

THE DYNAMIC AND IMPORTANCE OF SMES IN ECONOMY

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Abstract:

In a world that is marked by a fierce competition, in which the actors that are in play change the rules of the market, forcing enterprises to change the fundamentals of their competitiveness and their economic performance, holding technological resources has become a major strategic stake for enterprises. SMEs, the backbone of an economy, whether we are referring to the economy of a random state, or the world economy, have to answer these changes and offer competitive goods and services, adjusting the quality of the production factors to these changes. Thus, the competitiveness for SMEs is an essential condition to be able to endure. This article will address the evolution and importance of SMEs in the economy. We will also focus on their classification as well as their contribution to the GDP and the world's economy.

Key words: SME, employment, GDP, growth, economy

JEL classification: E 20, E24, E 29, M 21

INTRODUCTION

The enterprise is the common ways of organization made of one or multiple persons who have economic activities using multiple material and economic means in order to obtain profit (Roman, 2010).

Internationally the SME abbreviation is used (Small and Medium Sized Enterprise). The MSME is also used (Micro, Small and Medium Sized Enterprise). Although abbreviations are accepted and very used, when it comes to defining the term of SME, opinions differ. You can find in the table below (table no.1) a synthesis about the different approaches of SMEs.

Table 1. Different approaches of the SME notion

No.	Approach categories		
	Criteria	Name	Dominant characteristic
1.	Economy sphere	Generalized	Establish different defining criteria of small and medium enterprises for all activity sectors.
		Diferenciate	Using various criteria of delineation of SMEs in taking into consideration the field of activity: transport, telecommunications, trade, etc.
2.	Number of indicators used	Unidimensional	Using in the definition of SMEs a single indicator. The most common indicator is the number of employees.
		Multi-dimensional	Define the size of SMEs based on several indicators. The most commonly used are the number of employees, turnover and capital.

(source: Nicolescu, Ovidiu; Nicolescu, Ciprian - *Intreprenoriatul și managementul întreprinderilor mici și mijlocii. Concepte, abordări, studii de caz*, Editura Economică, București, 2008, p. 60)

Lately we could observe an inclination towards generalized approaches, one-dimensional. More specific, SMEs are defined by using the employees' numbers, without taking into consideration characteristics like activity domain, organization form, technical endowments, profitability and their turnover. Although the employees' number is an important characteristic, which gives a clear description and allows an easy comparison between companies, I would rather be a supporter of multi-dimensional and differentiated approaches which points out the enterprise as a complex system, socio-economic, technical-material, dynamic and adaptive.

THE SME CONCEPT

Literature doesn't offer any universally accepted definition or a "founding father" of this topic, there are several approaches of the term.

The economic, cultural and social differences among the states of the world are reflected both in the definition as well as in the classification of SMEs. Over the years, each country has had different approaches when it comes to the small and medium enterprise notion. There are typologies which are based on the number of employees, made turnover or the industrial branch of the company.

A recent study (European Commission, 2012) pointed out that the most used factors in SMEs classification are: the number of employees, the annual turnover and the active balance. Other than these there are some more factors, of a smaller importance, like social capital or accessed credits.

The sole market developed by the EU has imposed the implementation of a universal definition for SMEs. In 1996 the European Commission has established the first definition of SMEs, applicable to the whole territory of the EU, through the 96/280/EC Recommendation (European Commission, 1996), according to article 1 from the Annex SMEs are the companies that:

- have less than 250 employees;
- their turnover is less than 40.000.000 EUR or their annual balance is less than 27.000.000 EUR;
- fulfills the independence criteria – does not hold more than 25% of another company;

In 2003 The European Commission revised the definition and added some amendments. The 361/2003/EC Recommendation corrects the old one by changing some values in the annual turnover and the annual balance. SMEs can have a turnover of up to 50.000.000 EUR or a value of its annual balance of up to 43.000.000 EUR. The EU's point of view is not mandatory but a recommendation in order to create common characteristics to compare statistics. If we analyze the classification criteria individually for each member state, we will find major differences imposed by other factors.

In Asia the situation is a bit different. The SME's industrial branch is important and then, in that branch indicators like number of employees, turnover, and balance are emphasized.

