

## THE CHOICE FOR GROWTH OF SMALL LOW-TECH MANUFACTURING COMPANIES IN BULGARIA\*

**Neli Rasheva**

*University of Ruse "Angel Kanchev", Bulgaria*

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### Abstract

In recent decades, as a result of the political and economic development of Bulgaria, many of the small companies in low-tech industries operate as subcontractors for foreign clients or large Bulgarian companies. This puts limits to their growth, and their existence is determined by the policies of other companies. We conducted a survey with the aim to reveal the determinants that may affect the transformation of subcontractors into independent companies with their own production, protected by intellectual property rights on their trademark. The purpose of this paper is to present a growth model in which the entrepreneur's personality is central. His attitudes and risk assessment as well as the valuation of company's capabilities and the opportunities of the external environment, have certain level of influence on the motivation of the entrepreneur and determine the choice of the firm growth strategy. This paper presents the results of our face-to-face survey in selected small clothing companies in the region of Ruse, Bulgaria.

**Keywords:** *small manufacturing company, clothing industry, growth, trademark property rights*

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### 1. INTRODUCTION

The transformation of the Bulgarian economy from planned to market-oriented in the 90s led to privatization of the state-owned enterprises. As a result the industrial business has lost its traditional markets. Relationships with suppliers and customers were cut off, and sources of raw materials were limited. A lot of large industrial companies have shrunk their production over the years or stopped their activity which enabled small and medium-sized firms to enter on the market. Demographic changes in Bulgaria have led to population decline (as a result of migration processes) and have reduced the household income and purchasing power of Bulgarians. Low-tech manufacturing companies faced the dilemma to decide how to continue their development. To protect their market positions many small companies were forced to work as subcontractors for foreign clients or large Bulgarian companies.

The European Union strategy "Europe 2020" adopted in 2010 set a goal for all of its members - smart, sustainable and inclusive economy delivering high levels of employment, productivity and social cohesion through a knowledge-based economy. To meet the

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requirements Bulgaria has made it a priority to increase the transfer of technology by attracting foreign investments and to enhance the competitiveness of SME's.

Ganchev and Naydenov (2018) analyze foreign investment activity in Bulgaria. The authors find that foreign investments in Bulgaria have been declining in recent years. Moreover, they are unevenly distributed and are concentrated mostly in Sofia, in the big cities, on the Black Sea coast and in some border areas. The result is socio-economic development imbalance of regions in Bulgaria.

In compliance with the Small Business Act for Europe, the Bulgarian National Strategy for SME is directed to encourage and support SMEs to increase their innovation activity and competitiveness. For small low-tech companies sustainable competitive development and growth can be achieved by their own production, protected through trademark rights.

Many theoretical and empirical studies use different determinants in their models for company growth, but there is no specific model adapted to the small low-tech manufacturing companies in Bulgaria. This provokes our interest to analyse what is the attitude and motivation of subcontractors to change their firm strategy

The objects of this study are small apparel company's /subcontractors/ in Ruse, Bulgaria. The subject of this study is the entrepreneur's choice of growth strategy of small low-tech manufacturing companies

The purpose is to present the results of a survey on the determinants that may affect the entrepreneur's choice of strategy for own production protected through trademark rights.

## **2. LITERATURE REVIEW**

In last decades the small firm growth and its determinants have been widely studied in the economic literature. O'Farrell and Hitchens (1988) present a review of different theories of the small firm growth. Hristova (2018) analyzes the problems of entrepreneurship in Bulgaria. Todorov (2001) studies the strategic management in small and medium enterprises. Papazov and Mihaylova (2010) emphasize on the importance of strategic planning in SMEs, which should be based on prompt and accurate information on internal determinants (human resources, fixed assets, financial opportunities, etc.) and on external factors (branch position, competitive opportunities and etc.). The information can be obtained by professional consulting assistance (statistical, marketing and other) about the environment where company operates. In another study Papazov and Mihaylova (2018) present techniques for identifying firm's existing direct business competitors. Bogdanova et al. (2012) study risk management in business organizations. The authors suggest that the implementation of risk management systems in the company reduces operating costs and the probability of human error, increases the quality of service and productivity and helps to optimize processes and integrate existing systems.

