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NEEDS AND MEASURES FOR INNOVATIONS OF SMES IN THE BALTIC SEA REGION

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Abstract. Small and medium sized enterprises (SMEs) are the growth drivers of EU economy. In the Baltic Sea Region 99 % of all companies are considered SMEs and thus the backbone of the economy. To stay competitive versus low labour cost countries, the regional enterprises must create products and services of high quality and exploit their full innovation potential. To identify the exact needs, a survey has been conducted in 11 countries around the Baltic Sea Region in 2010. The paper will present the results and highlight first measures developed by Business Organisations and Universities in order to support the innovation in companies. The paper will show short-term solutions as well as long-term measures in the qualification and educational sector. A special emphasis will be put on SME specific dual study courses.

Keywords: SMEs, economic growth, innovation, dual education, Baltic Sea region.

Jel classification: M2, I23, O3

1. Introduction

Enterprises with less than 250 employees and equal to or less than either €50 million turnover or €43 million balance sheet total are considered SMEs by the European Commission. Micro-enterprises are the smallest category of SME, with less than ten employees and a turnover or balance sheet total equal to or less than €2 million (European Commission COM 2011).Small and medium-sized enterprises (SMEs) are the backbone and the driving force of the social and economic development in Europe (Wymenga, Spanikova 2011). Over 99% of all enterprises in the Baltic Sea Region (BSR) are SMEs which provide up to 70% of all jobs. Between 2002 and 2010 about 85% of net new jobs were created by small and medium sized enterprises (de Kok, Vroonhof *et al.* 2011). However, the European SMEs face many challenges.

Due to relative high tax and social costs in the Baltic Sea Region, the local companies cannot compete with other countries in terms of prices, but only with quality and reliability. To stay competitive versus fast growing low labour cost countries like China (Heinonen 2010), SMEs need to be more innovative.

Innovations, as the key to success, are supported intensively through the cooperation of various cultures, learning from each other and through impulses from the new requirements, as well as international activity.

Numerous small companies feel threatened by the Globalisation. This term used in the last 20 years on a regular basis to describe the world economic in this period is not a new concept. It has been highlighted early, that there have been many economic global movements' decades before. What has changed is the dynamic of it (Hogeforster 2007). The recent globalisation has gained in prominence thanks to massively improved telecommunications and IT as well as the cheaper and better international transport systems (van Liemt 1992).

In fact, one of the most successful networks of a globalised character was the historical Hanseatic League. It made the Baltic Sea Region (BSR) to the most innovative and economically strongest regions in the world at that time. The network was founded by merchants and craftsmen – SMEs - as a protective alliance, and it acquired stability and growth through trade and commerce. This internationality has been of a significantly smaller importance for SMEs in many EU member states in the last few decades. They were first of all involved in the local and regional markets which offered sufficient growth and development potential. Today these former domestic growth reserves are largely fully exploited in the key areas, whereas there are still unsatisfied needs worldwide. At the same time, the internationalisation does not stop the SMEs. The biggest innovation and growth opportunities for SMEs today and for the future are in particular (again) in the increase of international cooperation.

One of the keys to an enhanced innovation capability is R&D and education. This demands a

close cooperation of academic institutions and companies.

2. Cooperation of SMEs in the BSR

The criteria for being a small and medium-sized company differ in the countries around the Baltic Sea, for this paper the definition of the European Commission of less than 250 employees is considered. The latest reports show, that there is a very clear correlation between the number of SMEs and the GDP and stability of an economy (Cheburok 2011): The highest rates of micro and small companies have the northern, Scandinavian countries, e.g. 87, 4 % of all business in Denmark have up to 9 employees and thus are micro companies, while only 0, 5 % have more than 250 and are considered major businesses. These European small companies face several challenges. One of the most serious ones is a lack of qualified personnel.

Strengthened by the not surprising demographic situation, one of the biggest risks is to find the correctly qualified personnel. There is an increased competition for the best talents in the Baltic Sea Region (Heikilä, Järvinen *et al.* 2004). Another threat comes derives from the low labour cost countries, that are increasingly exporting to Europe. Local companies cannot compete with identical products produced for much less than it is possible in Europe. SMEs have a decisive advantage in comparison to large enterprises: they are flexible, fast, in-novative and dynamically-growing. The organizational culture of SMEs in Europe can also be key factor of competitiveness (Vallejo-Martos 2011). In particular the non-hierarch leadership allows a higher degree of commitment from the employees compared to large companies.

