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GLOBALISATION AND THE PORTUGUESE SMES

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INTRODUCTION¹

SMES are, in Portugal, a central pillar of present economic structure (64% of the value added in Manufacturing, 67.5% of employment and 30% of all firms) and will play a decisive role in shaping the evolution and the future of Portuguese economic situation.

Those figures are not strikingly different from those of most countries. Behind this apparent statistical regularity there are, however, some major differences among countries, namely between large and small economies. As a matter of fact, because of their size, small countries were not able in most cases (the best known exceptions being the Netherlands and Switzerland), to develop an elite of large firms which, in large countries, did play a structural role in economic activity.

Historically, SMES produced primarily to domestic markets and tended to specialise in non-tradable goods. Recent trends of internationalisation and globalization threaten such "establishment" and are a matter of concern for economies very dependent from SMES. This is specially the case in small open economies.

In Portugal, such a situation is particularly felt because of the role that, historically, SMES also had in export oriented sectors. Portuguese SMES are, thus, subject to increased competitive pressures both domestically and in international markets. Within this context, the purpose of this paper is to characterise the importance of SMES in overall economic activity (part 1), to study their role in export oriented sectors and the evidence on whether, and how, SMES are coping with internationalisation and globalisation (part 2), and to analyse the factors and affecting the involvement of SMES in globalisation. We conclude with some remarks about some policy and strategy issues.

¹ This paper draws on a research being done for an OECD project on SMES and Globalisation.

1. The role of SMEs in the Portuguese Economy

In Portugal, a firm is classified as a Small and Medium Sized Enterprise (SMEs) whenever it has less than 500 employees, less than 2,4 billion Escudos in sales (value for 1993) and it is not controlled (more than 50%) by any company nor does it hold over 50% of any other company, not meeting the first two requirements. However, because of the difficulty in obtaining information relating to the last criterion, this is often omitted in empirical studies.

Given the scope of this study, as well as the type of information mostly available, we will primarily resort to the criterion "number of employees" to classify firms as outlined below:

- <10 — micro-companies
- 10 to 99 — small companies
- 100 to 499 — medium companies
- >500 — large companies

SMEs do assume a crucial role in the Portuguese economy. More than half of the Portuguese work force is presently employed by SMEs, whose output represents about 50% of total turnover.

SMEs contribute somewhere between 26 and 83% of employment and between 20 and 96% of value added, depending on the industry.

An analysis of SMEs by sector (see Table 1) reveals that with respect to manufacturing industries, SMEs are dominant in foodstuffs, beverages and tobacco, clothing and footwear, wood, wood products and non-metal minerals (70% to 90% of the total value added).

Throughout the 80s SMEs seem to have contributed more to job creation than larger firms.

In recent years SMEs importance evolved twofold: the share of SMEs decreased to 25% from 30% of the total number of firms but their share of the work force grew from 55% to 59%. This increase in terms of employment is not only a sign of SMEs potency as regards employment growth but, at least in part, also due to the diminished role of larger corporations, which were compelled to cut down on jobs. Simultaneously, the reduction in terms of number of firms results from the increased weight of micro firms.

SMEs account for a small proportion of firms being created each year (7.4% in 1990); the vast majority (99.4%) of new firms employed less than 10 workers. Notwithstanding, new SMEs contribute with more than 30% of total jobs created by new firms. In what firms closure is concerned, micro-firms are also over represented. Nevertheless, SMEs account for a large proportion of closures than they do of creations, a natural consequence of industrial restructuring processes.

2. Evidence on the Extent and Trends of Globalisation of SMEs

The Portuguese economy, although largely internationalised and exposed to globalisation forces, is only moderately globalised.

Overall, the Portuguese economy has attained a high level of internationalisation, which steadily increased throughout the 80s; the openness degree of the economy was around 80% in the early 90s. Among other reasons, such fact is primarily due to the pattern of specialisation of the economy (built around manufacturing of tradable goods) and the fairly small size of the domestic market.

