

# SME' IMPACT ON ECONOMIC DEVELOPMENT

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## **Abstract**

*The development of the economic environment over the last decades has led to changes in ownership patterns and the emergence of new, independent private enterprises that have grown steadily. The evolution of these entities from temporary activities to companies that operate and develop both in domestic and foreign markets has contributed to their impregnation in the economic environment, having an impact on its evolution. SMEs are those companies with a high degree of flexibility and resilience that ensure stability both economically and socially. Their ability to adapt to continual changes in the market and to contribute to innovation determines the importance they have in developing the economic environment. The paper presents a study of the role of the SME sector in the EU economic environment.*

**Keywords:** SME development, Economic growth, SME definition, SME opportunities

**JEL Classification:** L10, L25, L26

## **1. Definition of SMEs**

Although the criteria for identifying an entity as an SME are similar and have dimensional characteristics as the primary object of measurement, the definitions accepted for SMEs differ from country to country. Below we present the definitions given by several countries.

### **SMEs in the EU sense**

The first definition of SMEs set by the European Commission was adopted in a 1996 recommendation. This definition has been applied throughout the European Union. On 6 May 2003, the Commission adopted a new recommendation, taking into account economic development since 1996. This recommendation entered into force on 1 January 2005 and will apply to all policies, programs and measures initiated by the Commission for SMEs -hate.

For Member States, the use of the definition is optional, but the Commission recommends them, as well as the European Investment Bank and the European Investment Fund, to use it on a large scale.

The SME assessment is generally based on three criteria: the number of employees, the turnover and the total value of the assets (EC, 2009). Total assets include fixed assets, current assets and prepayments. The regulations specify that the average number of employees must be taken into account in the grouping of SMEs, while, with respect to the other two criteria, one can opt for one or the other. So, according to European legislation, micro-enterprises or small and medium-sized enterprises are enterprises with an average annual number of employees of less than 250 and achieve a net annual turnover of 50 million EUR, or hold total assets which do not exceed the EUR 43 million (Abrudan, I et. al (2003)).

Based on the above, SMEs are divided into three categories:

1. Micro-enterprises: have up to 9 employees and achieve annual net turnover or have total assets of up to EUR 2 million;
2. Small enterprises: have between 10 and 49 employees and a net annual turnover or total assets of up to EUR 10 million;

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3. Medium-sized enterprises: have between 50 and 249 employees and have a net annual turnover of up to EUR 50 million or have total assets not exceeding EUR 43 million.

The above can be schematically represented as follows:

**Table 1. The SME categories**

<b>Company category</b>	<b>Staff headcount</b>	<b>Turnover</b>	<b>or</b>	<b>Balance sheet total</b>
<b>Medium-sized</b>	< 250	≤ € 50 m		≤ € 43 m
<b>Small</b>	< 50	≤ € 10 m		≤ € 10 m
<b>Micro</b>	< 10	≤ € 2 m		≤ € 2 m

Source: COMMISSION STAFF WORKING DOCUMENT on the implementation of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises

The European Union regulates the classification of small and medium-sized enterprises in this category and their relationship with other enterprises. These relationships, especially if they create important financial links with other enterprises, can generate a situation where a particular enterprise that meets the requirements of the number of employees and total turnover / assets is not an SME. It is important for entrepreneurial owners of micro, small or medium-sized enterprises to know the status of their enterprise because they can often benefit from specific legislation for SMEs. As regards the connected undertakings, this type of relationship corresponds to the economic situation of the undertakings forming a group by direct or indirect control of the majority of the voting rights of an undertaking or by the ability to exercise a dominant influence over the undertaking. These cases are uncommon.

Linked enterprises are enterprises that have any of the following relationships:

1. An enterprise holds a majority of the voting rights of the shareholders or associates of the other undertaking;
2. An enterprise has the right to appoint or dismiss a majority of the members of the board of directors, management or supervisors of the other enterprise;
3. An enterprise has the right to exercise a dominant influence over the other under a contract with that undertaking or a clause in its statutes;
4. An enterprise is the shareholder or associate of the other enterprise and owns, by virtue of an agreement with other shareholders or members of that enterprise, the majority of the voting rights of the shareholders or members of that enterprise.

With certain exceptions provided by law, a company can not be considered small or medium if at least 25% of the capital or of the voting rights thereof are controlled, directly or indirectly, jointly or individually, by one or several public bodies or organizations. Also, a non-SME enterprise may not hold more than 25% of the share capital (or voting right) of an enterprise that is considered a small or medium-sized enterprise. If this happens, that enterprise is no longer considered to be part of the SME category.

