The Importance of SMEs in Developing Economies

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Abstract: The economy of the 20th and 21st century has a different set of rules than Smith's economy of the 19th century. The new ideology of neo-liberalism and globalization emphasizes the role of SMEs as promoters of a healthy business climate, economic efficiency and power for economic development, especially in developing countries. Today, instead of large-scale industries, SMEs having gained importance in the developing economies, become advantageous being economic enterprises having the capability of quick adaptation, working with less capital but more intense labor and having low cost of management and thus having cheap production. Although SMEs have some weaknesses, they are less affected from economic crises due to its flexibility and abilities which keep up with changed conditions. SMEs are vital actors for enhancing innovation, competitiveness, entrepreneurship and the establishment of an effective innovation system for developing countries. Therefore, in this study the importance of SMEs for developing countries is considered. First, the regulations related to SME definition and EU's SME definitions are mentioned. In the second section, the advantages and disadvantages of SMEs are considered. Then, the importance of SMEs in the economies is discussed by groups of countries with the help of various indicators. Finally, the importance of SMEs in developing countries is discussed.

Introduction

SMEs are seen as the main actors of both national and regional development in many countries. There are a lot of researches about the importance of SMEs in the country's economy. Many countries are implemented support for SMEs in the various programs and policies. In this context, the changes were made about definition of SMEs in EU. Many programs have been implemented to improve the innovation and entrepreneurship of SMEs.

Therefore, support for SMEs is one of the European Commission's priorities for economic growth, job creation and economic and social cohesion. SMEs play an important role in the EU economy. In addition EU is seen SMEs as an important tool in achieving the Lisbon Strategy.

The importance of the SME sector is well recognized worldwide due to its significant contribution to gratifying various socio-economic objectives, such as higher growth of employment, output, promotion of exports and fostering entrepreneurship. Recent empirical studies show that SME's contribute to over 55% of GDP and over 65% of total employment in high-income countries. SME's and informal enterprises, account for over 60% of GDP and over 70% of total employment in low-income countries, while they contribute over 95% of total employment and about 70% of GDP in middle-income countries. In the European Union countries, for example, there are some 25 million small businesses, constituting 99% of all businesses; they employ almost 95 million people, providing 55% of total jobs in the private sector. Important contribution is also on exports and on productivity growth (OECD, 2004). However, the actual importance of SMEs is emerged to adapt the changing conditions of competition and innovation with the globalization process. SMEs, in many studies, are seen as key actors in innovation systems and are important in increasing the competitive and innovative capacity of the countries / regions.

Porter (1996; 2000; 2001; 2003) mention that the new concepts such as region, clustering, innovation substitute traditional competitiveness factors and become the main factors determining the competitive power of firms and local economies Orientation for new sources is experienced in identifying competitiveness and new pursuits are emerged in the areas of economy and business science interests. In fact, the change in these areas of interest can be regarded as a natural extension of "economic reconstruction" which is accompanied globalization process. Post-Fordist production processes of economic activities have intensified the need for redefinition of the relationship among firm-local and regional economy -national economies. As a result, firms-regional and international economies which are regarded as relatively isolated units previously, began to be perceived as the actors constantly interact within a dynamic network. Then global actors and powers also have been included as active partners of this network. With this change, the main concepts such as networks (Hakanson, 1992; Thompson and others, 1991), goods (supply) chains (Dickens, 1998), business systems (Whitley, 1992), clusters(Porter, 1990; Schmitz, 1995) and production systems (Scott ve Storper, 1992), are gain importance. And also SMEs are accepted as the main elements of this concept of "proximity and regional tissue".

In accordance with the above-mentioned developments, SMEs are vital actors for enhancing innovation, competitiveness, entrepreneurship and the establishment of an effective innovation system for developing countries. Therefore, in this study the importance of SMEs for developing countries is considered. First, the regulations related to SME definition and EU's SME definition will be mentioned. In the second section, the advantages and disadvantages of SMEs will be considered. Then, the importance of SMEs in the country's economy will be discussed by groups of countries with the help of various indicators. Finally, the importance of SMEs in developing countries will be discussed.

