

Small Businesses, Promoters of Development, International Evidence

Jorida Tabaku, MA

Lecturer of Entrepreneurship and Corporate Governance
University of Tirana, Faculty of Economy
jorida.tabaku@gmail.com

Saimir Sallaku, MBA

Public Expenditure Adviser, REPIM
saimir.sallaku@gmail.com

Abstract

The correlation between small business and economic activity has drawn significant attention over the past decades. Several attributes of small businesses are widely held and supported by very good panel of data, others are new only to countries with a strong entrepreneurial history and background. This article examines the contribution made by small businesses in various countries, reviewing factors highlighted in case studies as instrumental to the development. The study uses data from developed countries such as USA, emerging economies and transition countries such as Slovenia, Hungary and Albania. The study will conclude with some suggestions how to use the best case examples and how entrepreneurship promotes development.

Keywords: small businesses, growth, development, employment, transition, international

Introduction

Storey (1994) argues that there is no uniformly acceptable definition of small firms due to a variety of factors such as; industry and sector effect in size, yardstick used and subjective and conflicting statistical data in the case of small and new firms. Bolton Committee (1971) tried to relate the economic and statistical features and linked those with industry effect, and regarded small firms as:

- With relatively small share of market;
- Managed by owners or part-owners in a personalized way;
- Independent

Wynarczyk et al. (1993) tried to identify characteristics of the small firm other than size arguing that small and large firms are as fundamentally different from each other as a caterpillar is from a butterfly (Storey, 1994). The definition is influenced by his status of economists and states that small firms are risky because:

- Being price-taker;
- Limited customer base;
- Diversity of objectives of owners.

European Commission definition uses a combination of different factors such as employment and financial data in order to create a more sophisticated and objective approach to smallness, where small firms have:

- less than 250 employees;
- less than 50 ml Euros of Turnover: and/or
- an annual balance sheet total not exceeding 43 million euro. (European Commission, 2003).

Considering that this paper focuses on several countries which use different definitions regarding SME's it is important to mention those differences in order to make comparisons and generalise the results. For example, although 'micro firms' is normally understood to refer to firms employing less than ten people, Poland and the Czech Republic do not adopt such a definition. However, efforts by these countries to comply with the *acquis communautaire* (or the compliance of the accession countries' firms with EU regulations) allow greater comparability for recent years. Second, the informal sector (i.e. unregistered businesses) is estimated at between 10 and 30 per cent of the GDP in some transition economies, whereas the incidence of inactive registered firms is quite high. According to the United Nations Industrial Development Organisation (UNIDO), up to 30 per cent of all firms on the register of countries such as Hungary and the Czech Republic were inactive, whereas this share was estimated as being as high as 40 per cent in the case of Slovenia in the early 1990s (Glas & Drnovsek 1999). Other countries such as Albania refer to micro enterprises to firms that employ less than 6 and small enterprises employ less than 10.

Even though there have been some controversial definitions there is the wide-accepted view: "*I can't define it: But I Know it when I see it*" (Acs and Audretsch, 1992).

There are many different ways of understanding the concept of entrepreneurship. Dictionary definitions of "entrepreneur" cover three distinct functions: management, risk-taking and innovation, ranging from "a person who undertakes or controls a business or enterprise and bears the risk of profit or loss; a contractor who acts as an intermediary", "one who organises, owns, manages and assumes the risks of a business", to an "individual who initiates business activity; often associated with one who takes business risks". Many writers have contributed to the body of literature on the theory and practice of entrepreneurship, not least to the "born-or made" debate, an issue raised later. Although in the minds of most people, policy-makers included, there is a strong association between entrepreneurship and small business, and the aims of both are valuable to any society, they differ radically in the contribution they make to the economy. The prime distinction lies in the concept of the entrepreneur as innovator, thereby distinguishing the business-owner looking for development and expansion (often using outside resources, whether technological, financial or human), from the small-business owner whose aim is self-sufficiency and remaining in business.