Regarding the first point, one should emphasize the importance assumed by tradable goods, namely textiles, clothing and footwear, food and beverages, metal products, tools and instruments, wood, and wood products. Therefore, Portuguese economy is by its nature potentially exposed to international competition. Furthermore, it is important to stress that, due to the small size of the domestic market, Portuguese industrial firms have, since long, been compelled to seek alternative markets for their products. This is precisely one of the main reasons why Portugal was among EFTA founding members. Consequently, since the 60s Portuguese firms became a regular presence in the international arena, mostly in Europe and the USA. Although this pattern is not evenly distributed, the most important sectors of the Portuguese industrial structure are among the most export oriented. Among the sectors predominantly confined to the domestic market are the chemicals and metallurgical industries (see Table 2).

Recently, import penetration has experienced a large increase. For many years the flow of imports was discouraged by governmental duties and regulations, not to mention the small dimension of the domestic market (not large enough to entice foreign firms). In spite of that, imports have been reasonably important, mainly due to a lack of raw materials and the weakness of some manufacturing sectors (machinery and equipment, chemical products and basic metal industries, etc.). From this standpoint, the relationship between imports and domestic products can be said to be complementary rather than competitive: imported goods were primarily produced by sectors less export oriented. However, these words should be taken carefully as the available data concern the year of 1988 and, subsequently, foreign products have acquired a larger share of the market, mainly in consumer goods such as clothing, footwear, furniture and food products. Therefore, the described complementary role is progressively being eroded and replaced by competitiveness and inter-industry trade by intra-industry trade.

From the mid 80s on the Portuguese economy has become more exposed to world trade flows. This trend has evolved twofold: on the one hand, due to a growing world tendency towards free trade, Portuguese exports were submitted to strong competitive pressures, even in their traditional markets; on the other hand, the same forces and trends were also at work inside the country, irreversibly pushing its domestic market towards globalisation. The latter could in part be explained by a substantial deregulation of trade and a strong increase of demand, originated by a period of sustained economic growth, which in turn rendered the domestic market more attractive to foreign manufacturers.

This phenomenon, occurring by means of an international trade expansion, maintains, nevertheless, a well defined geographical pattern. Relations with traditional EC commercial partners still prevail and, if anything, were reinforced. To be stressed is the increased importance assumed by Spain, both as a supplier and as a buyer ensuing the accession of both countries to the EC. An analysis by sector reveals that, although

the pattern of trade did not change significantly, some sectors, traditionally sheltered from commercial trade inflows, have been gradually facing foreign competition. Some examples can be found not only in some manufacturing sectors (namely furniture) but also in agriculture and construction.

Growing foreign investment also became an important component in the globalisation process, especially in the late 80s. Capital inflows and outflows, traditionally of a reduced significance, went through a sustained growing period, particularly regarding foreign direct investment in Portugal. In spite of that, the share of capital of foreign-owned firms only amounts to 3% of total capital in manufacturing. Although showing a rapid increase in recent years, Portuguese investment abroad remains modest, representing a diminute fraction of each sector Gross Capital Formation (Figure 1).

Foreign Direct Investment originates primarily in Europe, particularly in EC Member States. Spain and Germany represent the major sources of capital aimed at industry, whereas the UK and France assume the same role in services.

Investment outflows are preferentially targeted at the Portuguese Speaking African Nations. France (commercial sector) and Spain (manufacturing sector) stand as the European countries favoured by Portuguese investment abroad.

While striving for globalisation, the economy clearly operates in two different geographical fronts: foreign capital inflows and commercial trade take primarily place with EC Members States; foreign capital outflows, still representing the weakest link in the Portuguese globalisation process, follow a rather distinct geographical pattern, being mostly directed to Africa.

SMEs are well represented in export oriented sectors and under-represented in sectors with high level of foreign ownership.

There is virtually no comprehensive, statistical evidence on the extent to which Portuguese SMEs are engaged in international activities (exports, imports or foreign investment). To our knowledge, data on external trade and investment flows are not collected by size class of firm. Nevertheless, we gained access to some data that, although not necessarily representative, can give an idea of some practices of Portuguese firms in dealing with international activities. For a sample of some 1660 Manufacturing firms, 50% of them export. Export ratio is not correlated with firm size with the highest value (52.8%) being attained for size class 50-99 employees. By type of product, the highest values (60 to 90% of total turnover being exported) are obtained for some traditional industries (clothing, footwear, cork) in which SMES prevail.