A regulation concerning the classification standards for small and medium enterprises has been created by *China* in 2011. This regulation divides companies into activity sectors, then small and middle size enterprises are split into three categories: medium, small and micro. All the values for the turnover and actives are presented in Chinese Yuan. We would like to add that 1 EUR is approximately 8.35 Yuan.

Japan uses a similar, but simpler classification than China. According to the second article from the Base SME Act, these have as main classification criteria these three indicators: activity branch, turnover and employees' number.

In the *USA* the classification of SMEs is established by a governmental department, called Small Business Administration – SBA. It uses certain "size standards" in order to show how large a company can be in order to be considered a SME. The table below (table no.2) presents a classification of American SMEs according to employees' number, annual turnover and line of work.

Table 2. Classification of SMEs on U.S.

	Manufacturing and service industry	Services		Agriculture
		Majority	Maximum value	
No of employees	<500	<500	<500	<500
Turnover	-	≤7mil. \$	≤25mil. \$	≤0.25mil. \$

(source: United States International Trade Commission, *Small and Medium-Sized Enterprises: Overview of Participation in U.S.Exports*, 2010, p.1-3, <http://www.usitc.gov/publications/332/pub4125.pdf>)

Taking into consideration the activities a company performs, one can separate them into three large domains: industry, services and agriculture. Enterprises are split according to this in companies that handle their business only in the USA and exporters.

From the employees' number point of view, companies that have less than 500 employees are considered to be SMEs. We encounter a small problem here. Now the employees' number is not considered enough of a characteristic to characterize SMEs. Approximately 99% of all active enterprises in the USA are in this category.

From the analysis we have seen the importance given to the industry in defining and classifying SMEs. The industry is the criterion that distinguishes SMEs from the EU from the ones from Asia and Nord America.

SMES – THE ENGINE OF MODERN ECONOMY

Small and medium enterprises (SMEs) are considered the backbone of an economy, whether we are referring to a random state, or if we are talking globally. These companies represent an essential source of economic growth, dynamic and flexibility in advanced industrialized countries, just like they do in emergent economies and in development. The main argument for this is that SMEs are the dominant form of business organization, representing roughly 95 – 99% of all companies. According to the Organization for Economic Cooperation and Development (OECD), SMEs represent more than 95% of enterprises and ensure 60-70% of the jobs.

Small enterprises are very important in promoting competitiveness and to bring new products or technics to the market. SMEs increase their productivity mostly through finance. Investments provide access to technologies and helps expand the business, thus ensuring the competitiveness of a company and, by extrapolating, the one of a nation as a whole. It's fair to say that the performances and the development level of a national economy depends a lot on the capacity to create a good environment for SMEs, which can supply quality services and competitive products at a low cost and in quantities that are adjusted to the market.

In 132 of covered economies, there are 125 million SMEs. From these, 89 million are located in countries in the developing world.