Definition of Small and Medium-Sized Enterprises (SMEs)

Institutions working on SMEs case can make several definitions. Limit of SMEs definition generally changes according to economic size of countries. Thus SMEs phrase have economical meaning rather than legal meaning. Most of countries accept that number of employee is a common measurement of SMEs definition. Definition of SMEs and their size criteria is a controversial subject. There are various opinions about SMEs size measurement criteria and their amount (Dinçer, 1994).

According to some institutions number of employee has more importance, for the others enterprises turnover have more importance in SMEs definition.

World Bank's definition of SMEs is that micro scale; less than 50 employee, small scale; 50 employees, medium scale; 50-200 employees.

Following the first SMEs definition of EU in 1996, the SME definition which is related with personel numbers is required to revised because of increases in inflation and productivity.

As a result of this; On 6 May 2003 the Commission adopted Recommendation 2003/361/EC regarding the SME definition which replaced Recommendation 96/280/EC as from 1 January 2005. The revision takes account of the economic developments since 1996 and the lessons drawn from the application of the definition. The new SME definition represents a major step towards an improved business environment for SMEs and aims at promoting entrepreneurship, investments and growth. This definition has been elaborated after broad consultations with the stakeholders involved which proves that listening to SMEs is a key towards the successful implementation of the Lisbon goals (EC, 2009). The criteria, about EU definition of SME in 1996 and 2005, are presented in Table 1 below:

SME CATEGORY	EMPLOYMENT*	TURNOVER (Million €)		BALANCE SHEET (Million €)	
		1996	2005	1996	2005
Medium	250	40	50	27	43
Small	50	7	10	5	10
Micro	10	**	2	**	2

Table 1: Definition of SME in European Union

In European Union, the new definition of SME includes those with fewer than 250 employees (EC, 2003). This group is further disaggregated into micro enterprises (with fewer than 10 employees), small enterprises (with 10-49 employees) and medium sized enterprises (with 50-249 employees). Micro enterprises would include self-employed people working for themselves with no employees.[32]

[32] Sometimes the term small, medium and micro-sized enterprises (SMMEs) are used rather than SMEs.

Eurostat has made re-arrangement on statistics of EU by enterprises scale and Eurostat definition of SMEs is that not employee and 1–9 employees are micro scale, 10–49 employees is small scale, 50–249 employee is medium scale, 250–499 employee is large scale (EC, 2003).

Advantages and Disadvantages of SMEs

Small and medium size enterprises have become popular in the world especially since 1960s. Schumacher (1973) denotes the superiorities of SMEs as such:

- SMEs have a competitive structure.
- SMEs are more efficient.
- SMEs keep up with the new demands and new technology easier.
- SMEs' working styles are not monotonous or boring.
- SMEs are more enduring to the economic crisis.
- SMEs have a more successful role in increasing employment and arranging income.

SMEs have been leading enterprises in the industrialization of Western Countries since 1960 (Çarıkçı, 2001). SMEs, observing the market closely, understanding the requirements of customers better and having intimate relations with its employee, have more elasticity than the large ones in terms of manufacturing, marketing and service. As this elasticity enables harmony with the changes in outside in time and on-site, SMEs pass over many troubles lightly with less damage. Right along with these, SMEs may obtain some advantages in some surroundings. SMEs' advantages are (Yılmaz, 2004):

- SMEs provide the strength of element of "balance" income spectrum. This balance gains importance in terms of both social and economic sides. These enterprises are the sources of new ideas and discoveries. They contribute to the industries for providing required elasticity.
- SMEs have the opportunity to make a decision more quickly. Because they work with less expense of management and general operating, they have faster and cheaper production.
- SMEs play an important role in creating private initiatives. Also they enjoy large shares in employment and training. These enterprises are the first establishments in which many qualified workers receive technical training.
- SMEs constitute an effective way to expand the manufacturing and industrialization to the whole country.
- SMEs are of the situation to be the manufacturer of intermediate goods and inputs of large industrial enterprises.
- SMEs may be effective in increasing quality of life providing some opportunities for small investments to use labor force, raw material and financial sources that cannot be used because of social and political reasons.
- SMEs possess a significant role to fulfill the function to reflect small savings and family savings directly to the investments.

