

Lecture 1

Small and Medium Enterprises (SMEs): definition and characteristics

Agenda

- ❑ SMEs: a definition
- ❑ The dimension of the phenomenon
- ❑ The main difficulties for SMEs
- ❑ The main characteristics of SMEs
- ❑ The family business
- ❑ Some myths about SMEs

SMEs Definition



SMEs Thresholds

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover	or	Annual balance sheet total
Medium-sized	< 250	≤ €50 million (in 1996 € 40 million)	or	≤ €43 million (in 1996 € 27 million)
Small	< 50	≤ €10 million (in 1996 € 7 million)	or	≤ €10 million (in 1996 € 5 million)
Micro	< 10	≤ €2 million (previously not defined)	or	≤ €2 million (previously not defined)

This classification is used in the EU and other countries, but not worldwide. The US consider as SMEs when having less than 500, while in Indonesia is less than 20 employees.

SMEs Indipendence

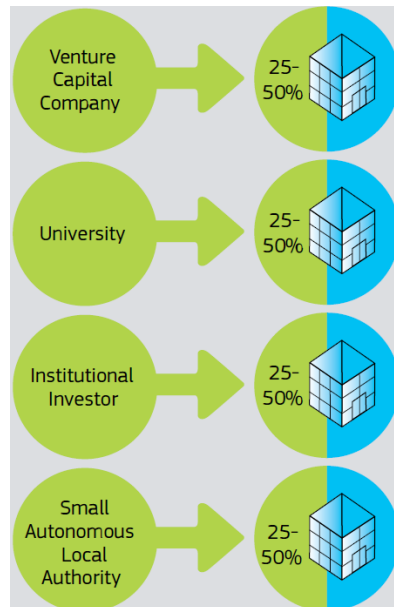
A SME is independent if:

- No other enterprise has a participation in it
- It has no participation in other enterprise

Or

- It has a holding of less than 25% of the capital or voting rights (whichever is higher) in one or more other enterprises; and/or
- Any external parties have a stake of no more than 25% of the capital or voting rights (whichever is higher) in the enterprise.

Exceptions:



SMEs Indipendence

A SME is a *partner* if:

- The enterprise has a holding equal to or greater than 25% of the capital or voting rights in another enterprise and/or
- Another enterprise has a holding equal to or greater than 25% of the capital or voting rights in the enterprise in question.

The thresholds for SMEs are accounted as taking into account also the percentage of holding by and of other enterprises.

Example: Company A has 150 employees, it also owns 25% of Company B employing 400 people.
Is company A a SME, in terms of headcount?

Solution: $150 + (400 \times 25\%) = 250$

SMEs Indipendence

A SME is a *linked* company:

- One enterprise holds a majority of the shareholders' or members' voting rights in another
- One enterprise is entitled to appoint or remove a majority of the administrative, management or supervisory body of another
- A contract between the enterprises, or a provision in the memorandum or articles of association of one of the enterprises, enables one of the exercise a dominant influence over the other
- One enterprise is able, by agreement, to exercise sole control over a majority of shareholders' or members' voting rights in another.

The thresholds for SMEs are accounted as taking into account also the data of other enterprises.

Example: Company A has 150 employees, it also owns 50,1 % of Company B employing 400 people. Is Company A a SME in terms of headcount?

Solution: $150 + 400 = 550$ (not a SME)

SMEs: how many in EU (2017)