Anyhow, manufacturing and service industries with higher levels of foreign ownership (e.g., chemical and transport and equipment) tend to have low levels of SME employment and high import to turnover ratios. On the contrary, manufacturing sectors with very high level of SME employment (clothing, footwear and miscellaneous manufacturing, for example) tend to be nationally owned and have high export to turnover ratios.

Portuguese SMEs are increasingly subject to global competition.

Throughout the 80s, Portuguese SME exposure to international competition is, primarily, the result of three joint factors: (1) the world globalisation process; (2) domestic policies; (3) the pattern of Portuguese industry specialisation.

During the 80s, globalisation intensified worldwide due, to a large extent, to the development of new information technologies. Economic integration (mainly the Single European Market and the European Monetary Union) and world trade liberalisation (of which the recent completion of GATT negotiations is the best example) constitute, perhaps, the two most important trends in this process. For Portugal such phenomena were of crucial importance namely because their development coincided with its accession to EC in 1986.

At the domestic level, there was a shift of focus in economic policies that resulted in a stimulus to the internationalisation process. Among others, three aspects deserve to be mentioned:

- Protectionist barriers, which still sheltered the Portuguese economy, were dismantled, both as a result of Portugal's accession to EC and of the different stand of the Administration vis-à-vis globalisation ; furthermore, liberalisation was extended to capital and labour movements and to the establishment and provision of services;
- New policy instruments were introduced aiming at internationalisation promotion;
- Finally, exchange rate policy operated to reinforce the trends above mentioned (initially a weak Escudo helped exports; later imports were rendered more competitive by a strong Escudo).

The pattern of specialisation of the Portuguese economy, resulting in a high exposure of the productive sector to world globalisation forces, was the underlying factor to understand the impact of such measures. Furthermore, such specialisation is instrumental to understand both enterprises' reactions to globalisation support programs and the consequences of shifting exchange rate policies.

The timing and extent of the impact of globalisation forces upon industries and, particularly, upon SMEs will differ according to the nature of the goods being produced. Thus, export oriented companies will be submitted to tensions, different from the pressures affecting companies producing tradable goods aimed at the domestic market, or enterprises producing non-tradable goods.

Foreign competition was felt in the first place by export oriented companies, due to a high degree of competitiveness characterising their traditional European markets. Such trend is prone to intensify even further, since those markets have opened up to the Newly Industrialised Countries (NICs), Developing Countries and, particularly, to Central and Eastern European Nations.

Most Portuguese enterprises, namely SMEs, approach international markets in a dependent manner. They compete mainly through price, do not have a direct presence in those markets, and sell their goods primarily to large wholesalers or retailers. Therefore, they are more vulnerable to globalisation which translates in strong pressures on production costs. Invariable the consequences will be the irreversible loss of competitiveness capabilities (with operations being phased-out subsequently), or re-organisation/modernisation, namely at the production level (often with jobs being shed), or the adoption of new/re-defined marketing strategies.

In the first scenario, companies are unable to adjust to globalisation, while firms in the two other situations (which frequently concur), represent a successful adaptation to the process in question. The later contribute to intensify the globalisation process. To

pursue these strategies, firms introduce new products, direct production to new markets, promote new marketing techniques in the export markets, de-localise their facilities, etc. Furthermore, globalisation is not only a threat but it can also create new market opportunities abroad, since foreign markets also become less regulated and protected. The Portuguese textile, clothing and footwear industries are typical examples of the threats and opportunities ensuing from globalisation processes. The access to the Spanish market is a case of new market opportunities opened up by globalisation processes.

Even for industries producing tradable goods directed to the domestic market, globalisation brings about an increased competition drive. Nevertheless, firms tend to have a longer period to introduce adjustment. Facing a mature, close to saturation, domestic market, expansion into foreign market represents an alternative often discussed, not always implemented. On the contrary, seldomly de-localisation of production facilities is seen as an alternative.