Their decisive disadvantage in comparison to large concerns is that they cannot have in-house staff and services at their disposal. While large enterprises have support in the form of in-house departments, such as research, marketing, human resources, legal department, etc., these functions have to be performed on a broad basis by the owners individually, which quickly leads to an overload of the business. This dis-advantage of SMEs is especially difficult in view of the globalisation and internationalisation, complex issues, information overload and far-reaching structural changes.One solution to overcome this hindrance is to cooperate with other companies. Cooperation in this context can be described as creating a synergetic economic effect by partnering with another company (Sakals, Savanavičienė 2000). Cooperation between companies can help to strengthen their position in the market and survive a possible crisis (Kaul 1999). Especially companies not capable to produce or sell their desired products on their own will cooperate with other companies (Ginevičius 2010). As table 1 shows, indeed most SMEs cooperate with other companies.

Table 1. The Baltic Sea Region SMEs cooperation on innovations until present (in %)

	Poland	Norway	Lithuania	Germany	Russia
local authorities	12.6	44	37.5	56.3	36.4
local administration	9.8	24	25.8	25	18.6
R&D institutions	2.2	24	25	12.5	18.2
Financial institutions	9.6	4	58.3	25	0
Business support institutions	7.8	4	12.5	12.5	36.4
Universities	5.8	8	33.3	31.3	27.3
Consulting companies	9.8	4	0	25	27.3
Other entrepreneurs	26.2	16	16.6	37.5	9.1

Data: N for Poland = 446, N for Norway = 25, N for Lithuania = 24, N for Germany = 16, N for Russia = 11.
based on a survey of the Baltic Sea Academy in 2011 (Olczyk 2011).

However, a cooperation between companies might maintain the status quo and allow a slight development, but a sustainable development asks for a cooperation with other stakeholders. This can be public offices or local administrations and organisations such as Chambers of Crafts, Trade and Commerce. In today's Europe these are excellent connected and can bring in the full potential of networking.

Even more important should be the cooperation with R&D institutions and Universities, that can play an essential role in boosting the innovation capability of firms - and, is highlighted before, Innovation is dearly needed for companies in the Baltic Sea Region to stay competitive (Mäkinen 2011).

3. Innovations in SMEs

In principle, SMEs have a high power of innovation. In Europe, two-third of all newly patents are registered by SMEs. But it is not only the quantity of patents, but especially the quality that makes it special. Innovations are the key to a successful economy in Europe. And SMEs are the key players. Innovation can be differentiated between "Breakthrough innovation" that represent revolutions in technologies and markets, and "Incremental Innovation" that are rather small improvements of existing products and processes (Baumol 2002). The majority of the significant breakthrough innovations in the last decades have come from new or small firms, while the big companies concentrated on incremental innovations to improve their existing products (Baumol 2002).

The term Innovation is not easy to define (Berkun 2009); however different types of innovation can be identified (Olcyzk 2011):

a) Product innovation is understood as launching a commodity or service, which is new or refined in its features or applications.

b) Process innovation is defined as implementing new or substantially refined production methods, distribution methods and supporting operation in goods manufacturing and services.

c) Organization innovation means implementing new organizational methods in the company's rules of operation (knowledge management), in the organization of the workplace or the rapport with the environment, which have not been used so far in the enterprise. In particular the implementation of new organisational methods in company's' practices, work-place organisation and external relations can have a substantial impact on the competitiveness, productivity growth and value creation (OECD 2010).

d) Finally, marketing innovation relies on implementing a new concept or strategy substantially standing out from past marketing methods applied in the company. It comprises important changes in the project/construction of products, packaging, product distribu-tion and promotion as well as influencing product prices. It does not comprise, however, seasonal changes or regular and routine changes in marketing methods.

The data of table 2 shows, that in Poland and Russia most companies implement product innovations, while in Germany the firms rather concentrate on innovation based in process and organisational context. Mainly due to high labour costs, the innovations which allow the reduction of costs were in the foreground. A new innovation type that will become of high importance is the so-called social innovation (OECD 2010).

Table 2. Type of implemented innovation in the analysed enterprises in the last 3 years in %

innovation type	Poland	Norway	Lithuania	Germany	Russia
product	62,33	48	62,5	43,75	54,54
process	35,42	44	59,2	56,25	36,36
organization	48,2	40	58,33	56,25	44,45
marketing	50,22	52	62,5	31,26	54,54

Data: N for Poland= 446, N for Norway = 25, N for Lithuania = 24, N for Germany = 16, N for Russia = 11 based on a survey of the Baltic Sea Academy in 2011 (Olczyk 2011).

However innovations cannot eliminate growth barriers permanently – at least within economic affairs. For example, with the on-going industrialisation, crude oil has become a scarce resource. Innovations which reach beyond the boundaries of restrictions and which allow for further growth are triggered. New techniques reduce for example the fuel consumption of vehicles and machines or make it profitable to extract oil from shale rock with low oil content. Thus only a delay in time is achieved, until it is no longer possible to move the limits further.