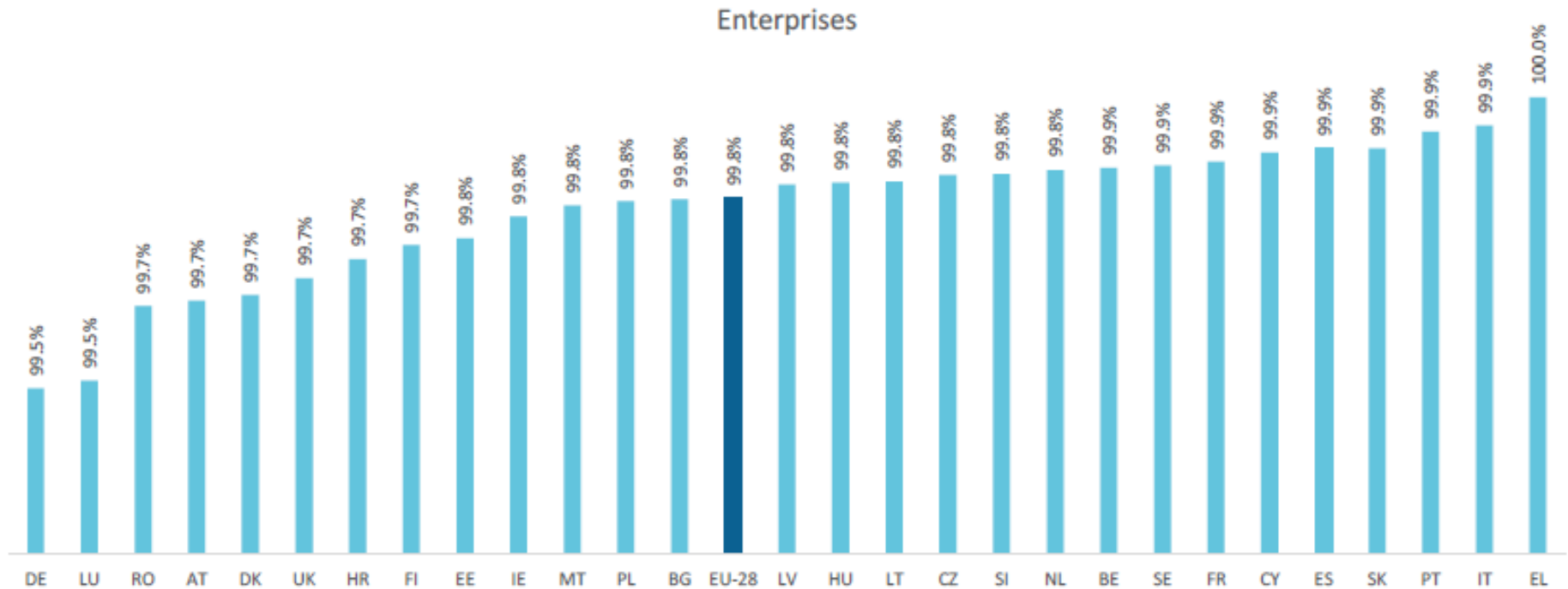
Table 2: Number of SMEs and large enterprises in the EU-28 non-financial business sector in 2017 and their value added and employment

	Micro SMEs	Small SMEs	Medium-sized SMEs	All SMEs	Large enterprises	All enterprises
Enterprises						
Number	22,830,944	1,420,693	231,857	24,483,496	46,547	24,530,050
%	93.1%	5.8%	0.9%	99.8%	0.2%	100.0%
Value added						
Value in € (trillion)	1,525.6	1,292.1	1,343.0	4,160.7	3,167.9	7,328.1
%	20.8%	17.6%	18.3%	56.8%	43.2%	100.0%
Employment						
Number (in 000)	41,980,528	28,582,254	24,201,840	94,764,624	47,933,208	142,697,824
%	29.4%	20.0%	17.0%	66.4%	33.6%	100.0%

