

Small and Medium Enterprises – Economic Development Drivers

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Considering the fact that many of the countries are going through a transitional period, the drivers of development should be small and medium enterprises. In this paper an analysis of the meaning of SME's will be performed in a way to show the huge contribution of SME's for overcoming the causes of transition and recovering the competition, entrepreneurship and increasing the economy efficiency. The elaboration of perspectives and advantages of small and medium enterprises is given at the end.

Introduction

Considering the fact that many of the countries are going through transitional period the drivers of development should be small and medium enterprises. The significant appearance in the period of the seventies of the 20th century was decreasing the rate of GDP, increasing the unemployment, decreasing the investment activities. The only way for enlarging the economic activities is bigger liberty on the market and decreasing the role of the state in the economy life. This is important for stimulating the competition, entrepreneurship and economy efficiency in the national economy. It helps for entrepreneurship's reconstitution, manifested by establishing the small and medium enterprises which lean on creativity, entrepreneurship spirit and individual innovation. On this way the economy structure has more flexibility and the probabilities for productivity –technically reconstructions. The number of SMEs is increasing permanently in developed countries but also in developing countries. The

growing of SMEs depends on character of the socio – economic development.

1. SMEs and economy development

SMEs are usually defined as independent firms which employ 250 people at the most. There are a lot of definitions and criteria for dividing the SME. For example, in France, German and Italy the criterion is 50 employees, in Great Britain – 200, Holland – 100 employees and in Belgium and Denmark- 70 employees. [1]

Beside this criteria other criteria are used with the same function such as volume of production, the assets of the company, the participation in capital property etc. In the most economies, smaller enterprises are much greater in number than the big enterprises. In Republic of Macedonia by the Trade Companies Law the enterprises are divided into small and medium enterprises by using three criteria [2]: number of employees, annual turnover and value of assets.

| Criteria's | Dimension of enterprises | | |
|-----------------------------|--------------------------|-------------------|-------------------------|
| | small | medium | big |
| average number of employees | to 50 employees | to 250 employees | more than 250 employees |
| average incomes | < of 8.000 wages | < of 40.000 wages | > of 40.000 wages |
| average of assets | < of 6.000 wages | < of 30.000 wages | > of 30.000 wages |

Table 1: *SMEs definition [2]*

SMEs have a huge contribution for economics activities in the country and usually are appointing the question: What are the reasons and advantages of SMEs and why are they so important for country development?

SMEs are expected to boost efficiency and growth and they lead the economy development because:

- SMEs constitute the most dynamic segment of many transition and developing economies
- they are engine of job creation

- SMEs boost the innovations, entrepreneurship , competition and flexibility
- important role in promoting growth and development

The other advantages of SMEs establishment are:

- direct control of the costs;
- easier and cheaper function control;
- more liberal and free flows for entering a foreign capital;
- faster noticing of the direction for more successful investments, innovations and market participation;
- team work;
- bigger responsibilities in work organization, etc.

In most economies, SMEs are much greater in number than big enterprises. In the EU, SMEs comprise approximately 99% of all firms and employ about 65 million people. In many sectors, SMEs are also responsible for setting up innovation and competition. Globally SMEs account for 99% of business numbers and 40% to 50% of GDP.

The most important condition for SMEs development is the business environment.

There are many terms used to describe the conditions in which SMEs operate. The term “investment climate” is the broadest and most commonly used. It refers to the location – specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand. There are three key elements of the investment climate. The first is costs, which are most commonly affected by the burden of regulation, taxes, corruption, infrastructure services and the cost of finance. The second is risks, which refers to policy predictability, property rights and contract enforcement affecting investment risks. The third is barriers to competition, which is affected by the regulations controlling business start-up and bankruptcy, competition low, and entry to finance and infrastructure markets. The other used term is business environment it gives attention to the role of business in creating investment and economic growth. [3]

The most important measures to improve the business climate and to increase the SMEs are:

- economic and political stability

- cheaper and faster start –ups
- better legislation and regulations
- availability of skills
- education and training for entrepreneurship
- getting more out of the single market
- tax relief
- financial support for SME
- strengthening the SME technological capacity
- developing stronger, more effective representation of SME interests
- one –stop shop system
- strengthening the infrastructure for SME support

2. Actuality with SMEs in Republic of Macedonia

Private sector development has started since 1990. In 1990 7234 enterprises were established and in 2009 there were 70 710 active enterprises.

The sectors with the highest share in the structure of business entities were: wholesale and retail sale; repair of vehicles, motorcycles and personal and household goods with 29 270 entities or 41.4% and manufacturing with 8 225 entities or 11.6%, whereas the least represented were the sectors fishing with 57 entities or 0.1% and mining and quarrying with 144 entities or 0.2%.