In this regard the small firm is too important, too dominant and too much about creating the future business generation for marketing practitioners (Day, 2000:1034). According to the report of European Community, the contribution of SMEs to the economic system are summarized as the following; "these enterprises constitute a required part of commercial and industrial structure because of their numbers and studies about different cases; effects over all sectors having a field of manufacturing, trade and service; contributions to employment and level of welfare" (EC, 2003).

However, SMEs have also some disadvantages[33]. These are lack of general administration, especially the lack of total participation of low level workers to the decisions taken by the owners or partners, not employing specialist and financial consultants in the enterprise, lack of an expert group in financing and lack of department, lack of capital and financial planning, not taking enough support from the banks and other financial corporations, lack of product development, lack of coordination between production and sale, not showing the activities of modern marketing, littleness of business sites and residential areas, risk of bankruptcy and losing its independency, not to be able to provide specialized staff, legislation and bureaucracy, SMEs may be called disadvantageous.

It should be noted that among disadvantages of SMEs exhibit a lower level of profitability than do their larger counterparts. However this lower level of profitability is consistent with at least two of the many roles (Carree and Thurik, 2003) SMEs play in the economy: "the seedbed and turbulence role" (Beesley and Hamilton, 1984) which creates economic growth at the expense of survival rates and profitability of those firms involved in this roles (Fritsch and Mueller, 2008) and interacting with their larger counterparts as a supplier while large firms outsource their less profitable non-core activities (Baumol, 2002).

[33] See also Table 1.

	Small Firms	Large Firms
Marketing	Ability to react quickly to keep abreast of fast-changing market requirements.	Comprehensive distribution and servicing facilities. High degree of market power with existing products.
Management	Lack of bureaucracy. Dynamic, entrepreneurial managers react quickly to take advantage of new opportunities and are more willing to accept risk.	Professional managers able to control complex organisations and to establish corporate strategies.
Internal Communications	Efficient and informal internal communication networks. Affords a fast response to internal problem-solving: provides ability to recognise rapidly to adapt to change in the external environment.	Internal communications often cumbersome: this can lead to slow reaction to external threats and opportunities.
Qualified Technical Manpower	Frequent lack of suitably qualified technical specialists. Often unable to support a formal R&D effort on an appreciable scale.	Ability to attract highly-skilled technical specialists. Can support the establishment of a large R&D laboratory.
External Communications	Frequent lack of time or resources to identify and use important external sources of scientific and technological expertise.	Ability to "plug in" to external sources of scientific and technological expertise. Can afford library and information services. Can buy crucial technical information and technology.
Finance	Great difficulty in attracting capital, especially risk capital. Innovation can represent a disproportionately large financial risk.	Ability to borrow on capital market. Ability to spread risk over a portfolio of projects. Better able to fund diversification into new technologies and new markets.
Economies of Scale and the Systems Approach	In some areas scale economies of form substantial entry barriers to small firms. Inability to offer integrated product lines or systems.	Ability to gain scale economies in R&D, production and marketing. Ability to offer a range of complementary products.
Growth	Can experience difficulty in acquiring external capital necessary for rapid growth.	Ability to finance expansion of production base. Ability to fund growth via diversification and acquisition.
Patents	Can experience problems in coping with the patent system. Cannot afford time and costs involved in patent litigation.	Ability to employ patent specialists. Can afford to litigate to defend patents against infringement.
Government Regulations	Often cannot cope with complex regulations. Unit costs of compliance for small firms often high.	Ability to fund legal services to cope with complex regulatory requirements. Can spread regulatory costs. Able to fund R&D necessary for compliance.

