Overview of Small enterprises

What are SMEs?

SME stands for Small and medium-sized enterprises (SMEs) or small and medium-sized businesses (SMBs) are business whose personnel numbers fall below certain limits. Actually the SME sector plays an extremely important part in modern economy, proving to be the most attractive and tremendous innovative system. The number of employees in SMEs vary from industry to industry.

The CEOs of SMEs often are the founders, owners, and manager of the SMEs. A CEO needs to strategically allocate her/his time, energy, and assets to direct the SMEs. CEO is the reason of whether the SMEs is going to develop or going to fail

The features & the importance of small and medium-size enterprises

SMEs are jobs creators for employees where the motivation and flexibility are better. Also, SMEs have created the competitive state of the market which lead to better satisfaction of consumer's needs. SMEs also contribute in supplying certain activities to help big enterprises in a way of producing goods and services efficiently. Another important feature of SMEs is Focusing on innovative processes, both in technology and in management. Thus, they help in forming the GDP and increasing the national export and play role in maintaining the social-political stability in a country

SME and Entrepreneurship Financing

SME finance is the funding of small and medium-sized enterprises, and represents a major function of the general business finance market Capital is supplied through the business finance market in the form of bank loans and overdrafts; leasing and hire-purchase arrangements; equity/corporate bond issues; venture capital or private equity asset-based finance and government funding in the form of grants or loans.

Across all stages of their life cycle, SMEs require access to appropriate sources of financing for their creation, survival and growth. Although SME access to bank finance largely recovered after the financial crisis, long-standing challenges remain such as information asymmetries, high transaction costs, and lack of financial skills and knowledge among small business owners. In addition, the potential of financing instruments other than straight debt often remains underdeveloped. Micro-enterprises, innovative ventures, start-ups and young firms tend to face more difficulties in accessing finance.

Cultivating successful entrepreneurs

Entrepreneurship is at the heart of national and local economic growth. By innovating and seizing opportunities, entrepreneurs drive national and local economic change and competitiveness.(Al-Awlaqi, Aamer, & Habtoor, 2018)

But there are many barriers to entrepreneurship that policy must address – obstacles in the regulatory environment, access to finance, exploitation of knowledge from research, skills for entrepreneurship, and ensuring that women, youth and people from all social groups have an opportunity to create successful businesses. ("SMEs and entrepreneurship - OECD," n.d.)

SME Productivity

Productivity can be defined simply as a total output produced per input within an economy. A small and medium-sized enterprise is defined as a company that employs under 250 employees. A small business is a company that has fewer than 50 employees and a micro business employs fewer than 10 people. Productivity is a key driver of long-term economic growth. Many factors affect SME productivity, both external and internal to the firm. most famous are competition and openness to trade. At the firm level, key drivers of SME productivity include managerial and workforce skills, and innovation, access to technology, access to business networks and to financial resources.

Digital for SMEs and Entrepreneurs

Digitalization is re-shaping the world economy. Digital technologies offer new opportunities for start-ups and established small and medium-sized enterprises (SMEs) to participate in the global economy, tap into skills and talent, access diverse financing instruments, innovate and grow. However, uptake of digital technologies is uneven and many SMEs are lagging behind, particularly in the adoption of productivity-enhancing digital tools and applications.

Problems confronted by SMEs

The greater variance in profitability, survival and growth of SMEs compared to larger firms accounts for special problems in *financing*. SMEs generally tend to be confronted with *higher interest rates*, as well as credit rationing due to shortage of collateral. The issues that arise in financing differ considerably between existing and new firms, as well as between those which grow slowly and those that grow rapidly. The expansion of *private equity markets*, including informal markets, has greatly improved the access to venture capital for start-ups and SMEs, but considerable differences remain among countries.

Regulatory burdens remain a major obstacle for SMEs as these firms tend to be poorly equipped to deal with the problems arising from regulations. Access to information about regulations should be made available to SMEs at minimum cost. Policy makers must ensure that the compliance procedures associated with, e.g. R&D and new technologies, are not unnecessarily costly, complex or lengthy. *Transparency* is of particular importance to SMEs, and *information technology* has great potential to narrow the information gap. It would be of great help to set up a "one-stop-shop system", where all the necessary information which affects firm strategies and decisions is made available in one place, as exists already in some countries.