Then the basic breakthrough innovations are needed, for example for the development and use of renewable energies, which has been identified quite early as a major sector for European SMEs (Greenan 1997). They are able to move the limits of growth of "fossil energy carriers", however, with time, new barriers are created. Currently especially the breakthrough innovations are needed to remove the existing bottlenecks and open up the growth opportunities of tomorrow. Exactly these breakthrough innovations ask for a cooperation with highly skilled R&D institutions (Narula 2004) and a better cooperation between companies and academia, that has been rather poor so far (Gokhberg 2010).

4. Innovation Infrastructure for SMEs

Within the countries around the Baltic Sea Region, the willingness to invest in R&D for the benefit of companies is quite different. For example in 2009 Latvia invested only 0,21 % GDP, Estonia more than double with 0,54 % GDP. Subsequently, Latvian SMEs introducing innovations were around 14,4 % compared to Estonian SMEs that introduced 45,8 % of innovations (Dombrovsky 2009). Clearly needs is a common infrastructure for the Baltic Sea Region, that reaches beyond national policies. Promotion of innovation so far has reached only a few SMEs, since there is no SME-specific infrastructure of innovation promotion between academic institutions and private companies. This must be achieved through cooperation of chambers as external SME promoters, as well as universities as researchers, developers and knowledge carriers. This is the optimal way for the SMEs to increase innovations, productivity and competitiveness on a broad basis. Such a structure is the" Baltic Sea Academy" network that was founded in 2010 with the overall goal to bring the universities and SME stakeholder together to implement innovations and foster the education in and for SMEs.

The association has 15 universities and polytechnics that are strongly connected to the Hanse Parlament, representing 45 SME associations like Chambers of Crafts and Commerce in all 11 countries around the Baltic Sea. The recent survey revealed, that in most countries there is a huge potential for such cooperation between companies and universities. While in Lithuania the participating companies have already ties with the universities, there is hardly any cooperation between universities and polish companies (only 5,6 %). In Scandinavian countries like in Norway the best approach is to form the SMEs into clusters. Naturally it is more interesting for an academic institution to cooperate and evaluate a group of SMEs from the same sector than only with one firm that does not allow any collection of comparable data. On the other hand, a cluster can be beneficial for the companies since they can exchange know-how and experience with similar businesses form the same industry.

5. Clustering of SMEs in the BSR

Cluster is defined as a 'geographical concentration of reciprocally interrelated companies, specialized suppliers, service suppliers, companies operating in related sectors and relevant institutions (i.e. universities, normalization organizations and sectorial associations) which cooperate and compete with one another in particular fields (Porter 1986) . The research on clusters carried out so far has shown that there are substantial economic benefits resulting from cluster activities, both for the economy and companies operating in the cluster.

From a micro-scale point of view, companies operating in a cluster can inexpensively get information about the environment, properly assess their capacities, and get a better access to suppliers and companies providing specialized services and specialized work market. More importantly, however, the existence of clusters fosters intellectual capital growth in companies which are gathered in them. Consequently this growth spurs technological transfer and facilitates innovation implementation in companies in a cluster (Brodzicki, Tamowicz 2008). This is why companies operating in clusters have a higher level of innovation than enterprises which do not belong to any cluster organization.

Table 3. Current cooperation of the analysed SMEs with R&D institutions (in %)

	Poland	Norway	Lithuania	Germany	Russia
universities	5.6	16	54.16	43.75	36.4
scientific and R&D institutions	3.36	16	33.33	25	27.3
technology transfer centres	3.13	12	12.5	18.75	27.3
technological incubators	4.7	12	16.66	12.5	9.1
cluster initiative	2.02	40	20.83	18.75	18.2

Data: N for Poland = 446, N for Norway = 25, N for Lithuania = 24, N for Germany = 16, N for Russia = 11. based on a survey of the Baltic Sea Academy in 2011 (Olczyk 2011).

As a recent survey clearly indicates that the majority of the companies in the Baltic Sea Region could not boast of any cluster membership (Olcyzk 2011). This is true for 96.3 % of the Polish companies, about 1/2 of the Russian and Norwegian SMEs, 1/3 of the Lithuanian SMEs and 14.8% of the German SMEs. The above results show a relatively low level of SMEs involvement in this kind of cooperation.

Most companies are not aware of the benefits of clustering and are reluctant to join in cluster initiatives(Olcyzk 2011). Generally, these results

indicate that it is necessary to undertake intense activity to increase SMEs' understanding of benefits flowing from mutual cooperation in a cluster.A cooperation with scientific and R&D circles and other institutions designed to increase SMEs innovation level is vital on the account of the specificity of SMEs, which generally have limited human resources and a low financial potential. The results of the analysis indicate that local authorities including chambers of crafts and commerce and entrepreneurs associations are major partners in innovation cooperation for SMEs (Olcyzk 2011).