It does not fall under the category of SMEs: banking companies, insurance and reinsurance companies, investment fund management companies, security companies and companies with exclusive foreign trade activities.

### **SMEs in the US sense**

The US is a landmark for small business, being a country where large corporations are formed based on small family businesses. Whether we're talking about the Ford garage, the McDonald's brothers' tonette, or Bill Gates's computer, little business has found the ground here to become the big corporations known today.

In the United States, the Small Business Administration (SBA), a federal government agency specially designed to assist, advise and protect the interests of small businesses, operates. The SBA defines the small business as the independently owned business that acts

to profit, not being dominant in its business. The aforementioned agency classifies enterprises according to a definition using four delimitation criteria:

- field of activity;
- average sales volume over the last 3 years;
- profit;
- Average number of employees in the last 12 months.

#### **SMEs in the Canadian sense**

Canada defines SMEs in many ways, but the definitions used are usually based on turnover, value of assets and / or number of employees.

A definition says that SMEs have less than 500 employees and annual turnover below \$ 50 million. Another defines SMEs according to the number of employees, but also to the field of activity, as follows:

- small enterprise: - less than 100 employees if it produces goods, less than 50 employees if providing services;
- medium-sized enterprise: - less than 500 employees.

The Canadian Government attaches great importance to small and medium-sized businesses, considering that these small businesses offer large amounts of goods and services, and sometimes they appeal to them even for government procurement.

#### **SMEs in Japan**

Since 1948, Japan has set up a Small Business Agency (Small Business Agency), and in 1999, as a result of the unprecedented development of this type of business, a law that exclusively addresses SMEs has been voted.

Thus, for the implementation of SME support policies, 3 key factors were delineated:

- promoting business innovation and the creation of new small and medium-sized enterprises;
- Strengthening the performance management at the level of SMEs;
- facilitating the adaptation of SMEs to economic and social change.

#### **SMEs in Romania**

Small and Medium Enterprises are defined in Romania by Law no. 346/2004 -

Updated, which takes over exactly the definition of the European Union. Small and medium-sized enterprises are defined as those enterprises that meet cumulatively the following conditions:

- a) have an average annual number of employees of less than 250;
- b) has a net annual turnover of up to EUR 50 million, equivalent in lei, or holds total assets not exceeding the equivalent in lei of EUR 43 million, according to the latest approved financial statement. Total assets include: "fixed assets plus current assets plus prepaid expenses". The turnover ceiling may be changed, depending on the evolution of the macroeconomic indicators, by Government decision.

Small and medium-sized enterprises are classified according to the average annual number of employees and the net annual turnover or total assets they hold in the following categories:

- micro-enterprises - have up to 9 employees and have a net annual turnover or have total assets of up to 2 million euro, equivalent in lei;
- small enterprises - have between 10 and 49 employees and have a net annual turnover or have total assets up to 10 million, equivalent in lei;

- Medium enterprises - have between 50 and 249 employees and achieve a net annual turnover of up to EUR 50 million, equivalent in lei, or hold total assets that do not exceed the equivalent in lei of EUR 43 million.

Therefore, although there are no very large differences, each country uses a definition that preserves a specificity resulting from its own economic conditions. Reducing these definitions to one can only be desired for statistical reasons. Otherwise, a unique definition could be restrictive and irrelevant for those organizations that have emerged and developed independently, without following any predefined model. On the other hand, it is necessary to define the notion, because only in this way can realistic policies be established to support these enterprises.

SME dynamics are an impediment for researchers trying to develop a clear and stable definition for these organizations. Any attempt to redefine small and medium-sized enterprises is preferable to refer to several dimensional criteria. Without becoming restrictive of their development, these organizations are small and must remain small and the definition should highlight this. Taking into account the expansion of SMEs in the knowledge-based society, they could be defined taking into account the economic (profit) performances obtained in correlation with the economic sector in which they operate. The unanimous acceptance of the fact that SMEs are the most important in terms of jobs allows for the design of definitions that no longer refer to this issue first, and criteria such as the value of assets held are no longer up to date.

## **2. The SMEs peculiarities**

Compared to large enterprises, SMEs are more flexible, responding better to changing business conditions and market demands. SMEs also offer real opportunities to implement the entrepreneur's creative capabilities and leadership. SMEs are the most widespread organizational form of business. And this, due to the fact that this sector, through its development, ensures the increase of prosperity and the living standard of the population. "Small Businesses are the main catalyst for economic growth" (*Drucker, P. 2014*). Small businesses contribute greatly to achieving the fundamental objectives of the national economy.