The successes

A limited number of so-called high-growth SMEs make important contributions to job creation and productivity growth in the OECD area. At the earlier stages, *management capabilities* are crucial to survival. As the firm matures, human resource and innovation strategies increase in importance. By the time the firm has become established, *innovation* is crucial for growth. The fastest growing entrants are those that translate strategy into action in the form of R&D, innovation and training, put great emphasis on hiring skilled employees and motivating employees, and *balance* the enhancement of their capabilities in different areas -- the last being particularly important in high-knowledge sectors. The main barriers to the development of high-growth SMEs are *market failures in capital markets, government regulations, indirect labour costs, access to foreign markets*, and difficulties *in recruiting qualified staff and skilled workers*.

The primary policy tools for attracting firms to disadvantaged regions are investment in infrastructure, social assistance, training and other forms of public assistance. The regional dimension of entrepreneurship is not limited to clusters of enterprises but also includes micro enterprises. Programmes to assist the creation and development of micro enterprises in *inner cities* and *remote rural areas* have become widespread policy tools. Governments wishing to adopt policies used successfully in other regions or countries should take the regional context into account.

Best practice policies

The report ends with lessons from policies undertaken in *five areas*:

-- ***Financing***

The primary role of the public sector in supporting *venture capital* is to reduce the risk and cost of private equity finance, complementing and encouraging the development of the private capital industry. There is major variation across OECD countries in the use of funding methods for SMEs, but the provision of *equity financing to start-up companies* is more advanced in the United States and Canada than elsewhere. Taxation should not impose a disproportionately heavy burden on SMEs.

-- ***The business environment***

This can be improved by systematic and careful scrutiny of new regulations and by implementation of a business impact system to ensure the audit and monitoring of new legislation. Canada, the United Kingdom and the Netherlands have successfully introduced procedures to that end. The use of information technologies provides opportunities for reducing bureaucratic burdens on all companies, including SMEs.

-- ***Technology***

Technology diffusion programmes should: ensure quality control; promote customer-orientation; upgrade the innovative capacity of firms -- including the promotion of general awareness of the value of innovation among management -- and stimulate demand for technical and organisational change; build on existing inter-relationships in national innovation systems and provide greater coherence between programme design (e.g. targets, objectives, modes of support) and service delivery; build on evaluation and assessment. Technology diffusion programmes should in particular have mechanisms for assessment which can guide and improve their operation and management on a continuing basis. The United States has programmes effectively stimulating quality in diffusion processes, while Germany has sophisticated institutional set-up catalysing interactions between existing actors in the national innovation system.

-- ***Management capabilities***

Several G7 governments have sought to enhance the "quality" of owner/managers of SMEs either by encouraging *training* and/or by providing access to *advisory and consultancy services*. The most extensive assistance is provided by Japan which has both a highly developed system of advisory services and SME colleges. The United Kingdom and Italy have also implemented interesting schemes. Subsidy-schemes aimed at enhancing the skill base of SMEs should take the following into consideration: specification of objectives; situation after the removal of the subsidy; collecting information from SMEs themselves. Measures to encourage information networks must seek to customise databases and avoid information overload. Four approaches have been developed to address these issues: know your customer; access; explicitly avoid interference with market mechanisms; and subsidisation of information.

-- ***Access to markets***

Measures to ease *access to markets* have focused on *international markets*, on the one hand, and *public procurement*, on the other. Japan has the most developed policy and institutional set-up for the former, based upon the use of non-discriminatory measures which seek to support efforts made by SMEs themselves. Policy in this area seeks to tackle the disadvantages experienced by SMEs due to their lack of access to human resources, to external markets and to technology. Regarding public procurement, the United States, and other OECD countries such as Australia, have made comprehensive efforts to increase the "share" which small firms obtain of government contracts.