Note: Large enterprises are enterprises with 250 or more employees

Source: Eurostat, National Statistical Offices, DIW Econ

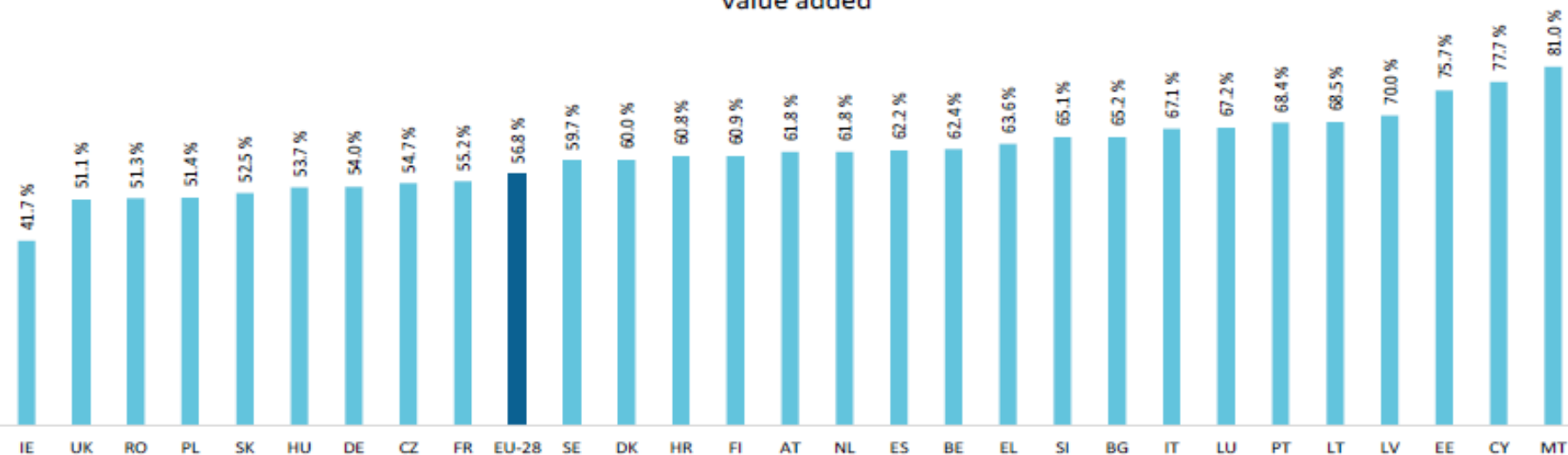
SMEs: national variation



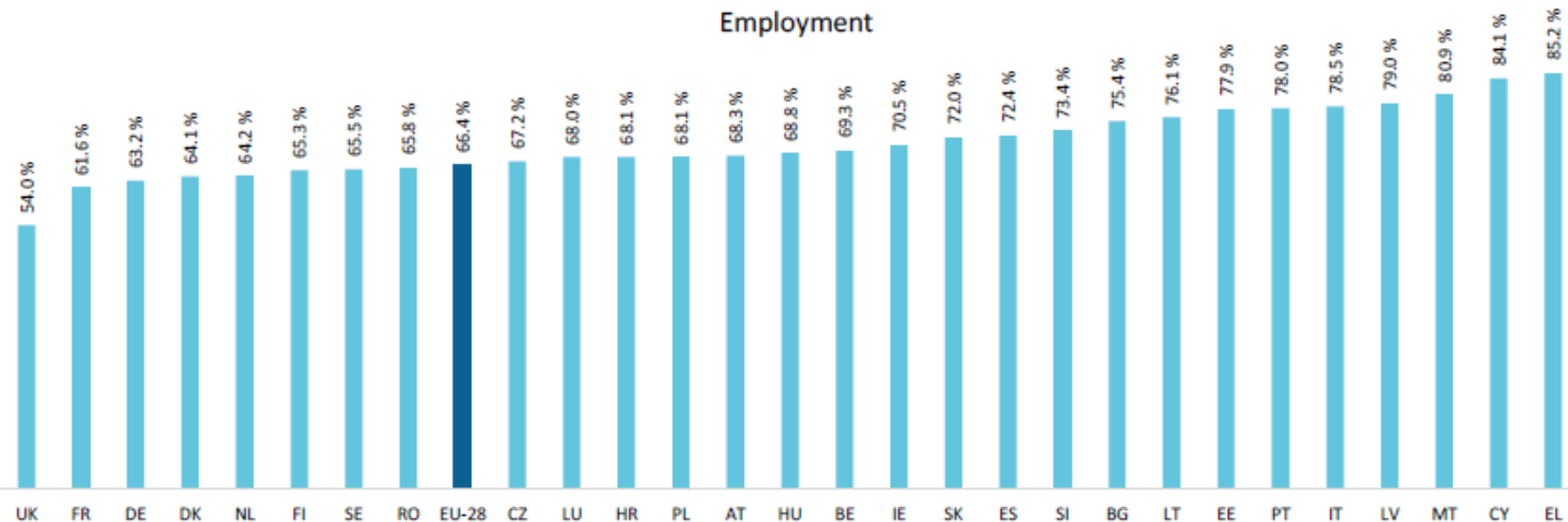
Source: Eurostat, National Statistical Offices, DIW Econ