There were no registered business entities in 2009 in the sectors Private households employing domestic staff and undifferentiated production activities of households for own use and Extra-territorial organizations and bodies.

The data on the structure of active business entities according to the number of employed shows that the highest share of 84.0% belongs to business entities with 1-9 employed, followed by business entities without employed (or the entities did not provide information about employed) with 8.8%, and entities with 10-19 employed with 3.1%. The share of entities with 20-49 employed was 2.1%, those with 50-249 employed participated with 1.6%, while entities with 250 or more employed had a share of only 0.3%. [7]

Considering the fact than SMEs have the important role of economy development the number of SME has been steadily increasing.

| | 1991 | 1994 | 1997 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2009 |
|------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| SMEs | 9,703 | 28,551 | 32,934 | 31,204 | 33,151 | 34,991 | 36,963 | 39,096 | 41,517 | 44,340 | 70,506 |
| All-active | 10,270 | 29,157 | 33,455 | 31,795 | 33,269 | 35,110 | 37,074 | 39,199 | 41,590 | 44,424 | 70,710 |

Table 2: Number of SMEs in Republic of Macedonia [6]

| Sector | small | medium | Large |
|--|-------|--------|-------|
| Agriculture, hunting and forestry | 2778 | 32 | 5 |
| Fishing | 57 | - | - |
| Mining and quarrying | 133 | 7 | 4 |
| Manufacturing | 7787 | 364 | 74 |
| Electricity, gas and water supply | 93 | 22 | 9 |
| Construction | 3944 | 53 | 7 |
| Wholesale and retail sale; repair of vehicles, motorcycles and personal and household goods | 29165 | 96 | 9 |
| Hotels and restaurants | 3920 | 17 | 1 |
| Transport, storage and communication | 6459 | 26 | 11 |
| Financial intermediation | 308 | 17 | 9 |
| Real estate, renting and business activities | 6161 | 41 | 13 |
| Public administration and defence; compulsory social security | 146 | 47 | 26 |
| Education | 677 | 274 | 3 |
| Health and social work | 3106 | 119 | 21 |
| Other community, social and personal service activities | 4613 | 44 | 12 |
| Private households employing domestic staff and undifferentiated production activities of households for own use | - | - | - |
| Extra-territorial organizations and bodies | - | - | - |
| Total | 69347 | 1159 | 204 |

Table 3: *The table below indicates the number of active enterprises in Republic of Macedonia by sectors and number of employed [6]*

Financing of SMEs - The process of financing is important for enterprises existence. The financial situation is one of the key characteristics of every enterprise.

There are many resources for financing the SMEs in Republic of Macedonia but there is mainly need for:

- medium- and long term finance, especially for equipment purchase;
- working capital credit lines, including seasonal and sector specific;
- more complex products such as factoring, leasing and professional and affordable payment services;
- export financing, including reverse factoring, pre-order purchase finance;

And alternative financial instruments for small and medium sized companies are:

- real estate leasing
- long-term equipment purchase
- mortgages
- mezzanine finance
- private equity investment

SMEs and Employment - one of the important advantages of SMEs is creating new working places. In 2005 the number of employed in small, medium and large enterprises was 267.251 and 54,4% of them were employed by small enterprises and 21.3% by medium-sized enterprises. This illustrates the importance of SME sector for job creating (¾ or 75.7% of employ were employed in SME).[4]

Considering the advantages of establishing and functioning small and medium enterprises every national economy should make a reforms to develop them.

SMEs and Foreign Trade – Since independence trading with foreign countries has generated trade deficit, that is a big problem for the Macedonian economy and it is necessary to take measures for increasing the export and the main objective is to make Macedonian products more competitive on the foreign markets.

| Country | export in thousand dollars January February 2010 |
|--------------------|---|
| German | 86 807 |
| Russia | 1 737 |
| Greece | 32 705 |
| Serbia | 26 443 |
| Bulgaria | 43 900 |
| Italy | 27 003 |
| Kosovo | 51 606 |
| China | 11 196 |
| Turkey | 6 432 |
| Croatia | 18 039 |
| Slovenia | 5 253 |
| Great Britain | 6 350 |
| Belgium | 20 134 |
| Romania | 2 477 |
| Switzerland | 1 872 |
| Netherlands | 8 270 |
| Spain | 8 685 |
| Bosnia-Herzegovina | 9 852 |
| Ukraine | 243 |
| Austria | 3 391 |
| Total | 401 019 |

Table 4: *Countries in which Macedonia enterprises export in [5]*

Unfortunately the SME operate mainly in the domestic markets, and have a very small percentage in export.