FINANCING SMALL AND MEDIUM-SIZED ENTERPRISES

Key differences in financing smaller and larger enterprises

The variance of both profitability and growth decreases with firm size. The second key source of divergence is that smaller enterprises have a lower probability of survival than larger enterprises. In a normally functioning financial market, some of these differences should be reflected in higher interest rates or less favourable terms of debt financing. This general observation, as well as the following points, should be taken into account in the design of policy responses to the needs of SMEs:

- Financial institutions assess smaller and medium enterprises as being inherently more risky.

- Larger firms usually comply with higher disclosure requirements to a greater extent than SMEs because of their access to a broad range of external funds (including bonds, equity and loans). Financial institutions charge higher interest rates to SMEs than to bigger companies in order to compensate for the higher costs of information collection, the smaller volume of external financing and the greater risk of failure.

- For many existing SMEs "insiders" (the entrepreneur, management) have better information about the expected profits of activities than external financial institutions. This lack of information leads to higher market rates to compensate for risk which may crowd out low-risk, low-return borrowers, leaving a relatively higher number of high risk/return borrowers in the market. Charging higher interest rates may therefore not be in the interest of banks as low-risk borrowers -- those most likely to repay loans -- are driven from the market.

- In the case of new enterprises or activities, outsiders (experienced bankers or other specialised financial intermediaries) can, in many cases, better assess the risks involved than relatively inexperienced "insiders". A specific disadvantage of young firms is that they cannot point to credit histories which provide important signals and help facilitate access to debt financing.

- Lending to SMEs is more likely to be based on collateral than is the case for loans to larger firms. This may lead to situations in which lending is not based on expected return but rather upon access to collateral. On the other hand, collateral reduces or eliminates contract problems such as "moral hazard" and "adverse selection". Many SMEs lacking access to "good collateral" suffer from credit rationing.

Venture capital

Venture capital is risk finance, usually provided in the form of a long-term equity investment, to fund the start-up, expansion or purchase of private businesses. Venture capital financing is usually provided without collateral or guarantees in the private equity market.

The stages of venture capital investing can be classified as follows:

- seed capital for financing the initial concept of the business;
- start-up capital for product development and initial marketing;
- expansion capital for financing the growth and expansion of the company;
- mezzanine capital for preparing the company for a public offering;
- buy-out or buy-in capital for purchasing a firm from its owners.

Venture funds can be classified as follows: i) captive funds that are subsidiaries of industrial corporations or financial institutions; ii) public-sector funds; iii) independent funds. These structural differences determine the sources of finance of the different types of funds: the parent company for captive funds and government institutions for public sector venture funds. The sources of finance of the independent venture funds are more varied: private individuals (including business angels); institutional investors; corporations; government; foreign investors.

SMES AND REGULATORY REFORM

The regulatory burden

A review of the regulations that govern the establishment of an enterprise is of particular relevance for creating a favourable regulatory environment and should be at the forefront of the overall economic policy agenda. One of the effects of such regulations is that they appear to discourage the creation of new technology-based firms and innovative start-ups which are important for employment growth, technological change and innovation.[1]

Establishing a relationship between regulation and a firm's competitive capacity is particularly arduous in the case of SMEs. Regulatory regimes will have very different impacts from one firm to another. While empirical studies may shed light on the problems of a particular category of SMEs, it will be hard to draw general lessons.

Analysis suggests that, while some regulations may deliberately favour SMEs (many regulations exclude the smallest firms), in general the adverse impact of regulations on SMEs can be particularly harmful. This is because SMEs are less equipped to deal with problems arising from regulations since they have less capacity than larger firms to navigate through the complexities of regulatory and bureaucratic networks. SMEs are more likely to be hampered by regulations because their strength stems from their flexibility. Some regulations designed to prevent entry into the market by dynamic SMEs are particularly detrimental.

Creating an SME environment conducive to R&D

To the extent that costs for R&D, technology generation and meeting associated standards are high or increasing more rapidly than other costs, smaller firms and businesses may, due to inadequate resources, be (increasingly) excluded from R&D and technology development.