Concerning the production of non tradable goods, normally lacking an international market, globalisation takes place by means of foreign investors' participation in local enterprises. This tends to be the case for construction, commerce (wholesale and retail), financial services (although with a smaller SME participation) and specialised consultancy. In some cases, namely construction and commerce, domestic firms (including SMEs) are also attempting internationalisation pushing into Spain (commerce) and into Developing countries (construction).

In Figures 2, 3 and 4 we present a typology of the strategies that Portuguese firms seem to be developing and some evidence of recent evolution at the sector level regarding import penetration and export ratios.

Some projects surveyed confirm the geographic pattern referred to above. Portuguese Speaking African Countries are the preferred destination for location of production facilities abroad. SMEs see them as having a good market potential. Incentives given by their Governments and the knowledge of the language reinforce that feeling.

On the other hand, locations of commercial facilities abroad are primarily directed towards EC countries. For SMEs with a tradition of exporting to those countries those investments are seen as a way to gain control of distribution channels for their products. They attempt to reduce their present dependency from buying agents (both national or foreigners) and even from their own agents and distributors, evolving towards the creation of their own distribution networks and to a closer contact with the final consumer. Available evidence is still very sparse. In most cases those projects end up associating Portuguese firms with their previous agents for those markets.

3. Factors Affecting the Globalisation of Activities by SMEs

For the purpose of evaluating the relative importance of the different factors potentially relevant for a process of globalisation we will take into consideration, on the one hand, firm specific factors (internal factors) and, on the other hand, aspects related to market structures and technology (external factors).

Globalisation precipitating factors tend to be external to the firm while sustaining factors are mostly firm specific.

Regarding globalisation precipitating factors, firms tend to consider that external factors are determinant. Among them, the *small size* of the domestic market and its *saturation* are the elements most frequently quoted by the firms questioned. Simultaneously, also the tendency towards greater *liberalisation of world trade* and the *completion of European economic integration* operated as facilitators / inductors of internationalisation processes, namely within European Countries. Among internal factors, previous *firm experience* in external markets is acknowledged as a factor favouring internationalisation, but only by a relatively small number of firms.

Firm specific factors are clearly considered as sustaining factors for the purpose of globalisation initiatives. When asked about factors sustaining globalisation procedures, firms stress the importance of their *commercial organisation* and, at the same time, undervalue aspects like *flexibility of production*, *human capital* or *finance*. However, among firms that were actually involved in international business, insufficient *financial capacity* tends to be considered the main cause for the failure of some globalisation projects.

Only for a relatively small number of firms do strategic aspects appear as determinants and, more generally, as sustaining factors for the globalisation process. Among them the need to *vertical integration*, *upstream integration* (in an attempt to have a privileged access to *raw materials*), pressure to *keep up with large firms and competitors*, focus on specific markets (*niche strategies*), and *diversification/risk reduction* are mentioned.

As regards factors impeding globalisation Portuguese SMEs also tend to emphasize the role of external influences. Among them the intervention of public administration is seen by firms as inhibiting internationalisation processes. *Fiscal and exchange policies* are most referred to but even *export support programs* are cited, despite the priority given by the government to internationalisation promotion programs.

In some cases, internationalisation processes are also seen as very *risky*. Besides *financial requisites*, the *diversity of cultures* and their reflex on commercial practices as well as different legal environments operate, *de facto*, as *barriers to entry* in foreign markets. SMEs, especially because of weak organisation and management and marketing skills, tend to be particularly affected by those difficulties.

Finally, within internal factors production / sale of a *single product* is considered an impediment to internationalisation (see Figure 5). Simultaneously, SMEs involvement in world business is seen as a way to circumvent current weaknesses primarily concerning the access to new technologies.

4. Globalisation in Portugal - Policy Instruments and Issues

Policies in Portugal do not address the issue of globalisation of SMEs as such. However, there is a set of policies aimed at supporting SMEs, and other programs promoting internationalisation and competitiveness of Portuguese firms that, directly or indirectly, affect SMEs competitive and globalisation capacity as well. The next 6 years will bring about a closer integration of commercial and industrial policies. Nevertheless, once again SMEs are not specifically targeted, particularly in what internationalisation and globalisation are concerned.