For the purpose of our dissertation on small firm growth, we conducted a survey with the aim to reveal which are the determinants that may affect the transformation of subcontractors into independent companies with their own production, protected through trademark rights. This subject is significant because the sustainable growth of small low-tech companies may contribute to job creation and regional development. Also it has a great importance for overcoming the economic imbalance between the regions in Bulgaria, and improving the welfare of the population. Registration of trademark rights is the fastest and the cheapest way for small manufacturing companies to protect their production, to increase competitiveness and expand market share. Studies by Landes & Posner (1987),

Economides (1988), Davis (2006) show the economic functions of the brand and its importance for firm growth.

Based on the existing theoretical and empirical research, we have created a model for small low-tech manufacturing firms growth which has been tested in small apparel companies in Ruse region, Bulgaria. Deneva (2008) also studies the problems of SMEs in the apparel industry and finds that they have to change their survival strategy with that of a growth. These companies shouldn't strive for low costs and prices but to offer high quality products at higher prices which can be achieved through their own brand and internationalization. The author does not study the determinants that may change the entrepreneurs' strategy. An international team of scientists (Bakracheva et al., 2020) put the focus on intergenerational family businesses.

In our firm growth model the entrepreneur's personality is central. We define that his attitudes and risk assessment as well as the valuation of company's capabilities and the opportunities of the external environment, have certain level of influence on the motivation of the entrepreneur and determine his choice of firm growth strategy. The proposed model is based on Davidsson's economic-psychological model (1991). Because each entrepreneur has different individual characteristics, the motivation and behaviour of firms are different. The determinants that influence the motivation for growth are the Ability, Need and Opportunity perceived by the entrepreneur, with the variables showing differences in the need for growth having the greatest impact. The personal characteristics of the entrepreneur and his motivation for growth are important for the effective utilization of firm's resources and the abilities for their combination. Wiklund's model (1998) focuses on entrepreneurial orientation. The results of his empirical research show that company's strategy has the strongest impact on firm growth.

We think that entrepreneur's attitudes and motivation define his choice of strategy which the small low-tech manufacturing company will follow - to be independent with its own production, protected through trademark rights or to work as a subcontractor and the existence of the firm to depend on the policy of the contracting company. In times of crisis and unstable foreign policy environment, own-brand production can be of great importance for the survival of small business and its fast restructuring.

### **3. EMPIRICAL RESULTS**

The target group in our survey includes small apparel companies from Ruse region, Bulgaria with personnel of 10 to 50 people. Our interest is focused on firms that have passed the initial stage of their development and now they face the challenge to protect market positions and grow. Apparel industry is of great importance for the Ruse region. For many years it has established traditions and nowadays is well developed in the area.

From a total of 31 selected companies, 15 enterprises responded to the survey, which represents 48% of the target group. The results show that the majority of these firms, 53% operate as subcontractors, 20% have mixed production/own production and production as subcontractors/ and only 27% have own production.

This paper presents the results concerning subcontractors. First we studied the trends in firms' sales revenue and staff. The results show that from 2017 to 2019, these companies manage to maintain their revenues and personnel. The conclusion is that work as a subcontractor provides small business with steady market position and even growth for some of the firms. To find out what is the attitude of entrepreneurs to own production, we asked them if they are interested in it. The results are:

- 38% of the entrepreneurs are interested to start own production;
- 38% of respondents don't have an interest to start own production;
- the majority of the entrepreneurs (62%) either do not have an interest in own production (38%) or do not feel such a need now (24%).