For the purposes of this article we have chosen to include all categories of entrepreneurial and small-business activity.

Methodology of Research

The paper uses a large panel of data provided by several researches undertaken by the authors on barriers to SME's (Tabaku, 2005). A survey was designed based on the work of Muent et al. (2000). The survey was conducted in June 2005 and directed to owners/managers of

SMEs in Tirana, the capital city of Albania. The survey was in the form of a structured interview based on standardised questions, which allow easy comparison. In designing the survey questionnaire a combination of qualitative and quantitative issues were considered.

Although design is cross-sectional, using the same techniques with other studies helps the paper to have the advantages offered by the longitudinal design in order to first accept changes and then try to analyse the factors that lie beneath.

The secondary data used in this research mainly consist in: (i) macro and microeconomic data published from EBRD, IMF, WB and other Albanian institutions; (ii) data on other economies; etc. Desk research was also carried out to complement the research.

Role of small firms in economic activity

There has been a paradigm shift in importance of small businesses to economic activity (Kirchhoff, 1994). The large business was being promoted as source of employment and economies of scale. The 80s signed a shift turning attention to small firms and entrepreneurship.

Innovation

Schumpeter was the first to point out the role of entrepreneurship in innovation where key contribution is "newness" (Carree and Thurik, 2003). But innovation depends on industry, more specifically in capital intensive industries large firms are more innovative, conversely small firms are more innovative in less capital-intensive industries, where in 156 of industries (slightly more than one-third) small firms were more innovative, and in 122 (or slightly more than one quarter) large firms were more innovative (Acs and Audretsch, 1987).

This study examined a large panel of data in countries like Italy, Germany, France, Japan, United Kingdom and United States. There are several differences among countries where entrepreneurial activity varies, but the main idea of the study focuses in the role that SME's have on innovation. The most important results are: (1) there is no evident difference in quality of innovation between small and large firms. For example large firms in manufacturing in these countries introduced 2608 innovations while small firms 1923 innovations. (2) However, small-firms employment was half that of the large ones, so the mean innovation for small-firms was 322 per million employees and by contrast the mean in large firms was 225 innovations per million employees concluding that small firms generate more innovations per employee than large firms (Acs and Audretsch, 1987). This is supported by the fact that small firms produce more innovations per dollar of research and developed expenditure than do larger firms (Chakrabarti, cited by Kirchhoff, 1994).

Agents of Change

Small firms serve as agents of change in a market economy. Small firms generate turbulence, providing mechanisms for regeneration (Acs, 1992) and in the long run entry-exit turnover makes a significant contribution (Caves, cited by Carree and Thurik, 2003). While Kirchhoff (1994) argues that all new firm formations in US are essentially small firm formations. This implies that most of new

economic activity is generated by small firms. By having such a high rate of entry and exit, small firms generate change, increase the number of players in market economy, create an additional dimension of competition and hence stimulate economic growth and development. Audtretsch (1995) is of the idea that the turbulent, but successful, nature of US market is attributable to entrepreneurial activity, because individual agents actualize a perceived idea to do something different, to make a change.

This is supported by several studies in the United States which is considered as the most entrepreneurial country in the world. Evidence from USA shows that the high rate of new business start-up breeds a constant flow of new high-impact firms--the kind that create value and stimulate growth by bringing new ideas to market, be they new technologies, new business methods, or simply new and better ways of performing routine tasks. The essential role that new firms play in the U.S. economy is smoothing the exigencies of the business cycle. Time and again, the breeding of new companies, new jobs, and new industries has helped pull the economy out of a slump and fuel a rebound--as occurred after the recession in the early 1990s.

The latest Global Entrepreneurship Monitor (GEM) survey, funded by the Ewing Marion Kauffman Foundation, found that in 2007, approximately 11 of every 100 working adults in the United States were engaged in entrepreneurial activity, either starting a business or playing a lead role in one less than three and a half years old. That rate is higher than any in Europe and roughly twice that of Germany or the United Kingdom. And although most Americans work in large or mid-sized firms most net new jobs are created either by start-up activity or by firms in a rapid-expansion phase.