Table 2: A Comparison of Small and Large Firms (Advantages and Disadvantages)
Source: (Xhepa, 2006).

Importance of SMEs by Countries and Country Groups in the World Economy

Small and Medium Sized Enterprises (SMEs) have always taken significant roles in the world economy. SMEs, which are the driving force of economic growth, have an important effect on the economic activity.

In European Community, every three people out of 25 (12%) in 1985 were free from business. Therefore, a research has been made to achieve an important increase in employment in Europe. The results of the research show that one solution to achieve this rise is Small and Medium Size Enterprise (SMEs). It is noted that SMEs, the significance of which become clearer for resolving employment problem, have gained importance also in Europe after 1970s (Bulmuş, Oktay, Törüner; 1990).

It is seen that SMEs form a major part of total enterprises in the countries in Table 3 in the period between 1945 and 1970, emphasizing large size enterprises, economic growth and rehabilitation activities are implemented in the world. However, in this period, it is understood that SMEs have superior features compared to large size enterprises. In several countries, SMEs' role in creating employment and enabling competitive atmosphere, have gradually increased. In 1970s, the conjuncture on economic crisis has become effective in such a case. On the other hand, after the economies of scale have begun to decrease, SMEs have begun to construct the basis of macro economies' policies in many countries because SMEs have contributed to the usage of sources economically, the employment and income distribution after the depression in 1970. Contrary to the large enterprises focusing on the manufacturing of products the demand of which have showed high or low income elasticity, are the units affected least by the economic crisis (Yılmaz, 2004). Once the economies of developing and developed countries are analyzed, indicators of SMEs disclose the significance of this sector clearly. Although SMEs show agricultural and structural differences country to country, an invariable fact is that these enterprises have great contribution to the economies of whole world countries.

	USA	Germany	Japan	France	England	South-Korea	India	Turkey
SMEs in Total Enterprises (%)	97,2	99,8	99,4	99,9	96	97,8	98,6	99,5
SMEs in Total Employment (%)	50,4	64	81,4	49,4	36	61,9	63,2	61,1
SMEs in Total Investment (%)	38	44	40	45	29,5	35,7	27,8	56,5
SMEs in Total Value Added (%)	36,2	49	52	54	25,1	34,5	50	37,7
SMEs in Total Export (%)	32	31,1	38	23	22,2	20,2	40	8
SMEs in Total Credits (%)	42,7	35	50	48	27,2	46,8	15,3	4

Table 3: Share of SMEs in Some Countries (%) (2004)
Source: (Yılmaz, 2004).

SMEs constitute the basic source of materials, ideas, process and service that large enterprises cannot do or do not want to do. Because aiming to benefit from the cost advantage of economies of scale, large enterprises implement a policy of manufacturing a product for a long period due to the big investments for the machines, tools, devices and labor force. However, SMEs do not have such problems as maintaining a large scale investment. Because their economies are small and they possess more elastic structure when compared to large enterprises (Efe, 1998).

SMEs remain important not only in developing countries but also in developed and industrialized countries. In these years of 21st century, in developed countries, the policies aiming to increase employment of small enterprises, observed up to now, are postponed and it has been tried to constitute some policies enabling formation and competition of small enterprises making changes in production, sale and management. In developed countries, policies of small enterprises should be to improve alive, dynamic enterprising, not focusing on increasing employment (Sarıaslan, 1994). Despite these difficulties, in all countries, there can be made such a generalization that SMEs constitute about 99% of enterprises. Despite the change from one country to another, SMEs constitute 40-80% of employment and 30-70% of gross national product. 5% of the SMEs are of the statute of large enterprises. This data designates a superiority of small enterprises upon large ones. One of SMEs small but important characteristics is that they are in a leading position to improve industries and technologies. SMEs are densely existed within the enterprises implementing innovative studies. By decreasing cost of communication, SMEs technical opportunities will increase and thus, SMEs' achievement in global market will improve. Contribution of SMEs to the employment is also important (Küçükçolak, 1998).