3. Improving the business environment in Republic of Macedonia for SME development

The Business climate in Republic of Macedonia has the main role for economic activities and for boosting the economy.

According to the Doing business report 2009 Republic of Macedonia has done a lot of improvements in business climate. An analysis of business climate in R. Macedonia was performed according to the dates from

Doing business report for 2006 and 2009. That reports include the following criteria:

- starting a business;
- dealing with construction permits;
- employing workers;
- registering property;
- getting credit;
- protecting investors;
- paying taxes;
- trading across borders;
- enforcing contracts;
- closing a business.

| | | | | |
|---|-------|--|--|-------------------------------------|
| Macedonia Easy of doing business (rank) 81 | | | | |
| Starting a business | | | Registering property | Trading across borders |
| Procedures (number) | 13 | | Procedures (number) | 6 |
| | | | | Documents for export (number) |
| Time (days) | 48 | | Time (days) | 74 |
| | | | | Signatures for export (number) |
| Cost (% of income per capita) | 11.3 | | Cost (% of property value) | 3.6 |
| Minimum capital (% of income per capita) | 145.2 | | Getting credit | |
| | | | | Documents for import (number) |
| Dealing with licenses | | | Strength of legal rights index (0-10) | 6 |
| | | | | Signatures for import (number) |
| Procedures (number) | 18 | | Depth of credit information index (0-6) | 3 |
| | | | | Time for import (days) |
| Time (days) | 241 | | Public registry coverage (% of adults) | 1.9 |
| | | | | Enforcing contracts |
| Cost (% of income per capita) | 67.5 | | Private bureau coverage(% of adults) | 0.0 |
| | | | | Procedures (number) |
| Hiring and firing workers | | | Protecting investors | |
| | | | | Time (days) |
| Difficulty of hiring index (0-100) | 61 | | Extent of disclosure index (0-10) | 5 |
| | | | | Cost (% of debt) |
| Rigidity of hours index (0-100) | 60 | | Extent of director liability index (0-10) | 7 |
| | | | | Closing a business |
| Difficulty of firing index(0-100) | 40 | | Ease of shareholder suits index (0-10) | 6 |
| | | | | Time (year) |
| Rigidity of employment index(0-100) | 54 | | Strength of investor protection index (0-10) | 6.0 |
| | | | | Cost (% of estate) |
| Hiring cost (% of salary) | 33 | | Paying taxes | |
| | | | | Recovery rate (cents on the dollar) |
| Firing cost(weeks of salary) | 41 | | Payments (number) | 54 |
| | | | | Time (hours per year) |
| | | | Time (hours per year) | 96 |
| | | | Total tax payable (% of gross profit) | 40.1 |

Table 5: *Doing business ranking - Republic of Macedonia in 2006 [7]*

Source: Doing business report 2006

| | | |
|---|--|--|
| Macedonia Easy of doing business (rank) 71 | | |
| Starting a business | Registering property | Trading across borders |
| Procedures (number) 7 | Procedures (number) 6 | Documents for export (number) 6 |
| Time (days) 9 | Time (days) 66 | Time to export (days) 17 |
| Cost (% of income per capita) 3.8 | Cost (% of property value) 3.4 | Cost to export (US\$) 1.315 |
| Minimum capital (% of income per capita) 0.0 | Getting credit | Documents to import (number) 6 |
| Dealing with licenses | Strength of legal rights index (0-10) 7 | Time to import (days) 15 |
| Procedures (number) 21 | Depth of credit information index (0-6) 4 | Cost to import (US\$) 1.325 |
| Time (days) 198 | Public registry coverage (% of adults) 6.5 | Enforcing contracts |
| Cost (% of income per capita) 1.862.8 | Private bureau coverage (% of adults) 0.0 | Procedures (number) 38 |
| Hiring and firing workers | Protecting investors | Time (days) 385 |
| Difficulty of hiring index (0-100) 50 | Extent of disclosure index (0-10) 5 | Cost (% of debt) 33.1 |
| Rigidity of hours index (0-100) 60 | Extent of director liability index (0-10) 6 | Closing a business |
| Difficulty of firing index(0-100) 30 | Ease of shareholder suits index (0-10) 4 | Time (year) 3.7 |
| Rigidity of employment index(0-100) 47 | Strength of investor protection index (0-10) 5.0 | Cost (% of estate) 28 |
| Firing cost(weeks of salary) 26 | Paying taxes | Recovery rate (cents on the dollar) 16.7 |
| | Payments (number) 40 | |
| | Time (hours per year) 75 | |
| | Total tax payable (% of gross profit) 18.4 | |
| | | |

Table 6: *Doing business ranking - Republic of Macedonia [7]*

As we can see from the data Republic of Macedonia has huge progress in starting a business (today you can start a business for 7 days thanks to the introduction of the one stop shop system) and paying taxes thanks to the tax reliefs.