Throughout the 80s, and well into the middle of 1992, no specific programs designed to promote SME globalisation had been put in force. Excluding some low-budget, non-systematic actions striving to encourage exports, commercial strategies were certainly neglected in favour of industrial policies. Furthermore, despite the creation of IAPMEI in 1975, industrial policies seldom afforded any kind of preferential treatment to SMEs. There is, nevertheless, a set of policies affecting SME globalisation which are summarised in Figure 6.

In general, globalisation support strategies emphasize the removal of obstacles and financial impediments and a revamped international image of Portugal and Portuguese products.

Since 1986 the policy context in Portugal is dominated by the need to balance two sets of objectives: real convergence to EC average (GDP growth) and nominal convergence (inflation and interest rates, exchange rate stability, public sector deficits). Recently, employment has become a major economic policy issue. International competitiveness is a priority in industrial policy.

Both the policy importance attached to SMEs and the importance of internationalisation and globalisation has increased in the last years. Despite SMEs still being regarded largely as a domestic issue, internationalisation of their activities has been receiving increasing attention and support. Within this context, globalisation is, presently, still seen more as a threat and not so much as an opportunity for SMEs.

The policy importance attached to SMEs has been growing, recently, because of their contribution to job creation and their major presence in export industries. This last aspect was instrumental in determining that priority should be given to SME international competitiveness. Several policy instruments, although not addressing specifically the SME situation, provide support and incentives for internationalisation of their business.

The attention given to globalisation is even more recent and less concerned with SMEs. The importance attributed to globalisation results from its potential contribution to create a sustainable competitive advantage, thus contributing to keep and create jobs. There is a danger, however, that job creation occurs outside the country (e.g. de-localisation of production facilities to foreign countries in labour intensive industries). In any case, other jobs will be maintained and created in Portugal, related to the new organisation of business (operations management, design, marketing and other services). This means that, although potentially a positive sum game, globalisation might create, in the short term, regional imbalances, namely in terms of unemployment, and skill shortages that need to be carefully taken into consideration. This is particularly the case of Portugal where export oriented industries are rather regionally concentrated.

From a strictly microeconomic point of view, globalisation is especially demanding, particularly in terms of organisational and management competencies. Therefore, globalisation is still seen as an issue affecting SMEs and deserving close monitoring but, currently, very much outside of their reach. A quick diagnosis (in terms of their size; organisation; management; financial resources; etc.) of the Portuguese SMEs explains why this is so. Actually, very few Portuguese firms, disregarding of their size, can be considered globalised, at least if we consider the criteria established by the OECD.

For that reason, policy initiatives have been primarily targeted to promoting the internationalisation of economic activities as a first stage towards globalisation. Some programs, namely those concerned with information about markets, can also be very useful for the purpose of monitoring global competition.

There are, however, some cases of well succeeded internationalisation experiences which can be used as "best practice" examples. Recently, as mentioned before, these cases have been highlighted through some special awards as a way to stimulate the practice of benchmarking.

Although without a specific concern about SMEs or internationalisation, industrial policy programs have been subject to some attempts to assess their effectiveness. However, there is still not enough evidence to allow for a definite conclusion, namely concerning the design of new policy initiatives.

As regards SMEs, appropriate policy responses need to take into consideration several of the shortcomings previously mentioned. IAPMEI as an institution specifically concerned with SMEs can be a decisive instrument in achieving a better understanding of their capabilities and shortages. For the time being, policies promoting internationalisation are the decisive ones. Long term survival requires, however, a gradual evolution towards globalisation and imposes the creation of instruments adequate to SMEs. The experience (either positive or negative) of other countries of similar size and wealth can be very useful. However, in this process one could also resort to some specificities of the Portuguese culture and tradition as, for instance, the existence of a large number of Portuguese emigrants in several different countries who already run their own business. They can provide information about market opportunities, legal and institutional environment and also be partners for local initiatives.