SMEs: national variation

Value added



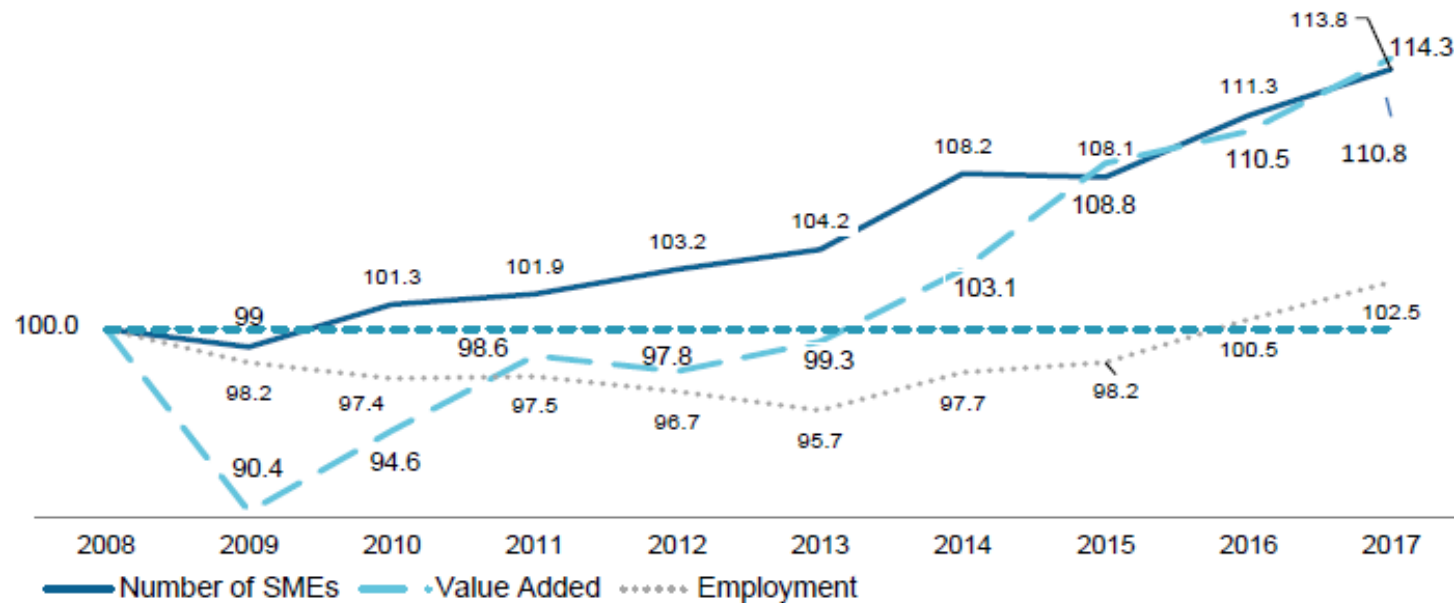
Employment



Source: Eurostat, National Statistical Offices, DIW Econ

SMEs: crisis and resilience

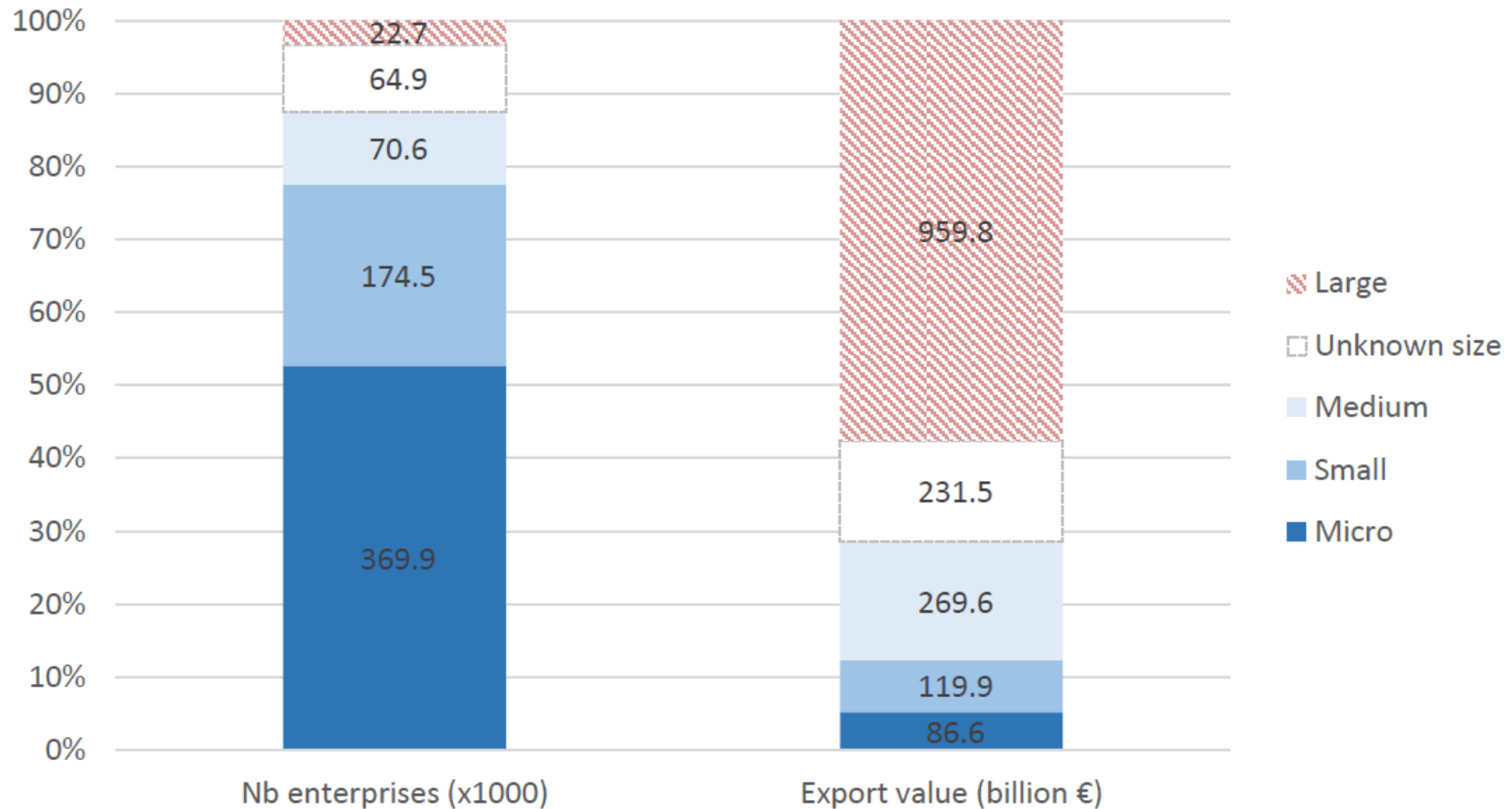
Figure 16: Evolution of SME value added and employment and number of SMEs in the EU-28 non-financial business sector (2008=100)