The most important condition for SMEs establishing is macroeconomic stability. The economics performance of the Macedonian economy is expressed through stable GDP growth of around 4%, a low rate inflation rate of 3% on average, fiscal discipline confirmed by the international financial institutions and a well- functioning coordination between fiscal and

monetary policy. In 2006, the Macedonia economy grew by 4%, which was both services and industry-driven. Inflation, as measured by the Consumer Price Index (CPI), was low and stable at 3.1%. The central government budget deficit in 2006 was only 0.5% of GDP, with surpluses on foreign accounts and the current account deficit around 1% of GDP. Furthermore, foreign exchange reserves increased to about 5 months of imports. These positive effects from a disciplined fiscal policy were reflected in monetary policy, causing a significant reduction in interest rates, which were 8% at the end of 2005 and 5.5% at the end of 2006. [4]

| | 2005 | 2006 |
|---|-----------|----------|
| GDP (real growth rates) | 4,1 | 3,2% |
| GDP (USD Bn) | 5,78 | 6,2 |
| Inflation (December December) | 1,2 | 2,9 |
| Inflation (average) | 0,5 | 3,2 |
| Retail Price Index (December December) | 3,2 | 2,9 |
| Retail Price Index (average) | 2,1 | 3,9 |
| Unemployment Rate (in %) | 37,3 | 35,9 |
| Budget deficit | 0,2 | - 0,56 |
| Money supply M1(percentages changes, December December) | 7,5 | 17,1 |
| Money supply M2 (percentages changes, December December) | 12,4 | 31,5 |
| Money supply M4 (percentages changes, December December) | 15,1 | 24,9 |
| Weighted lending interest rates (in %,p.a) | 12,1 | 11,3 |
| Weighted lending interest rates (in %,p.a) | 5,2 | 4,7 |
| Average exchange rate MKD/EUR | 61,3 | 61,2 |
| Average exchange rate MKD/USD | 49,3 | 48,8 |
| Exports f.o.b (in million of USD) | 2.039,6 | 2.396,3 |
| Imports f.o.b (in million USD) | 3.097,6 | 3.681,5 |
| Trade balance f.o.b (in million USD) | - 1.057,5 | -1.285,2 |
| Current account balance (in million USD) | -81,5 | -23,7 |
| Current account balance (as % of GDP) | -1,4 | -0,4 |
| Gross foreign reserves (stock, end period) | 1.324,7 | 1.865,8 |
| Import coverage (gross foreign reserves/import f.o.b plus payments for services)in months | 4,4 | 5,3 |
| Total external debt (stock, end of period, in million of USD) | 2.274,8 | 2.434,7 |
| Total debt services (in million of USD) | 234,4 | 481,5 |
| Total external debt (as % from GDP) | 39,1 | 39,2 |

Table 7: *Main economics indicators for Republic of Macedonia [8]*

Conclusion

The small and medium enterprises are the main factor for national economy development especially in developing countries where the processes of transitions are more and more frequent. The basic advantage of SMEs is the adaptation and the probability for transfer in the other sectors which is very important for realizing gain nowadays in terms of quick changes. The other advantage of SMEs is that the needed funding capital is smaller than the funding capital for the other enterprises, so many people can afford starting new business. SMEs participate in creating the GDP, they have an influence at the rate of employment, actually they engine job creation and they help improving the living standard of the people, so they can have a better life in the national economy. Considering in all these advantages of SMEs founding every national economy should take measures to improve the business climate for SMEs acting and to increase their number. In Republic of Macedonia a lot of measures are taken in order to provide SME development.

- improving the judicial system;
- declining the procedures and administrative burdens;
- adequate access to finances and high interest rates;
- increasing the productivity, quality and competitiveness of products;
- initiation of new technologies and transfer of know-how;
- entrepreneurial formal education (particularly in elementary and secondary schools);
- decreasing gap in the cooperation among education and business sector
- decreasing the corruption and strong political influence
- legal protection of creditors and enforcement of laws in general
- increasing the investments in SMEs sector
- creating a National strategy of the Government on development of SMEs

- SMEs support institutional infrastructure (Agency for Entrepreneurship promotion, Regional economics development centers, Entrepreneurship promotion agencies, Business incubators);
- cheaper and faster start – up (easier company registration with the establishment of one – stop shops now operational and a reduction in company registration numbers (only three required);
- relatively low –cost, skilled labor; etc.

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