TABLE 1
Role of SMEs in Portugal

	% of total value added*	% of total employment *	importance of SMEs (%)		
			number of firms**	value added**	employment *
Manufacturing	100.0	100.0	30.0	64.0	67.5
Food, Beverages, Tobacco	15.8	12.0	25.9	72.7	68.3
Textiles	15.7	16.4	41.8	57.6	61.4
Clothing, Footwear	7.5	19.9	41.5	80.0	82.7
Wood, Wood Products	4.3	9.3	20.6	88.3	68.7
Paper Products, Publishing	11.4	5.0	34.9	61.7	67.2
Chemicals, Coal, Petrol	15.8	7.0	44.6	62.9	61.7
Non Metal Mineral	8.6	7.1	33.1	71.8	68.7
Basic metals	3.2	2.3	39.9	42.3	47.6
Transport, Equipment	4.5	3.8	44.6	38.1	41.7
Other Machinery	13.0	15.7	23.8	56.2	64.5
Miscellaneous Manuf.	0.2	1.5	18.7	96.2	69.8

Source: * INE - Caracterização das Empresas Portuguesas (1988)
** INE - Estatísticas Industriais 1987 (apuramento especial)

TABLE 2
Overall Measure of Globalisation

	Exports as % of turnover (1988)	Imports as % of internal demand (1988)	% of foreign owned firms (1992)	Outward foreign investment as % of total (1988-90)
	* **	* **	****	***
Manufacturing	29.2	36.2	3	0.2
Food, Beverages, Tobacco	10.0	12.4	2	1.4
Textiles	44.2	34.8	0	0.1
Clothing, Footwear	70.5	31.9	1	(1)
Wood, Wood Products	35.7	7.1	1	0.2
Paper Products, Publishing	35.5	19.5	4	0.2
Chemicals, Coal, Petrol	17.4	32.7	12	0.3
Non Metal Mineral	21.8	13.6	8	0.7
Basic metals	10.4	49.1	0	0.1
Transport, Equipment	35.5	65.6	10	(2)
Other Machinery	30.4	59.8	4	0.4
Miscellaneous Manuf.	43.4	56.9	8	0.3

Source: * INE - Caracterização das Empresas Portuguesas (1988)
** INE - Estatísticas do Comércio Externo (1988)
*** Banco de Portugal / INE - Anuário Estatístico/Contas Nacionais
**** DEMESS-SISED (1992); data concerns the percentage of capital of firms with more than 50% of foreign capital in total capital.
(1) included as textiles
(2) included as other machinery

Figure 1

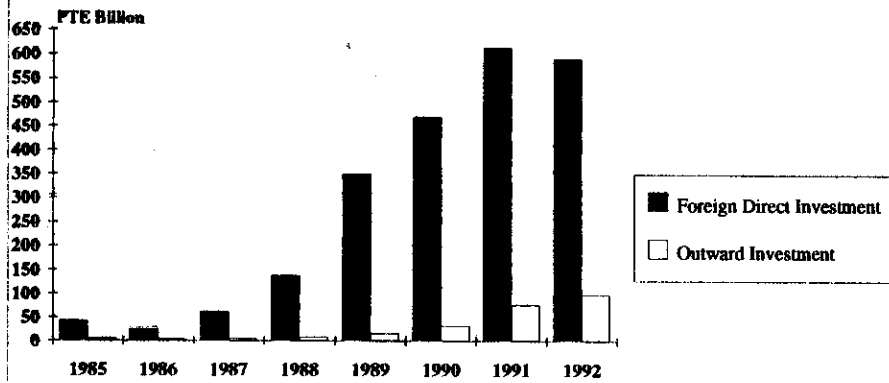
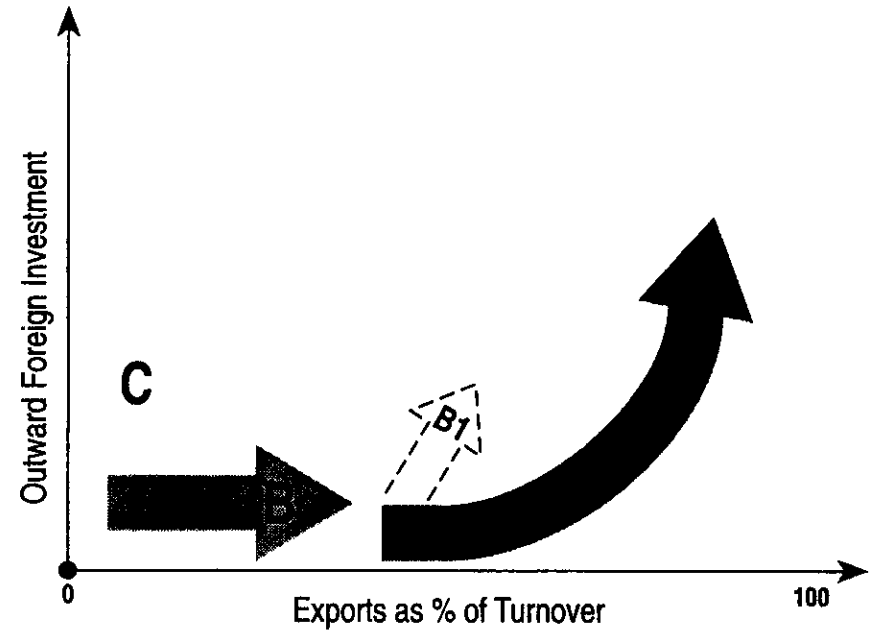