The conclusion is that work as a subcontractor fully satisfies the majority of small business entrepreneurs. The fact that for most of the companies this is a family business should also be taken into account.

For the purpose of our study it is important to identify what are the main constraints for motivation of entrepreneurs to start own production. Therefore, we asked the respondents to evaluate various barriers for production related to:

- characteristics of the owner – risk taking propensity and proactive behaviour;
- firm resources – qualify personnel, technological equipment and availability of funding;
- external /market/ environment – information for suppliers of raw materials, intensity and power of competitors, access to external financial resources, as well as the institutional / administrative and legislative/ barriers.

A descriptive analysis of the results was done, as well as a correlation analysis of the variable “interest in own production” and the variables related to the key constraints which companies have to overcome to change their strategy for firm development. The results from our analysis can be summarized as follows:

- The entrepreneur's risk assessment is the main constraint for own production. 75% of the respondents find own production as too risky.
- For over 60% of the entrepreneurs work as a subcontractor is a source of regular income and there's no need for additional investments. Correlation analysis shows that the entrepreneur's assessment for higher risk correlates to his weaker interest in own production. Economic risk and the long payback period of investment in new products are serious psychological barriers that entrepreneurs have to overcome. In most cases small business owners don't want to take the risk and to change the firm's strategy /from subcontractor to manufacturer of own production/. This finding corresponds with the fact that most of the subcontractors manage to keep their revenues and personnel.
- The entrepreneur's interest in own production depends on his ability to overcome a number of constraints. With regard to firm resources and external environment, the correlation analysis reveals a stronger relation between entrepreneur's interest in own production and constraints, related to: lack of qualified staff, insufficient information on raw material suppliers, access to external financing and intensity and power of the competitors.

For almost all of the entrepreneurs (88% of subcontractors) the main constraint to start own production is to attract and retain highly qualified and experienced personnel - technologists, designers, marketing specialists, etc. The regional profile of Ruse, prepared by Institute for Market Economics, reveals that in recent years, the demographic situation in the region is characterized by a declining and aging population. This together with the deterioration of education quality lead to a lack of personnel who is prepared to meet the business requirements. The problem is significant for companies from all branches in Ruse.

The low pay levels in the apparel industry have led to a lack of interest for work in this branch and to retraining of personnel. Moreover, only a small number of firms invest in trainings to improve the competence and skills of their personnel. Unlike large companies, managers of small firms often can't provide an adequate remuneration to attract qualified professionals.

Insufficient information for suppliers of raw materials is another important obstacle for decision to start own production. Small companies don't have enough funds for market research and they don't have specialists who can do it. Another reason for companies to prefer working as subcontractors is that materials and sales are provided by the client. The use of consulting services is not a practice for small firms yet.

Access to finance is essential for the business. Half of the respondents share that they rely on limited own funds. 63% of firms don't have access to external funding. In fact the bank financing for micro- and small enterprises is more limited compared to medium and large companies, due to the higher risk assessment and the requirements for collateral. Accounting statements of small firms are often incorrect which is another obstacle when applying for funding. Venture capital funds and "business angels" are not popular practices in Bulgaria. The access to the national and European funding programs is still limited, because the application procedures are difficult, cumbersome and time consuming.

In our survey half of the respondents define market competition as strong for the survival of firms with own production. A lot of medium-sized apparel companies in the Ruse region have a well-known own production with registered trademarks. Most of them have a decentralized structure and functional departments for finance, planning, marketing, R&D, and have established long-term relations with suppliers and customers.

Our analysis shows a weaker correlation between interest in own production and constraints related to staff turnover, need for additional investment in own production, lack of information on access to markets, limited own funds and availability of numerous legislative and administrative obstacles.