European Union (EU)	Of the 19.3 million enterprises in the European Union (EU) today, 99% are defined as SMEs and employ some 75 million people. There are only 35,000 enterprises, with more than 250 employees, but 18 million enterprises employ fewer than 10 people - the micro- enterprises. The average European business provides employment for 4 people, including the owner/manager, the average turnover being 500,000 euro.
OECD Countries	Of this group, SMEs represent over 95% of enterprises in most countries and generate over half of private sector employment. Moreover, most OECD governments promote entrepreneurship and develop SMEs with a myriad of policies and programmes because of SME difficulties such as financing, technology and innovation, e-commerce, management and internationalization. For example, in Korea measures include tax breaks and reduced interest loans for starting new businesses in rural areas.

Latin America	After focusing on large investments and wooing multinationals for years, Latin American politicians are beginning to realize that SMEs are the true job creators, as well as important players in technology supply chains. The vast majority (approximately 80-90%) of companies are micro enterprises and the governments have vastly reduced red tape to ensure SMEs needs are attended to swiftly. Among the major regional economies, except of Argentina, while these types of businesses flourished elsewhere in Latin-America, especially in Brazil and Mexico.
Asia	It has been recognised that some of the world's best performing economies, notably Taiwan and Hong Kong, are very heavily based on small enterprises'. 81% of all employment in Japan is in SMEs where the average enterprise employs nine staff as opposed to four in the EU.
South Africa	The share of employment located in the micro, small and medium sectors taken together is high – estimated recently at 60% while the sector generated about 40% of output.

Source: (Adapted from Lukacs, 2005).

Table 4: Share of SMEs in Global Economy

Regardless of the level of economic growth, in all countries SMEs are the basis of economic and social order in terms of numerical and job creation capability. In almost all of the countries, SMEs constitute nearly all of the enterprises. According to this, in all countries, SMEs have an active role (KOSGEB, 2000, 1993).

Consequently, today, with the globalization of world markets, developed and developing countries are more aware of the capability and elasticity of SMEs to keep up with the social and economic changes. Thus, they focus on incentive economic measures to increase their competition capability and technological level. In short, in the world, the concept of "Small is Beautiful" is common.

The Importance of SME in Developing Countries

The notion of SME and entrepreneurship development was introduced into the growth and development landscape as early as the late 1940's with the introduction of targeted policies (grants, subsidized credits, special tax treatment, etc.) and the establishment of small business or SME support agencies by governments (*e.g.* publicly funded SME agencies were set up in 1948 in Japan, 1953 in USA, 1954 in India, 1966 in Tanzania, 1976 in Turkey) (OECD, 2004).

As with any other component of an economy, the size and importance of the SME sector varies from country to country; the last few decades have seen an increasing recognition of the role it plays in industrial countries, something already more obvious for developing nations from the 1970s or so. SMEs are important to almost all economies in the world, but especially to those in developing countries (Berry, 2007). There is considerable interest in SMEs in developing countries. There are probably two main reasons for this. One is the belief that SME development may prove to be an effective antipoverty programme. The second is the belief that SME development is one of the building blocks of innovation and sustainable growth. These two reasons are of course linked because most of the international evidence says that growth and real poverty reduction go hand in hand. If SME development helps growth, more than likely it helps reduce poverty as well (Warner, 2001: 61)

SMEs contribute substantially to a stable economic environment and to the development of the economy. To achieve stable economic development the business of SMEs must be supported. They need especially financial and consulting services which help them to overcome difficulties during the start-up phase or to carry out their normal business activities. (Güttler, 2001:89)