Source: Eurostat, National Statistical Offices, DIW Econ

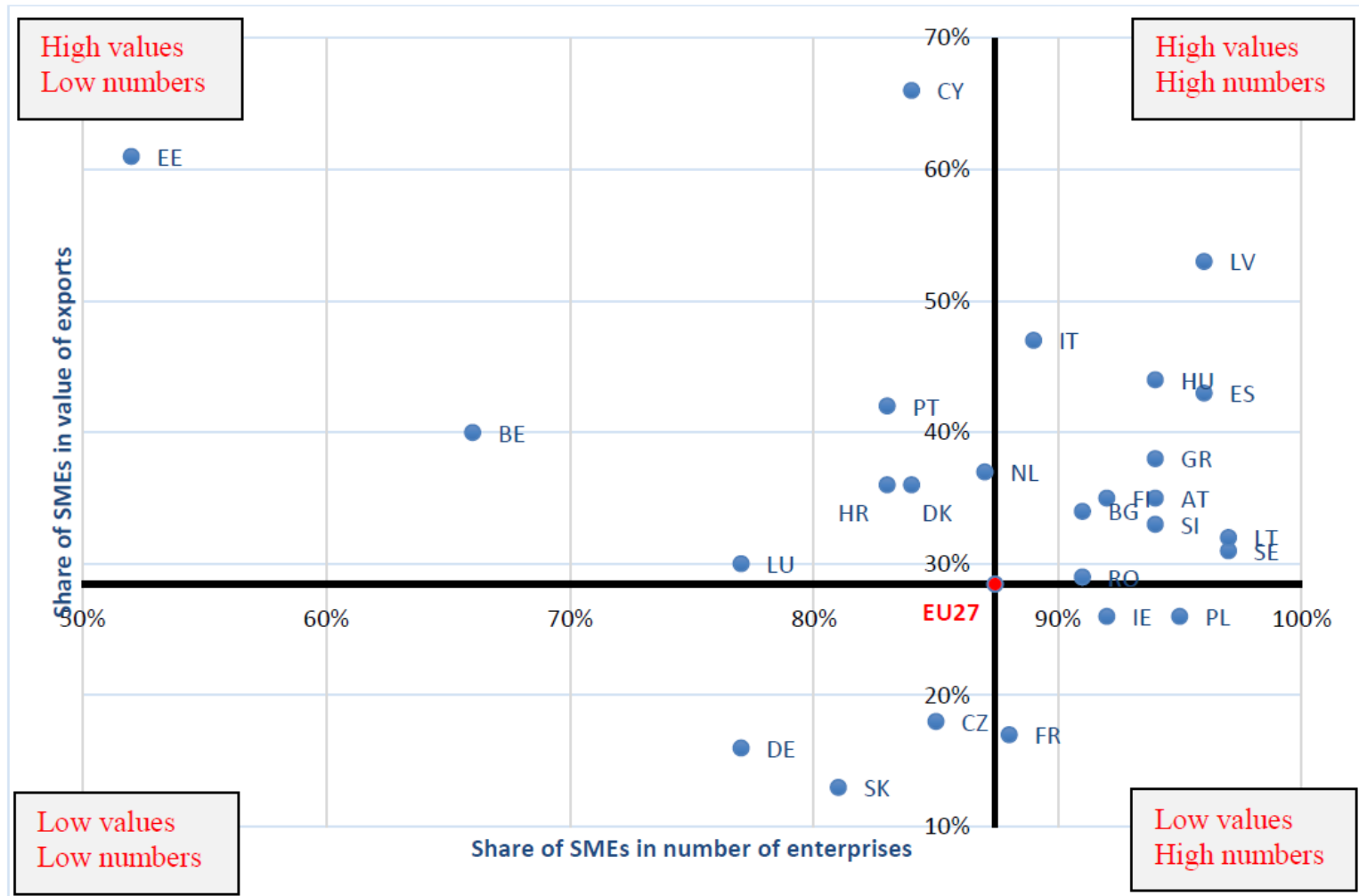
SMEs: Internationalisation

EU27 exporters of goods by size class, in number of enterprises and value of exports, 2017