Growth of SMEs in developed countries is mainly due to the following factors:

- Diversity of demand in current markets;
- Massive changes in the organizational structure of large enterprises;
- Diversification of services becomes a requirement of current markets;
- Western governments policy in the field of SME support;
- Increasing the number of unemployed.

All these factors have helped to increase the role and importance of SMEs in the economies of developed countries, namely:

- Contributing to the creation of new jobs;
- Diversification of products and services on the market;
- Improving product quality and meeting consumer demand;
- Increasing the welfare of the population;
- Rapid adjustment of product and service assortments at market demand;
- Educating entrepreneurs;
- Formation of the middle class of owners, ensuring stability in society.

## **3. The role of SMEs in the development of the market economy**

SMEs are contributing to economic growth, and through this increase state revenues are brought through the tax system. Subsequently, this revenue can be distributed to other members of the company.

The important role of SMEs in the economy is for many reasons, such as:

- Flexibility of structures, which give them a high capacity to adapt to the fluctuations of the economic environment;
- Small and medium-sized enterprises can integrate relatively easily into a regional industrial network, which contributes, on the one hand, to the economic development of the region and, on the other hand, to reducing unemployment and raising the standard of living, it offers jobs;
- Their small size, which helps avoid excessive bureaucracy and avoid dehumanization;
- SMEs form at the individual level a much easier to control and drive ensemble.

The European Union assesses the role of small and medium-sized enterprises in the economy in terms of three indicators, each having a distinct significance, as shown in Table 2 (Dinu, M. 2002):

**Table 2 SMEs analyzing criteria**

<i>Name of criteria</i>	<i>Signification</i>
<i>Number of enterprises</i>	Organizational development and competition
<i>Number of employees</i>	Reducing Unemployment
Turnover	Resource allocation

An analysis of the numerical criterion demonstrates a predominance of SMEs in almost all countries. Multi-country statistics show that SMEs are predominant in the economy and account for more than 99% of the total number of enterprises, as shown in Table 3 (Carta albă a IMM, 2006):

**Table 3. Share of SMEs in the economy of several countries**

<i>Nr.</i>	<i>Country</i>	<i>% of SMEs from all enterprises</i>	<i>% of SMEs in VAT</i>	<i>% of SMEs in providing jobs in the economy</i>
1	Austria	99,60	50,86	65,50
2	Belgium	99,80	64,49	68,90
3	Denmark	99,70	58,75	68,74
4	Finland	99,75	44,33	59,15
5	France	99,79	45,76	66,86
6	Germany	99,63	60,17	59,85
7	Greece	99,95	82,87	86,68
8	Ireland	99,59	33,02	69,59
9	Italy	99,94	71,38	80,34
10	Luxembourg	99,62	74,20	72,32
11	Netherlands	99,56	56,06	62,47
12	Portugal	99,87	66,80	78,87
13	Spain	99,89	55,30	79,45
14	Sweden	99,67	51,51	61,37
15	UK	99,80	38,40	55,30
<b>16</b>	<b>UE-15</b>	<b>99,81</b>	<b>51,69</b>	<b>66,32</b>

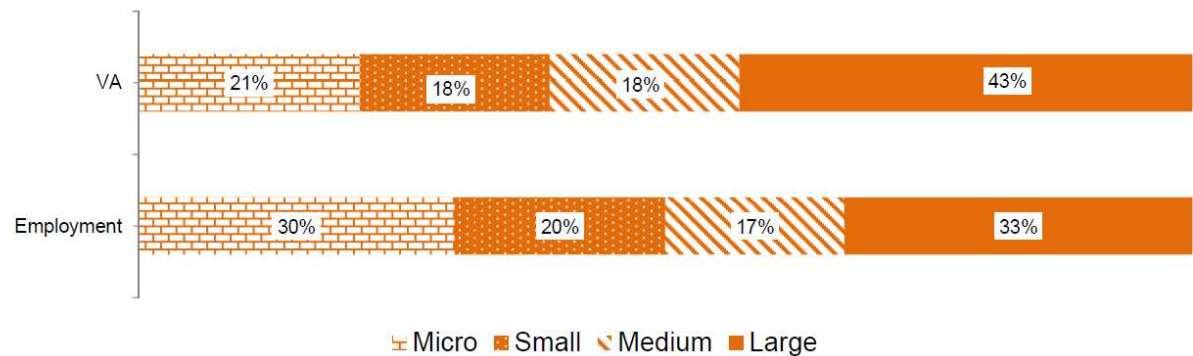
Numerical prevalence of SMEs, identifies as a driver of economic development and maintaining competitiveness in the market.