This is also supported by data from Albania, where there is a very high entry rate of SME-s. The entry rate has decreased over time, but this is also related to pull factors. The high rate of the early stages of transition is related with the lack of the regulatory and legal framework and as can be noticed the difference between the active and inactive enterprises during this first phase is considerable high.

Table 1: Registered vs. Active companies in Albania

Economic Activity	Year									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Registered	6713	7899	9608	8348	7622	10305	5206	5874	6234	6964
Active by size										
Micro	3276	4208	5227	4587	5270	7755	4100	5004	5270	6304
Small	187	141	139	96	59	23	120	89	63	73
Medium	58	40	35	28	12	24	24	40	34	13
Large	14	12	15	6	3	1	9	4	3	6
Total Active	3535	4401	5416	4717	5344	7803	4253	5137	5370	6396
Drout out rate	47,3%	44,3%	43,6%	43,5%	29,9%	24,3%	18,3%	12,5%	13,9%	8,2%

Source: Instat, 2007

International Competition

Small Businesses also promote international competition through newly created niches. It has been extensively argued that small firms are flexible, adapt very quickly to market trends and are able to exploit new product-class niches (Acs and Audretsch, 1991). This serves as bases for international competition by motivating small firms to export and to exploit market opportunities in international markets.

This export tendency of SME's is also supported by several studies (O'Callaghan, Lenihan, 2006). The data from this study shows that the export orientation is related to firm size (with medium-sized firms being more likely to export than small and above all, micro firms). It is true that foreign SME's are much more engaged in export activities in Ireland. For example in 2000, more than three-quarters (77.3 per cent) of output produced by foreign medium-sized firms was exported; this compared with 21.4 per cent of local medium-sized firms.

Job Generators and Economic growth

SME's are considered as job generators. The first research in job generation by small businesses in US, states that in a decade 81.5% of net new jobs were created by small firms, and typically in one year these firms account for 35 to 37 percent of total employment (Birch, cited by Kirchhoff, 1994). The dynamic process of new firm formation and growth creates new owners and jobs, thereby creating and distributing wealth (Kirchhoff, 1994). Small firms create larger shares of new employment during recessions and smaller shares during expansion stages, and furthermore employment is more consistent year in and year out in small than large firms (Kirchhoff, 1994). Authors believes that the greatest job creation during recessions is related with the push or necessity factors for opening a small business and is very important from a policy point of view.

Data from Ireland shows that even as far back as 1979, some 95 per cent of all manufacturing units in Ireland could be classified as SMEs. In the most recent year for which data is available (2000) this has risen to just in excess of 96 per cent. Of all SMEs, micro and small firms represent the largest shares with approximately 37 and 45 per cent of all manufacturing establishments in 2000 respectively. The share of micro firms in the grand total of all firms (as well as in the total of SMEs) was quite stable over the period 1980-2000. A closer look at the data shows, nevertheless, an increasing share of micro firms in the total number of firms throughout most of the 1980s, with peaks at 39.7 per cent reached in 1983 and 1987. This was a decade of slow growth in Ireland, epitomised by a decreased reliance on large firms. Micro and small firms have also provided an increasing share of employment and output over most of the 1980s, where in average 21% of the total output and 28% of employment is dedicated to SME's.

A comparative analysis across some eastern European is hampered by several factors. First, the definitions of micro, small and medium sized firms differ across these countries in particular, and across Europe in general. For example, although 'micro firms' is normally understood to refer to firms employing less than ten people, Poland and the Czech Republic and Albania do not adopt such a definition. However, efforts by some of these countries to comply with the *acquis communautaire* (or the compliance of the accession countries' firms with

EU regulations) allow greater comparability for recent years. Second, the informal sector (i.e. unregistered businesses) is estimated at between 10 and 30 per cent of the GDP in some countries, whereas the incidence of inactive registered firms is quite high. According to the United Nations Industrial Development Organisation (UNIDO), up to 30 per cent of all firms on the register of countries such as Hungary and the Czech Republic were inactive, whereas this share was estimated as being as high as 40 per cent in the case of Slovenia and 70 per cent in the case of Albania in the early 1990s (Glas & Drnovsek, 1999 & Instat, 2007).