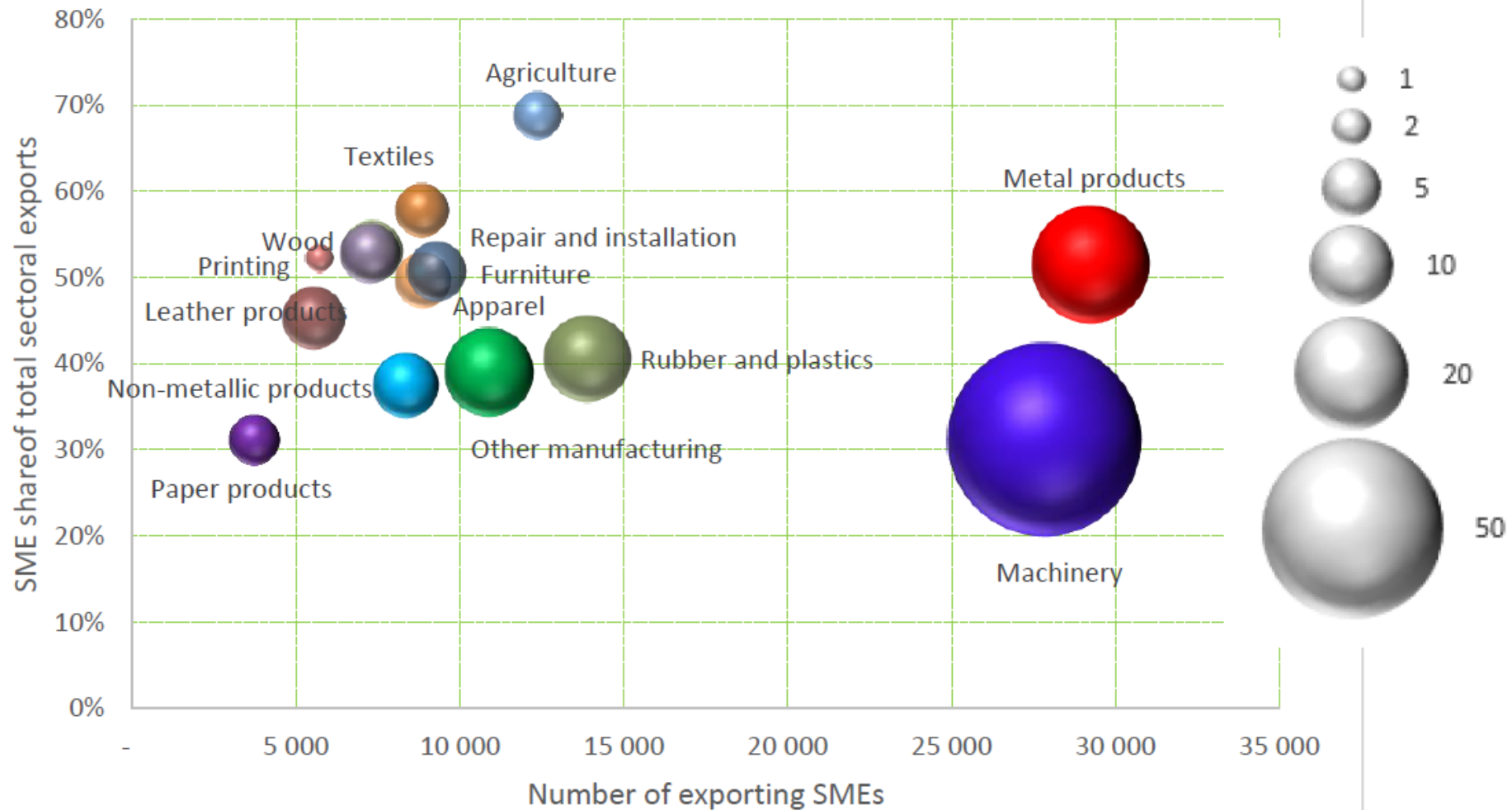
SMEs: Internationalisation

Share of exporting SMEs to total exporting firms, in number and trade value, 2017