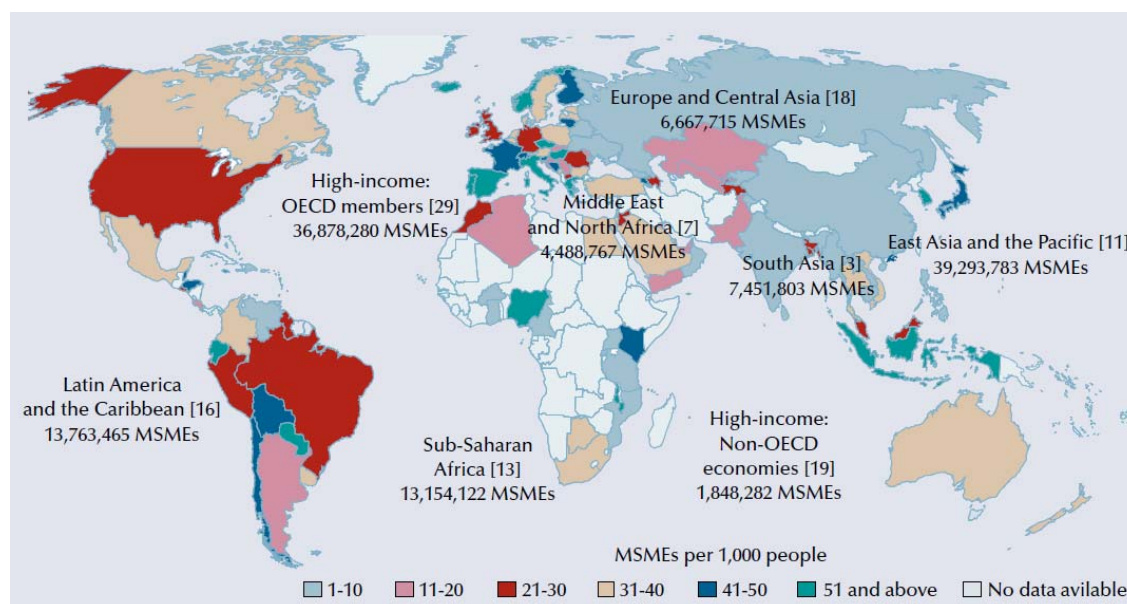


Figure 1. SMEs density around the globe

(source: Khrystyna Kushnir, Melina Laura Mirmulstein, Rita Ramalho - *Micro, Small, and Medium Enterprises Around the World: How Many Are There, and What Affects the Count?*, 2010, p. 3

[http://www.ifc.org/ifcext/globalfm.nsf/AttachmentsByTitle/MSME-Country-Indicators-Analysis-Note/\\$FILE/MSME-CI-AnalysisNote.pdf](http://www.ifc.org/ifcext/globalfm.nsf/AttachmentsByTitle/MSME-Country-Indicators-Analysis-Note/$FILE/MSME-CI-AnalysisNote.pdf))

On average, there are around 31 micro-enterprises, SMEs to each 1000 persons globally. There are countries that are above average, for instance Brunei Darussalam with 122 companies to 1000 inhabitants, Indonesia with 100, Paraguay with 95, Czech Republic with 85 or Ecuador with 84. The countries with a bigger income per capita tend to have a larger number of registered companies for 1000 persons.

The SMEs have a direct effect on GDP growth. This effect represents the difference between the return on capital employed and its cost.

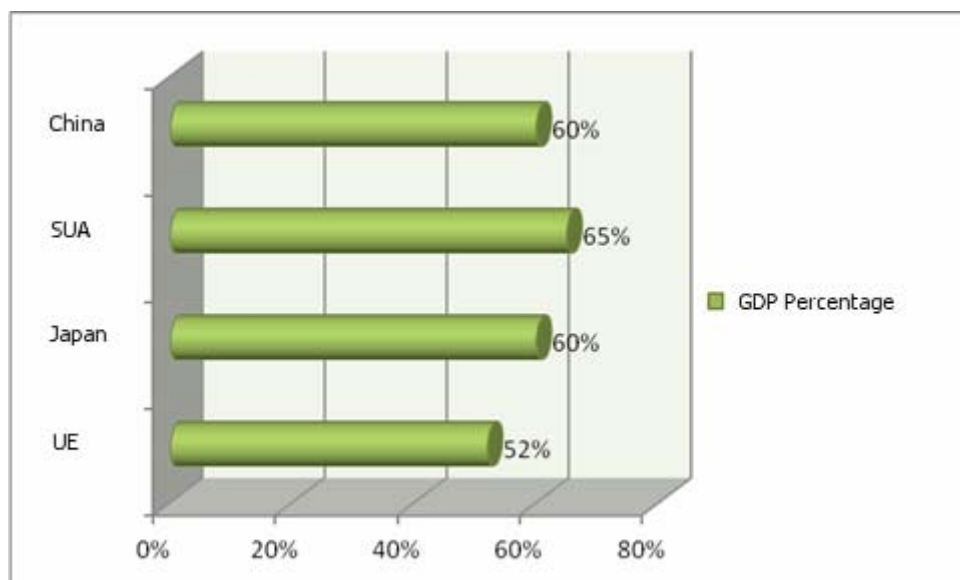


Figure 1.2. Contribution of SMEs to GDP of EU, Japan, SUA and China

Regardless of the degree of development and standard of living of the population of a state, SMEs are the biggest contributors to the gross domestic product. In countries like Japan or China 60% of GDP comes from SMEs, in the USA that percentage goes up to 65%, and in the UE SMEs generate 52% of GDP.

