what trends in the economy and in human preferences are at stake. The establishment of clusters such as the Technological Park, Aeronautic Valley and Valley of Ecological Food promotes sustainable development in the region.

On an individual level it is crucial to enhance innovative thinking, professional and more general education, and openness for risk taking and fair competitiveness. As these factors are less codified and generally not legally mandated, they have to be internalised by those who embark on careers in business. Weber's (1994) "capitalistic spirit", characterizing the entrepreneurial soul, is no less important than state and regional policies. While we do not discuss the issue of private ownership here, we should note that it is still problematic on a psychological level in Poland after 50 years of state ownership (Zaleski 2003), but the notion is becoming increasingly embedded in people's mentalities. Soon, the descriptive term "owner of X firm" (for example "Mr Nowak and Son Fruit Company"), will become typical, replacing such impersonally-named state firms as Chocolate Factory "22 July". The positive outcomes arising from an assumption of full responsibility, engagement, planning for the future and respect for other's possessions is only possible when one has a share in the ownership of the company or unit that employs him.

Creating a group of entrepreneurs rests on many conditions, among which trust and reliability are crucial. In a society divided for decades by the political strategy of the communist regime, the rebuilding of trust is not an

easy process. Legal contracts and agreed-upon rules of common activity will not be enough to ensure successful collaboration in the absence of mutual trust (see: Błachnio, 2005). When trust is present, a group works together and unites on common goals, in the process providing an atmosphere for risky but necessary experimentation and innovation. Where trust reigns, written assurances such as contracts are unnecessary. Thus, trust between partners is a condition sine qua non for the development of SMEs as well as for the economic activity of larger units (Buss, 2001).

Imagine that a pencil manufacturer does not trust a new distributor to pay a contractually-agreed amount on time. He would then be reluctant to deliver the product. The importance of trust may increase when a potential partner is distantly located in geographical, political or social senses, or when there is a lack of social embeddedness. Possessing a good reputation, particularly in small communities, can be a buffer against unfaithfulness. In sum, the presence of common trust in business is one of the significant factors underlying a willingness to engage in development through risky innovative experiments.

6. NOVELTY IN WOOD AND FOOD SECTORS?

In keeping with its agricultural character, the Lubelskie region has many woods with undergrowth such as blackberries, parks, nature reserves and lakes well stocked with fish – all the features needed to qualify it as a producer of healthy ecological food. Local firms, even though small, may generate effective growth in cooperation with academic centres, service providers and local government. An example is the regional innovation strategy named "Valley of ecological food" (Szymkowiak, 2005). This project supports education on healthy way of eating and the creation of

innovation clusters in the sector. Obviously, once put into practice, the project will stimulate other sectors such as packing (paper, plastic), distribution, services and storage. Modern eating habits (at work or during travel or teaching breaks) require the use of semi-prepared packages of food. This will change the whole food processing value chain by aiming at final consumption not in a restaurant but on the college-yard bench or in the social rooms of a factory or a mine. Thus by the nature of its potential customers, a college bar has a chance to supply new types of demand and to experiment in novel uses of products across a wide range – potatoes, ketchup, napkins, paper plates, plastic utensils, etc. In cooperation with the Management Department, the college bar can run a study among its customers regarding their preferences for served food. With the purchase of a microwave oven, the bar might serve famous "pierogi" in large quantities to the dietary satisfaction of customers and the financial satisfaction of producers of potatoes and milk, not to mention providers of transport services and cooking systems, and suppliers of paper and plastic products. On a larger scale, food festivals, competitions, medical advice and research might be undertaken. For example, the creation of a "Euroregion" near the Bug river with attractive lakes on the Polish and Ukrainian sides could be a premise for a "modern" food market.

Located at outskirts of Lublin, the agricultural wholesale market can serve the immediate region and beyond. The flavour of the common past before 1939 still has a strong potential to attract tourists from Western Europe to whom this part of the continent was effectively barred under the communist regime. Except for microwave ovens, all the necessary products can be produced by local SMEs if they work together and are open to

necessary changes demanded by the market and to novel changes introduced by the cluster itself.

Furthermore, the concept and its associated innovations can easily be exported to the neighbouring Ukraine. A relatively large number of students in the region come from there, and seasonal workers and tourists traverse the area. Polish services are regarded with high esteem as being Western, allowing the extended market to be stimulated and promoting cross-border cooperation.

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