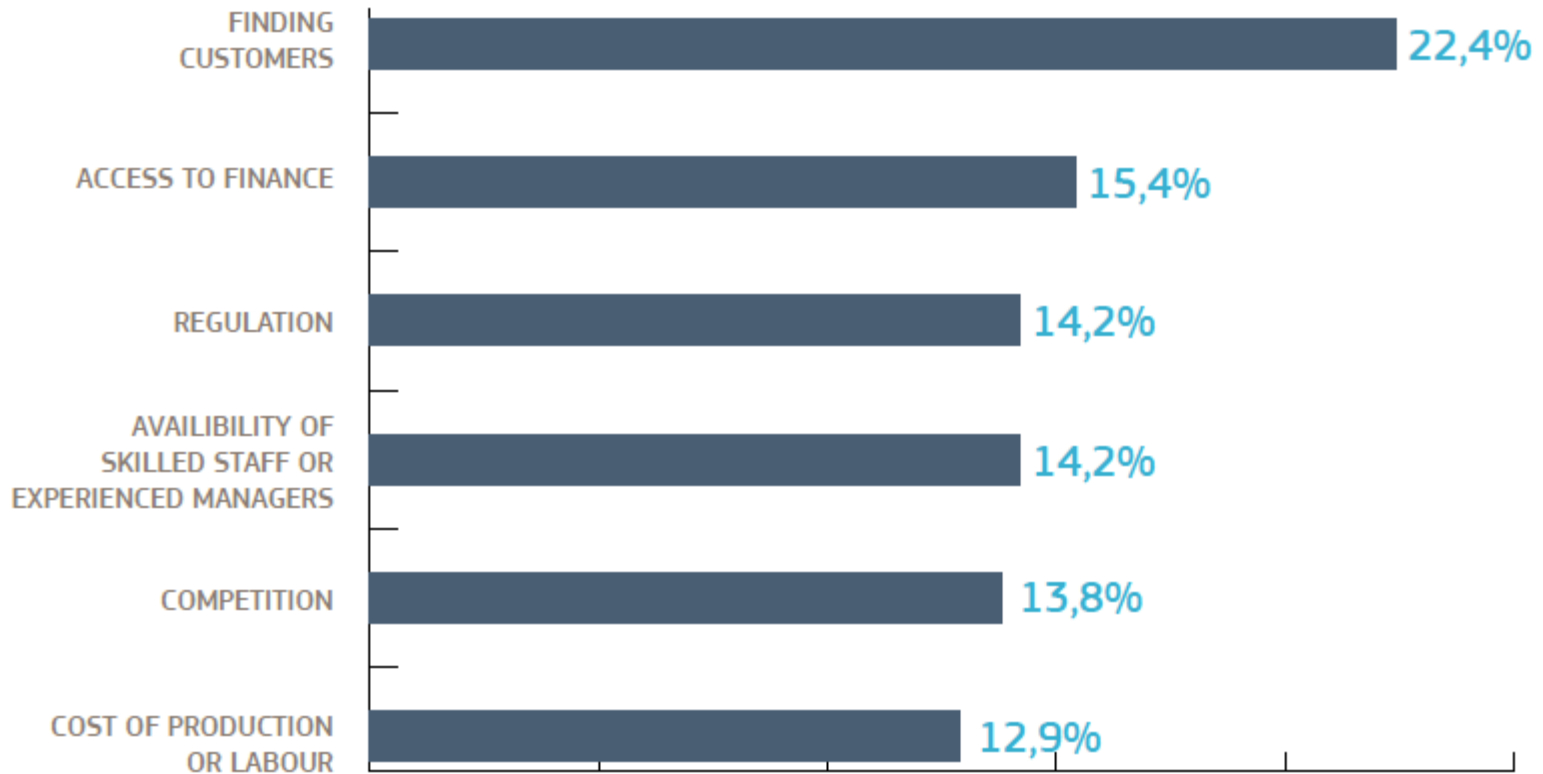


SMEs: Internationalisation

Economic sectors with higher than average shares of EU SME exports, 2017



SMEs: most pressing problems



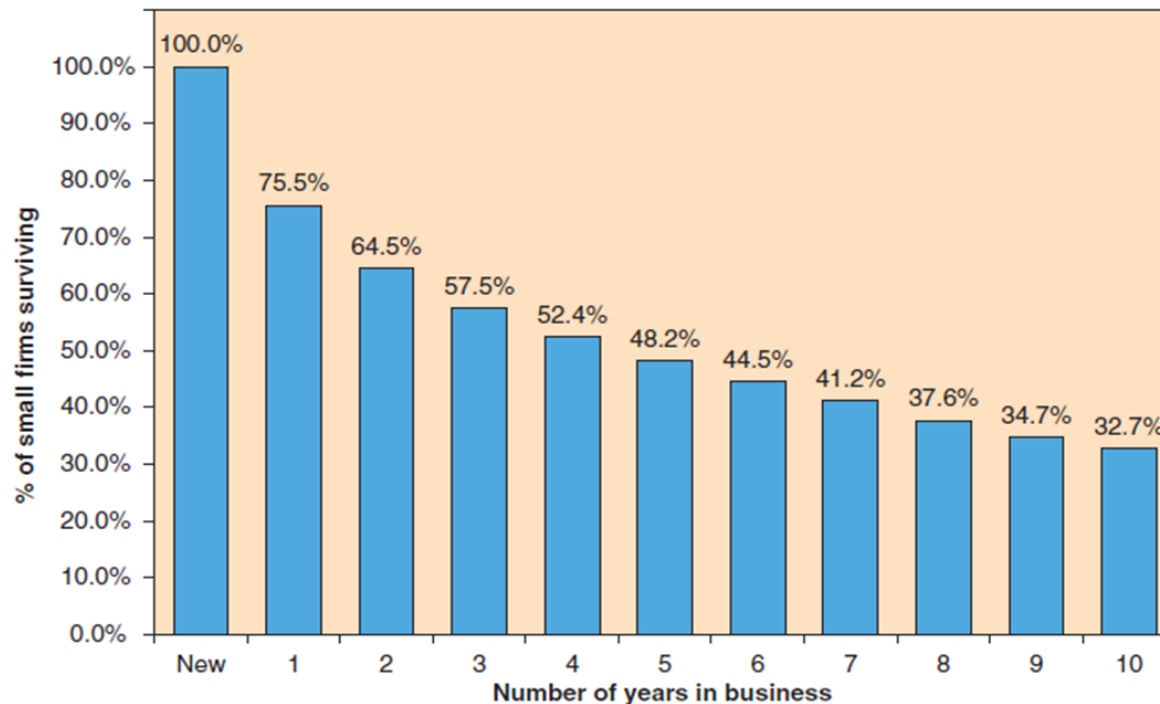
Source: EC/ECB - Safe Wave 9

SMEs key characteristics

- ☐ Flexibility
- ☐ Innovation
- ☐ Close relationship to customer
- ☐ High employee job satisfaction
- ☐ Encourage risk takers
- ☐ Family owned (Family business)

Putting Failure into Perspective

- About 50% of new ventures fail during the first five years
- About 70% of new ventures fail within 10 years
- Entrepreneurs are not paralyzed by the prospect of failure
 - Failure is a natural part of the creative process
- Successful entrepreneurs learn to fail intelligently



Main causes of SMEs failure

Bradley & Cowdery (2004) suggested the following causes for failure:

- Undercapitalisation
- Lack of planning
- Tax burdens and regulations
- Personal issues
- Unrealistic expectations
- Poor cash flow
- Loss of a key person
- Growing pains
- Lack of technology
- Poor location
- Failure to use advice

How to Avoid Pitfalls

- Know your business in depth
- Prepare a business plan
- Manage financial resources
- Understand financial statements
- Learn to manage people effectively
- Set your business apart from the competition
- Maintain a positive attitude

Myth about small business

- ❑ **It is highly risky:** true but risk can be managed through planning . The bankruptcy rate is no higher than bigger firms, but many entrepreneurs decide to abandon operations.
- ❑ **Lack of capital:** most of the time capital is not lacking, but its cost tend to be higher than bigger firms. Again, planning can support decision and the search for alternative forms of financing.
- ❑ **Heavy burdens of government-imposed regulations:** true but, the paper-work burden can be efficiently managed through a better organisation.