Table 2: The importance of small firms (%)

	EU	Ireland	Czech Republic	Slovakia	Slovenia	Albania
Population of small firms (<100)	99.4	89.9	98.4	99.23	96.8	99
of which, micro firms (1-10)	92.4	36.1	n/a	97.2	88.9	94
Employment in small firms	47	42.1	41.7	39	25.3	56

Source: (O'Callaghan, Lenihan, 2006) and for Albania (Xhepa, 2006)

Slovenia represents a special case in this group, given that, under Tito's rule, it was the most economically developed republic of the ex-Yugoslavia (and of Eastern Europe) with a tradition of economic openness through trade and business relations with western firms. The consolidation of private ownership in the ex-Yugoslavia by the 1988 New Enterprise Law triggered a modern wave of entrepreneurial activity and SME development in Slovenia. This is a country displaying a host of 'first mover' advantages, and the figures shown in Table 2 depict the fact that Slovenia has moved beyond the stage reached by other countries, with small firms maturing, developing and growing over the 1990s. It was reported indeed that the share of total sales and exports represented by small Slovenian firms has quintupled between 1989 and 1998, reaching more than a third of total sales and 17.9 per cent of total exports in 1998 (Glas & Drnovsek 1999).

The increasing percentage of micro and small firms over the 1990s is a direct result of the breaking up of the once dominant and large conglomerates into smaller units, through privatisation and MBO strategies. And this is also the case for Albania. This is also supported by data on the start-up rate during the first years of transition shown in Table 1. The economic and ownership structure of these countries changed drastically since the late 1980s, in line with the 'Copenhagen criteria'. Although most of the SMEs are not in the manufacturing sector, this is an important sector in terms of employment and value added (VA) for SMEs and large firms alike in these countries. According to Eurostat figures, SMEs in the ten countries (excluding Cyprus, Malta and Albania but including Bulgaria and Romania) represented 47 per cent of total manufacturing employment and 37 per cent of VA in 2001 (CEC 2004). Large firms are therefore dominant in the manufacturing sector, with 53 per cent of manufacturing employment and 63 per cent of the VA. Several countries also report labour productivity for micro enterprises varying from 3.7 (thousand Euro) in Czech Republic to 7.6, 10 and 17.3 (thousand Euro) respectively in Hungary, Latvia and Ireland. The same situation is also in Albania reporting where micro and SME's have provided 65% of

total turnover of the economy and 45% of total investment generated by private non agriculture sector. This figure will be higher if agriculture will be included considering the fact that this sector accounts for about x% of the total SME's sector.

Data from Spain show that small as they are, SME's account for 99.9% of business activity, generating 70% of employment and 65% of national sales. There are about 335,000 start-ups in Spain each year. This high incidence of start-ups can be partly explained by the prevalence of one-person businesses, and the greater simplicity of setting up a business involving one person. Most of these businesses are family businesses. Family businesses, some of them large, account for between 50% and 65% of Spain's GDP and generate 65% of employment, a figure even higher than that of the USA (Franquicias Hoy, 2000).

This is also particularly true in East Asia. In Taiwan, SME's account for at least 90 percent of the enterprises in each sector, and produce 60 percent of the total value exports. In Japan, SMEs accounted for 52 percent of manufacturing value added and sales. While Korea's development was driven by large conglomerates (chaebols), the SMEs sector began to grow rapidly in the 1980s and accounted for 5.2 percent of total manufacturing employment by 1988 and 34.9 percent of manufacturing value added (WB, 1993).