This suggests that consideration be given to such issues as: i) ensuring, wherever possible, that compliance procedures associated with R&D and new technologies are not unnecessarily costly, complex, or long; and ii) that competition regulations do not prevent SMEs from achieving economies of scale in R&D through consortia.

Providing broader access to information on regulations

As competition increases, and flexibility and the ability to respond to changing demand and supply conditions become even more crucial, continuous reconfiguration of enterprise resources is an increasingly important component of firm strategy. This calls for access to information, and the requisite resources not only to acquire that information but also to assimilate and act upon it. At the same time, there may be economies of scale in acquiring, assimilating and using information (including information about regulations), thus disfavouring smaller business units. Policy implications may include: i) facilitating the availability of information in the public domain of relevance to firm strategies and behaviour, and making sure that no unnecessary regulatory burdens exist which are exacerbated by small size, thus hindering access to such information; ii) where such information is not formalised, ensuring that mechanisms exist to codify and widely distribute it without regulatory hindrance; and iii) ensuring that regulatory procedures do not create needlessly high thresholds to access or use information that is, in principle, widely available and essential for business performance.

INNOVATIVE SMES

Technological progress is not translated into economic benefits and jobs by governments, countries, or sectors, but by innovative firms. Innovative firms are not superior algorithms to maximise production functions, but efficient learning organisations that seize technological and market opportunities creatively in order to expand production frontiers. The single most important finding of recent economic research might be that new evidence from longitudinal microeconomic data reveals that firms that innovate more consistently and rapidly employ more workers, demand higher skills, pay higher wages and offer more stable prospects for their workforce.

Among innovative firms, SMEs play an important and distinctive role and face specific obstacles. This explains why governments have generally increased the priority attached to SME policies while reconsidering their focus to give greater emphasis to the promotion of innovation and technology diffusion. However, given the variety of factors that determine SMEs' innovativeness and growth potential, and the heterogeneity of the SME population in terms of technological capabilities and needs (Figure 1), they are confronted with two main issues:

– What is the appropriate balance between action on framework conditions and more focused government support to innovation and technology diffusion?

– What is the appropriate technology and innovation policy mix between general measures addressing generic problems related to smallness or newness and more targeted approaches better suited to the specific requirements of particular types of SMEs, such as new technology-based firms?

Drawing from the literature reviewed, the following practices are recommended for business environment reforms that benefit the Small enterprise sectors:

•Give priority to levelling the playing field: ensure firms are not disadvantaged in the business environment based on their size or the sex of their owner (and recognise that while a law, regulation or procedure may appear neutral, it can have very different effects on firms of different sizes);

•Simplify, reduce costs and improve transparency: simplify the legal and regulatory regime, reduce the costs of compliance and improve the transparency of regulatory and administrative decisions for all firms;

•Invest in an objective assessment of the business environment: place more effort on proper diagnostics, improving the quality of data to guide policy making, including an assessment of how the business environment affects medium sized enterprises;

•Identify the causes and not just the symptoms: carefully analyse national circumstances and contexts and identify the root causes to poor MSE performance;

•Think small, aim for growth: understand how government policies, laws and regulations affect the MSE sector and its potential for growth;

•Avoid single, isolated reform measures: understand how change in one part of the system may affect other parts;

•Go beyond business environment reform: recognise how the business environment relates to other factors affecting MSE competitiveness and growth;

•Ensure integrated solutions: use technical and financial cooperation to create suitable framework conditions and public-private dialogue, while improving legislation and regulation, administrative provisions and bureaucratic procedures;

•Improve representation and voice: promote dialogue between the private and the public sector and ensure the MSE sector is able to participate in these processes;

•Improve policy coordination and coherence: ensure the specific needs and opportunities of the MSE sector are addressed by government, whether through specialised MSE development agencies or inter-ministerial mechanisms;

•Apply a gender lens to reform: ensure the sex of a business owner is not a determinant of success;

•Monitor and evaluate to stay on track: apply regular reviews and establish robust feedback mechanisms; and

•Invest in further research: fill the gaps in the knowledge on MSE development and the contribution of business environment reforms to improving MSE competitiveness and growth.

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