- ❑ **Low training and education:** true, but most of the time it is not the lack of willingness, but the lack of an offer suited for the small business environment (time, method, etc.)
- ❑ **Profit driven:** profit maximization is not the only motivation behind starting a venture, but also personal needs of realization, or social aspect when the family is involved.

Small business act EU

1. **Entrepreneurship:** Creating an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded.
2. **Second Chance:** Ensuring that honest entrepreneurs who have experienced bankruptcy are promptly given a second opportunity to succeed.
3. **Think Small First:** Designing rules modelled on the “Think Small First” principle
4. **Responsive Administration:** Making public administrations responsive to the needs of SMEs.
5. **State Aid and Public Procurement:** Adapting public policy tools to suit SME needs - facilitating SMEs’ participation in public procurement and ensuring better access to State Aid for SMEs.
6. **Access to Finance:** Facilitating SMEs’ access to finance and developing a legal and business environment conducive to the specific requirements of SMEs, including timely payments in commercial transactions.
7. **Single Market:** Helping SMEs to benefit more from the opportunities offered by the Single Market.
8. **Skills and Innovation:** Promoting the enhancement of skills in the SME workforce and all forms of innovation.
9. **Environment:** Enabling SMEs to transform environmental challenges into economic opportunities while acting sustainably.
10. **Internationalisation:** Encouraging SMEs to benefit from the growth of global markets and supporting them in this pursuit.

Readings

Bradley & Cowdery (2004), Small Business: causes of bankruptcy, downloaded from <http://uca.edu/sbanc/research-archive/association-of-small-business-and-entrepreneurship-asbe/2004>