According to the studies, the most important fields of activity of SMEs in the EU are accommodation and catering, finance, construction, manufacturing and trade. These areas

generated 71% of the Added Value of total SMEs in 2015 and provided 78% of the total employment in the SME sector.

According to the same studio, the average number of SMEs per 100 inhabitants in the EU is 4.5 units. This figure varies, for example in the Czech Republic the average number is 9.4 enterprises, the highest indicator in the EU, while in Romania 2.2 lowest indicator enterprises. We can assume that there is a direct link between the SME's density in a country and the economic development of that country, but there are also exceptions such as Germany, where this indicator is 2.7 SMEs per 100 inhabitants.

**Figure 1: Value added and employment in the non-financial business sector in the EU28 by enterprise size, 2015**

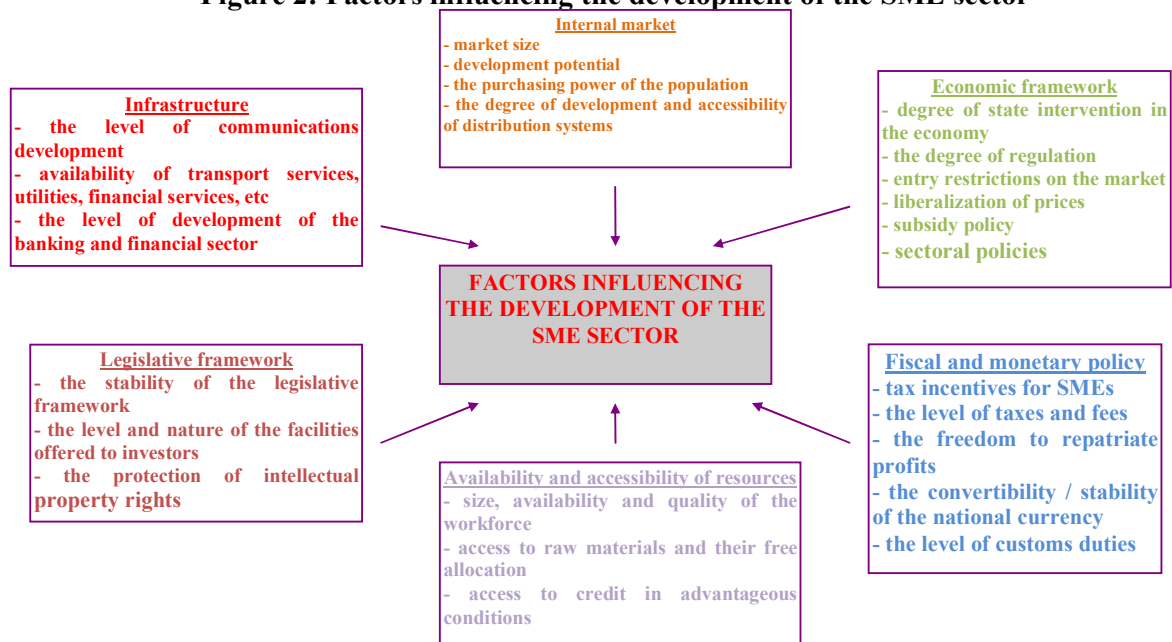


Source: Eurostat, National Statistical Offices and DIW Econ

For the EU as a whole, SMEs provide over 65% of jobs and achieve more than half of its GDP. The SME sector is the most active sector of the economy, it is a promoter of new skills and ideas.

At the same time, their activity is closely related to the environment in which they operate and their development is strongly influenced by a number of external factors, as shown in the scheme below:

**Figure 2: Factors influencing the development of the SME sector**



## **Conclusions**

The SME sector is an important part of the EU's economic environment. The results of their activity are steadily increasing, both in terms of financial results and in terms of numbers. Because of the flexibility, SMEs are advancing to develop continuously, responding promptly and precisely to changes in the external environment, and as a result they can respond to market demand. The impact of SMEs on the economic environment is positively in several aspects on the development of the economic, social, innovation and scientific environment.

Addressing the importance of SMEs for the European economy, they are a major objective of EU policy. Currently, the development of the SME sector is supported by various government tax relief, promotion and funding projects to stimulate the realization of their potential in the globalized economy.

The rise of SMEs, especially in the last three decades, allows them to appreciate that they will be a major driver of economic progress both in developed countries and in countries still in transition.

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