The system that generates and supports entrepreneurship in the United States is surprisingly unappreciated. Perhaps this is because when modern economic thought first took shape in the early and middle decades of the twentieth century, the West already had a mature industrial economy. With a universe of large corporations and modern equity markets already in place, economists were preoccupied with impersonal market forces, business cycles, capital markets, and government stimuli via fiscal and monetary policy. Microeconomic thinking also focused on big-firm behavior, rather than on the start-up process. Few people realize how many Americans today still make their living in entrepreneurial settings. More than 500,000 "employer firms" (businesses with employees) are started in the United States every year.

But the situation in USA is different because of the strong entrepreneurial background of the country. It is acknowledged that the USA owes much of the success of its entrepreneurial activity to its economic and cultural environment, including affirmative action, employment law, tax incentives, government support, mentoring, and a "can-do" attitude. Life-style changes in the USA accommodate entrepreneurs. Because people want more flexibility with their jobs and may well expect to have several careers in their lifetime, ongoing education and training are available. Moreover, people with the motivation and skills to start a new business are respected. On the other hand, in states that are "closed shop", labour unions can put obstacles in the way of the entrepreneur, by specifying that certain categories of work must be done by union crafts, thereby excluding any non-union individual (NRTW, 2001). Despite labour union difficulties, small businesses have attracted healthy financial investment. Venture capitalists have invested \$48 billion, and informal business angels and investors have invested more than \$54 billion in American small business every year for the last three years (Zacharakis, 2001). Although most of the capital investment has been in start-ups rather than expansion, the infusion of cash shows confidence in entrepreneurial activity overall.

Finally, this generates economic growth. Porter (1990, cited by Carree and Thurik, 2003), argues that "entrepreneurship is at the heart of the national advantage". And as a matter of fact, industries with a low large and medium-sized firm presence perform better in terms of output growth (Carree and Thurik, 1998). As Johansson (2004) argues new and small firms on average are more competitive than large ones, and will grow faster, because are open minded, flexible, innovative and less risk-averse. Empirical results from Brouwer et al. (1993) suggest that implications of small firms to the economy cannot be conceptualised separately, because are interrelated. Innovation amongst small firms has multiplier effects, increasing aggregate demand, and creating new job opportunities. Sales will grow rapidly; there will be multiplier effects in income and investments in new technology and processes that may also outstrip capacity effect. All this cycle initiated by small firms will result in economic growth and hence development.

Concluding Remarks

Several countries draw on different traditions of enterprise, varying from the most entrepreneurial such as USA, to the least ones such as the eastern European countries. Even though there are significant differences in regarding the legal, historical and business environment there is a clear understanding that the importance of SME's remains still very high in the following areas:

- Important role in innovation. There is increasing evidence that the role of entrepreneurship in innovation is very high, where the key contribution is "newness".
- Small firms serve as agents of change in a market economy. Small firms generate turbulence, providing mechanisms for regeneration.
- They promote international competition through newly created niches. It has been extensively argued that small firms are flexible, adapt very quickly to market trends and are able to exploit new product-class niches .
- They are considered as job generators and generate economic growth. Entrepreneurship is at the heart of the national advantage. And as a matter of fact, industries with a low large and medium-sized firm presence perform better in terms of output growth.

Empirical results suggest that implications of small firms to the economy cannot be conceptualised separately, because are interrelated. Innovation amongst small firms has multiplier effects, increasing aggregate demand, and creating new job opportunities. Sales will grow rapidly and there will be multiplier effects on income and investments in new technology and processes that may also outstrip capacity effect. All this cycle initiated by small firms will result in economic growth and development.

"Entry appears to be relatively easy, but survival is not" (Ausdretsch, 1995). This implies that even though the implications of the small businesses to economic growth are great, still a considerable part of them finds it difficult to grow and survive and next section provides some insights to understand financial obstacles of small business growth and survival.

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