To define the entrepreneur's attitude to own production, we asked the respondents if they have information about the procedures related to protection of own production through trademark rights. Another question was directed to their intention to receive information how to achieve firm growth with own production. The results show that:

- 50% of the entrepreneurs are aware of the procedures for trademark registration, but 75% of the interviewed don't show interest in it.
- 50% of the entrepreneurs have the intention to receive information on how to achieve firm growth with their own production. It should be noted that there are no entrepreneurs who have categorically stated this intention. The answer "rather yes" (50%) is an indication of a weaker attitude and hesitation in the interviewees.

Based on the results obtained, we find that subcontractors show modest interest in information about the opportunities for firm growth with their own production, protected through trademark rights. The assessment of the company's capabilities, lack of qualified personnel and financial resources, and the opportunities of the external environment, strong competition and lack of suppliers of raw materials, define the low motivation of the entrepreneur to start his own production and to change firm's strategy.

#### **4. CONCLUSIONS AND RECOMMENDATIONS**

In our survey we find that working as a subcontractor satisfies the majority of entrepreneurs because this business provides them with steady market positions. Most of small apparel companies manage to keep their revenues and personnel. The main constraints that have an impact on attitudes for own production are: lack of qualified staff, insufficient information on raw material suppliers, access to external financing and intensity, and power of the competitors. To change their motivation the entrepreneurs must have information about market opportunities and the benefits of own production. Therefore, our recommendations are below.

Improvement of cooperation networks between small business and educational institutions - the University of Ruse “Angel Kanchev”, Professional high school of apparel “Nedka Ivan Lazarova”, Ruse. Entrepreneurs should be encouraged to assign academic research on trends in economic development, state of apparel industry in Bulgaria and in the region, technological innovations, etc. The University of Ruse may take the initiative to organize seminars for small firms with participation of the Bulgarian Patent Office representatives who to present the regulations and procedures for trademark registration and its benefits for the business.

Stimulation of cooperation between the small business and regional intermediate Organizations - Regional Industrial Association, Ruse Chamber of Commerce and Industry, Bulgarian-Romanian Chamber of Commerce and Industry (BRCCI), Business Innovation Center - Innobridge, Bulgarian Association for Transfer of Technology and Innovation (BATTI). The activities of these organizations have been directed to support business and its internationalization – to provide access to information about potential clients in Bulgaria and abroad, to organise seminars and trainings, to connect local authority, university and business, to implement cross-border cooperation projects Bulgaria-Romania.

Participation of small apparel companies in Specialized Cluster Institute for Apparel and Textile / SCIAT / Danube. The cluster provides consultation of textile and clothing companies on organization, rationalization, optimization of production, engineering technology, better productivity, quality control, quality improvement, job fairs and staff training.

## IZBOR ZA RAST MALIH NISKOTEHNOLOŠKIH PROIZVODNIH KOMPANIJA U BUGARSKOJ

Neli Rasheva

University of Ruse "Angel Kanchev", Bulgaria

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### Izvod

Poslednjih decenija, kao rezultat političkog i ekonomskog razvoja Bugarske, mnoge male kompanije u niskotehnoj industriji posluju kao podizvođači za strane klijente ili veće bugarske kompanije. Ovo ograničava njihov rast, a njihov opstanak je uslovljen politikama drugih kompanija. Sproveli smo istraživanje sa ciljem da otkrijemo odrednice koje mogu uticati na transformaciju podizvođača u samostalne kompanije sa sopstvenom proizvodnjom, zaštićene pravima intelektualne svojine na svom žigu. Svrha ovog rada je da predstavi model rasta u kome je ličnost preduzetnika centralna. Njegovi stavovi i procena rizika kao i vrednovanje sposobnosti kompanije i šansi iz eksternog okruženja, imaju određeni nivo uticaja na motivaciju preduzetnika i određuju izbor strategije rasta firme. Ovaj rad predstavlja rezultate licem u lice anketa u odabranim malim kompanijama koje se bave proizvodnjom odeće iz Rusenske oblasti u Bugarskoj.

***Ključne reči:*** mala proizvodna kompanija, industrija odeće, rast, imovinska prava na žig

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