Developing countries without substantial SME sectors (hence often described as having a "missing middle" in their firm size structure) tend not only to have capital and the income from it concentrated in the larger firms but also to have a "labour elite" in that sector, able to bargain for wages much higher than elsewhere in the economy. With the economy's capital stock almost completely used up by the large firms (usually a result of capital market imperfections), there is little remaining capital to be distributed among the many workers not hired by large firms; this produces a large micro enterprise sector with the SME sector squeezed out for lack of capital. The equilibrium wage in the micro enterprise sector is very low and capital incomes are low there as well. In short, income is very unequally distributed. When the SME sector is large, these extremes in the distribution of both capital income and labour income are avoided. (Berry, 2007)

Furthermore, SMEs contribute to employment and income generation and export revenues in developing countries. However, in order to tap into the potential of SMEs for development and poverty reduction, transition and developing country governments, development partners and SMEs themselves need to address a number of challenges (OECD, 2004):

• The domestic SME/private sector has to expand, through:

− The creation of new and innovative firms and
− The graduation of as many informal enterprises as possible into the formal sector.
• SMEs have to become more competitive and productive at their home base.
• At least a proportion of these nationally competitive SMEs have to achieve a level of competitiveness that will enable them to integrate into the global value chains through trade (exports and internationalization) and investment, including linkages with FDI.

Conclusion

The economy of the 20th and 21st century has a different set of rules than Smith's economy of the 19th century. The new ideology of neo-liberalism and globalization emphasizes the role of SMEs as promoters of a healthy business climate, economic efficiency and power for economic development, especially in developing countries.

SMEs have an important role in terms of their economic share in developed and developing economies though there are different definitions of SME among various organizations and countries. Today, instead of large-scale firms, SMEs having gained importance in the developing economies, become advantageous being economic enterprises having the capability of quick adjudication, working with less capital but more intense labor and having low cost of management and thus having cheap production. In short, the concept of *small is beautiful* becomes important in the current economic conjuncture with large firms.

Although SMEs have some weaknesses, they are less affected from economic crises due to its flexibility and abilities which keep up with changed conditions. SMEs are vital actors for enhancing innovation, competitiveness, entrepreneurship and the establishment of an effective innovation system for developing countries. Improving the investment climate for SMEs, and strengthening their capacities to respond to trade and investment opportunities, does strengthen the economic performance of SMEs and this in turn has a positive impact on growth and poverty reduction in developing countries.

SMEs, observing the market closely, understanding the requirements of customers better and having intimate relations with its employee, have more elasticity than the large ones in terms of manufacturing, marketing and service. As this elasticity enables harmony with the changes in outside in time and on-site, SMEs pass over many troubles lightly with less damage. Although SMEs have some weaknesses, they are less affected from economic crises due to its flexibility and abilities which keep up with changed conditions. Besides they absorb economic crises effects and play a role as "compress". In this regard, SMEs have crucial importance, especially for the developing countries.

Even in 'normal' economic conditions governments have recognised that, to survive and grow, SMEs need specific policies and programmes. However, at the present time, SMEs have been especially hard hit by the global crisis. It is important to stress that SMEs are generally vulnerable in times of crisis for many reasons among which are (OECD, 2009):

- It is more difficult for them to downsize as they are already small;
- They are individually less diversified in their economic activities;
- They have a weaker financial structure (i.e. lower capitalisation);
- They have a lower or no credit rating;
- They are heavily dependent on credit and they have fewer financing options.

However current economic conjuncture has generated not only disadvantages but also advantages for developing countries' SMEs. We can expect that potential of SMEs' impulsive force in these countries which have less large firms (big business). Nonetheless lack of policy determinations and implications accrue coordination and promotion problems in SMEs' activities. Chronic economic problems of developing countries have affected energy of these enterprises, negatively. Briefly, providing necessary opportunities and directions of SMEs has emerged advantageous conditions for developing counties.

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