Figure 2



A = Export - oriented Companies

B = Companies producing tradable goods for the domestic market

= Companies producing non - tradable goods

Figure 3

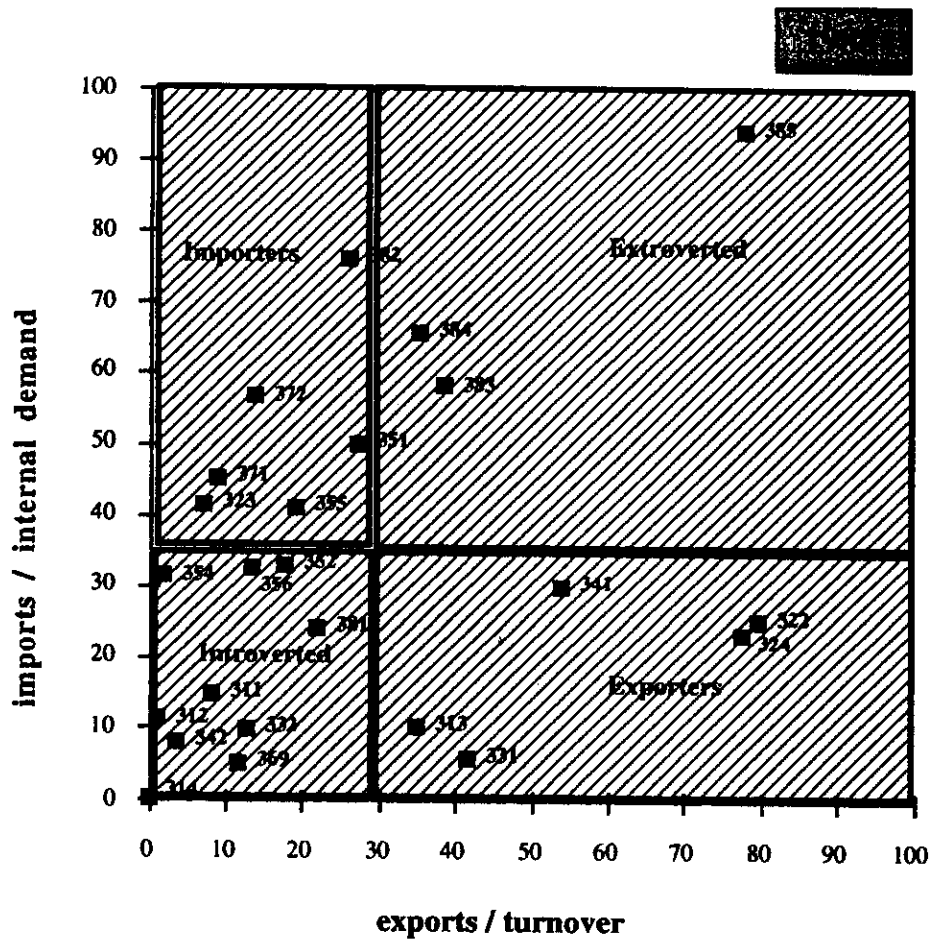


Figure 4

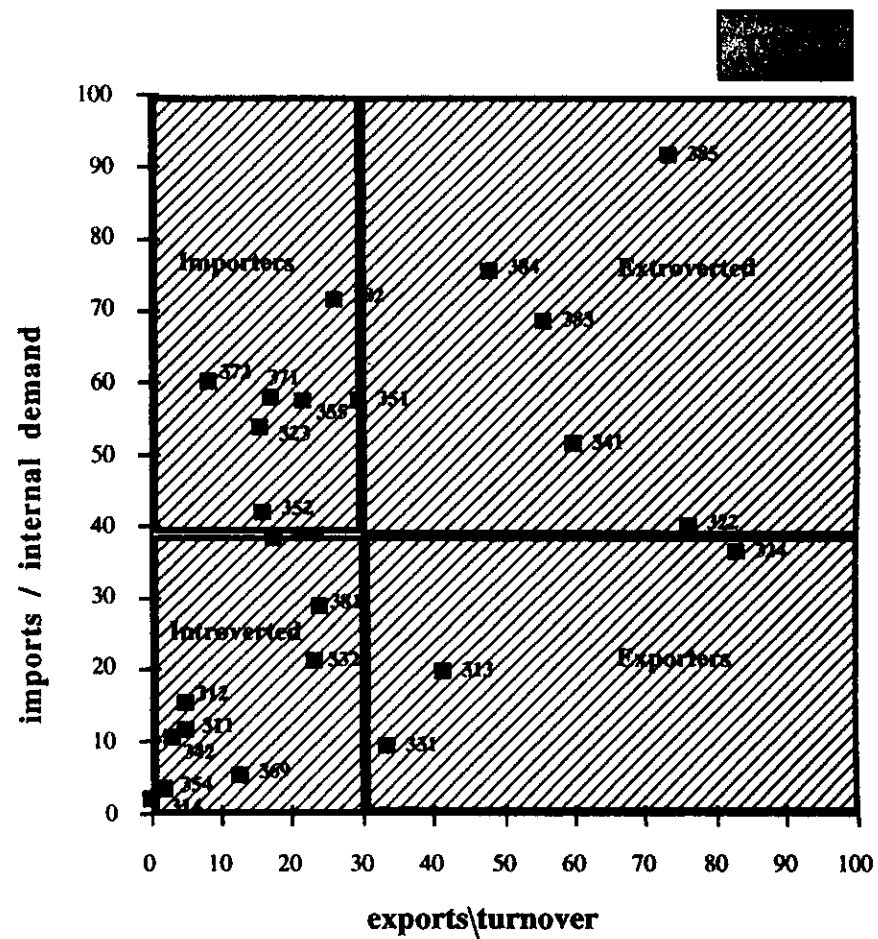


Figure 5

Main Factors Affecting Globalisation of SMEs

Factors	Manufacturing industries
<p>Precipitating small market foreign demand european single market</p> <p>Sustaining commercial organisation charact. decision maker/management innovation/successful R&D</p> <p>Impeding entry barriers</p>	

Source: Challenge (1993)

Figure 6

Portuguese Policies Related to the Globalisation of SMEs as at 1993

Policy Type or Program	SMEs		Policy emphasis			
	Targeted	Affected	Finance	Business	Access	Capability
PAIEP - Support Program for the Internationalisation of Portuguese Companies (1992/...)						
PEASE - Special Support Measures to the Export Sector (1993/94)						
PIAEI - Intermediate Support Program to Industrial Companies (1993/94)						
RETEX - Community's Initiative for the "Textile" Regions (1993/97)						
PEDIP II - Strategic Program for the Development and Internationalisation of Portuguese Industry (1994/99)						
TRADE AND SERVICES: Program for the International Development of Commerce and Services (1994/99)						