Small and medium enterprises are the biggest contributors to the employment of labor from a country. A study (Meghana et al., 2011) made on 47745 firms from 99 countries during 2006-2010 proved this. On average, the firms with 5 to 250 employees engage 66.76% of the active population of a state. We have to take into consideration the fact that this study does not take into account micro enterprises that have up to 5 employees. Other than the fact that they employ a large number of people, the SMEs from this category are also responsible for new employment. These generate approximately 86.01% of new jobs.

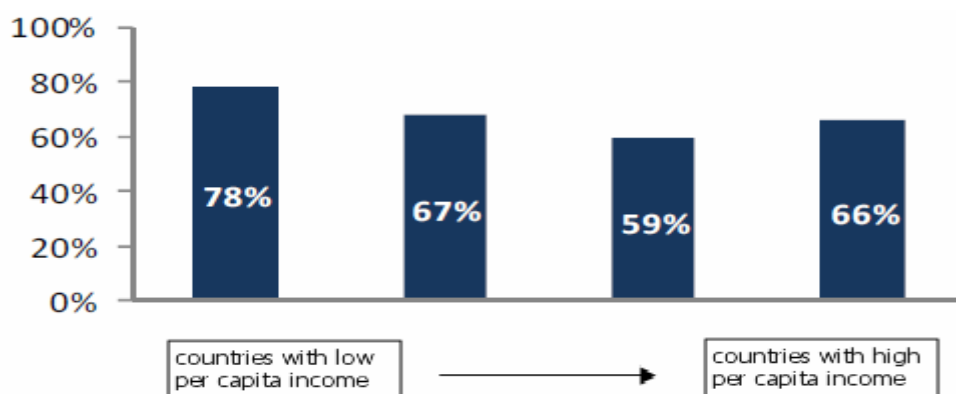


Figure 1.3. The contribution of SMEs to employment rate

(source: ***, The Steering Group (2011), *Report on Support to SMEs in Developing Countries Through Financial Intermediaries*, p. 8, http://www.eib.org/attachments/dalberg_sme-briefing-paper.pdf)

In the countries with a lower income per capita, SMEs have a higher impact on the employment level, about 78%, compared to countries with a larger income, where the percentage goes down to 59%.

In 2010 the degree of employment generated by SMEs in EU was 67%. Micro companies contribute to approximately 30% of that percentage, small enterprises with approximately 20% and middle companies with 17%. You can observe a growth of the employment and labor litigation since 2007 when the value of that indicator was 60% in EU (Wymenga et al., 2011). In 2007, in Japan, the degree of employment litigation relative to SMEs was 69%, while in the U.S. of 57,9% (Economist Intelligence Unit, 2010). Later reports have presented larger values of this indicator, pointing us to one conclusion: the growth of SMEs numbers globally has had a positive impact through creating new jobs and lowering unemployment.

The challenge of the 21st century for SME-s is global competitiveness. This means that customers need to be provided with constant and reliable products and services of a recognized quality, while the market environment is characterized by global competition.

CONCLUSIONS

We live in a world that is constantly moving and changing. SMEs are small companies that rapidly adjust to each environmental fluctuation. This offers them a big advantage in the context of globalization and the uprising of the informational society. Although their dimension offers them an edge in what concerns adaptability not the same can be said about the possibility of gaining resources and external financial help.

Globally two predominant ways of classifying enterprises prevail: the Asian perspective, which has in the center the industrial branch and the European one, which is based on three size indicators, turnover, employees' number and active value. China's classification is more complex because in the branch sub-classification they include the hierarchy criteria used in Europe, but according to the industry.

As we have stated at the beginning of this paper, small and middle enterprises represents 99% of the total active firms around the world. 60-70% of all jobs are created by SMEs. The economic crisis has affected micro enterprises, small enterprises and middle one all around the world, but their capacity to adapt has turned them into a lever to fight this phenomenon.

This paper is the starting point for future research work that will focus on the analysis of how new technologies can be the determining factors in terms of growth among SMEs.

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