As far as SMEs cooperation with R&D institu-tions is concerned, a leader-role is generally played by universities.In the framework of the Baltic Sea Academy initiative three innovation clusters were developed

a) Energy, Climate and Environmental Protection
b) Construction Technologies
c) Personnel and organisational development

Within these clusters, individual SMEs and SME sectors with similar innovation potentials, related technological solutions, etc. cooperate with universities and chambers. The essential feature of this clustering is that possibly no or only few SME sectors are omitted and thus the highest possible proportion of SMEs in the Baltic Sea Region can be assigned to one of the formed clusters. In contrast, the conventional clustering focusing on few sectors and companies with advanced technologies, i.e. biotechnology, medical technology, etc. the three identified sectors reach out to numerous companies.

For example almost every company can benefit from better use of renewable energies, better isolation of the production facility etc. Likewise, personnel development relates to all companies and is thus the most important cluster. Innovations which arise from the development of personnel are so far utilised to the lowest extent. At the same time, the development of personnel and organisations for SMEs is becoming increasingly important, e.g. for the cooperative management of the staff within a company, the communication between the staff and leadership, networking between companies etc. Only when the personnel and organisational structure of a firm is optimized, all employees will unleash their full commitment and innovative thinking for the benefit of that company.

6. Educational Measures for SMEs

To unleash the innovation capability of SMEs in the Baltic Sea Region by establishing the missing link between academic institutions and companies and create concrete innovations is one pillar for competitive region. The second pillar is of same importance, but has a long-term effect: Improved and specified education that corresponds to the needs of small- and medium sizes businesses.

To stay competitive, the firms in the region must design high-quality products and deliver best services. This asks for well-trained employees and owners. Overall, there are too many purely academic graduates while all countries around the Baltic Sea have a clear lack of skilled worker, e.g. in Poland almost 70 % of all school graduates choose to study, while only 12% choose a vocational education – even though there is a fast growing demand (Lenart 2011). At the same time, the number of employees retiring on grounds of age is constantly increasing and so is the demographic pressure (Stiller, Faltermeier 2011). In all the BSR states there is an increasing deficit of skilled workers.

A prominent role will be the transfer of the so-called dual-system, that has a German tradition (Blossfeld 1992; Dessinger 2000) and in recent years has been transferred to many countries. Dual study programs that combine study with vocational education or training are in line with the Bologna Process and results in two degrees: an academic bachelor or master degree and a skilled worker degree. The European Centre for the Development of Vocational Training closely observes the dual system and its effect on the job market (Gruber, Mandl, Oberholzner 2008). Recent reports point out, that in facht the dual training method tends to be better than the full-time college-based training method and consequently stronger trainees are more often found in the dual forms (Nickolaus, Gschwendtner, Geißel 2009) This also called “Hybrid Qualification” (Jørgensen 2011) describes qualifications that integrate vocational and general qualification and give access to higher education as well as to the occupational labour markets of skilled workers. This last point is of extreme importance, since the dual-systems serve the needs of the labour markets for SMEs, since the companies recruit and train their own future employees in strong cooperation with the teaching academic institutions.

Dual courses of study can be combined ideally with direct promotion of innovations. The students of dual courses learn and at the same time work in a company. This results in direct relationships between universities/colleges and SMEs which can

be used for personal counselling and transfer processes. As a part of the semester or bachelor work, manageable research and development tasks are conducted in direct cooperation between enterprises and universities. The dual education system allows a much higher innovation possibility, since there is a constant contact and exchange of know how between the student, the company owner and the professor.

This approach has proven especially reliable and has already led to the implementation of numerous joint development projects. Colleges and universities become important innovation promoters and guides for the entrepreneurs in the Baltic Sea Region. Evaluations indicate, that company owners are very content with the graduates from dual study courses and that these graduates have excellent job opportunities (Kiedrowski, Schaumman 2011).

7. Conclusions

SMEs in the Baltic Sea Region are essential for a healthy growth in all European countries. Today the Baltic Sea Region has again the best prospects for becoming an innovative and economically strong area of international standing. However, most companies do not make full use of their innovation potential.

To unlock it and stay competitive versus emerging markets from low labour cost countries, it is necessary to exploit the full potential of innovation of its SMEs. Organised in specified clusters, the cooperation between the firms, SME associations like chambers and companies will be highly successful. On the basis of a distinct SME structure and very good research and development capacities, the companies in the Baltic Sea region have basically a huge innovation potential.

In the long run, the qualification and education of owners and employees in SMEs must be adapted to the needs of companies, in particular by implementing dual study systems.

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