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## SIGNIFICANCE AND DEVELOPMENT PROBLEMS OF SME'S IN CONTEMPORARY MARKET ECONOMY

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### Abstract:

Small and medium enterprises (SMEs) represent the basis of economic development. Because of their characteristics, SMEs are far more flexible and responsive to frequent changes that occur in the contemporary global environment than large enterprises. This paper analyses significance of SMEs to the economies of EU and Serbia. The result is great significance due to the fact that more than 95% of all registered enterprises are SMEs. The paper also analyses the most frequent problems of SMEs in the EU and Serbian market. The results show that these problems are usually generic and that the most important ones are: lack of financial assets, small possibility of technology transfer, lack of capacity for permanent development of products and services, small possibility of internationalization of business operations, lack of quality management, inadequate administrative regulations, limited purchasing power, etc.

*Keywords:* SME, development problems, development, economy.

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### 1. INTRODUCTION

Small and medium size enterprises (SMEs) are the main developing force of developed marketing economies. They are usually representing the majority of all the enterprises and accordingly they are main driving force of entrepreneurship

development and economy as whole. In most of developed countries, percentage of SMEs in total number of enterprises is around 90%, while 60% of available workforce is employed in those firms.

If observing this issue through the scope presented in this paper, it is obvious that SMEs have large influence on development

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of modern economies. This is why it is necessary to perform permanent analysis of key problems facing SMEs during their development.

## **2. NOTIONAL DETERMINATION OF SMEs**

There is number of manners that could be used for notional determination of SMEs, while the main categorization is depending on quantitative or qualitative aspect of their defining. It should be noted that legal treatment of SMEs in EU is different compared to ours. Notional determination of SMEs in EU is including registered legal as well as physical subjects (the entrepreneurs). In our environment SMEs are exclusively legal subject.

Quantitative aspect of SMEs definition is different depending on applied criterion; also it depends on legal regulations of concrete country. As a criterion for SMEs categorization according to their size, following parameters are used: number of employees, incomes and active capital. Mentioned criterions for SMEs quantitative categorization are accepted in Serbia nowadays. Nevertheless, if we use number of the employees as criterion, number of differences is noticeable in legislation of different countries. In France, Germany and Italy 500 employees is criterion number for SMEs, in Great Britain this number is 200, in Holland 100, while in Belgium and Denmark it is less than 70 employees (Popović, 1996). Categorization of SMEs depending on their size is very illustrative presented in the work of group of American authors which revealed following classification: extremely small enterprises (less than 20 employees), small enterprises (20 – 99 employees), medium

sized enterprise (100-499 employees) and large enterprises (more than 500 employees) (Ceranić, 2004). In our country, following categorization is actual: micro enterprises (1-9 employees), small enterprises (10-49 employees) and large enterprises (250 and more employees).

Qualitative approach in determination of SMEs is based on some of enterprises assumed characteristics which place it in group of small or eventually medium sized. Those characteristics are: small size (in small enterprises it is usual that all employees know each other and this way they can function as a team, and not as group of individuals, this usually facilitates better work environment and increased satisfaction of the employees with it), centralization in decision making (The owner of the enterprise is usually top manager, this means that he must approve all the decisions. This could lead to large problem when enterprise start to grow, when it becomes physically impossible for the owner to be in charge of all the events), low level of specialization (this increase scope of the jobs, meaning larger diapason of work tasks for the employees, which is specially suitable for enterprises doing their business in unpredictable and highly dynamical conditions, when it is important to achieve high level of adaptability toward outside drawn changes), intuitive and low formalized strategy and business (enterprises management in these situation is usually narrowed on short termed planning and certain level of experience, good side of this relations is that business owner is usually in very tight engagement of direct task accomplishing, this means that he can permanently control its realization and momentary performs necessary adjustments), informal channels of internal

and external communication (internal communication is of two way type in vertical as well as in horizontal direction, this detain restraining of initiatives and ideas of the employees, while external communication enables easier information exchange with suppliers and customers, which are first next links in chain of new value development (Tomić, 2000).

Regardless if this is qualitative or quantitative definition of enterprises, it should be kept in mind that established size of enterprise in largely determining its organization and management style.

### 3. MAIN CHARACTERISTIC OF SMEs

Most of the enterprises is largely determined by the way on which they are functioning on their marketplace environment, as well as their basic business characteristics which can be positive or negative.

SMEs possess list of advantages. Some of those are: high level of flexibility (small dimensions of those enterprises enables them to respond quickly on their customers' demands, also to effectively adopt on all relevant environment driven changes), developed entrepreneurial spirit (visionability and energy of the owner could sustain innovative climate which backs up fast growth and development), precisely defined core of competence (because of largely limited resources and small amount of capital they own, SMEs are forced to analyze in details and to define tasks in which they have concurrent knowledge and skills), they are relatively easy for managing (small number of functions, business processes, employees, active capital, etc., which eases coordination of employees, also

control is direct and very precise) (Đurić, 2004), and they are able to find possibilities for growth and development easier (small dimensions are more suitable for managing growth and development).

SMEs, besides numerous advantages, are characterized with numerous disadvantages. Some of those are: impossibility to access large and lucrative markets (there are usually strong barriers for entering those markets, concerning investment in marketing research, promotional activities, development of distribution network, building of production capacities, etc.), inexistence of scale economy (knowledge and experience in certain field enables numerous advantages in structure of costs, during time it leads to extra capital accumulation which can be reinvested in different ways. Because of their small dimensions SMEs usually are not in position to accomplish this), troubles resulting from deficiency of cash (SMEs are not in position to raise enough cash in short terms, if opportunity arise for business extending their current possibilities), deficiency of expert personal (because of lack of financial resource, growth and development of the company usually is not adequately accompanied with employing of necessary personal from different fields, whose expertise is usually necessary).

List of advantages and demerits of SMEs is not ended with this discussion. Only the main characteristics of small size enterprises are listed here. This enables scope of general view of their importance and position on developed countries economy. Also, the aim was to depict logically the overall problems concerning SMEs development in market oriented economical systems.

#### 4. IMPORTANCE OF SMES IN MARKET ECONOMY

SMEs present one of the most important driving forces of economic development in market economies. They stimulate initiative, invention and overall entrepreneurial spirit. Their specificities enable them to be far more flexible than large enterprises, which is one of basic conditions to be adaptable to changes in relevant surroundings. Those are only some of reasons resulting with large number of SMEs existing in all developed economies, which advocate the fact of their extremely importance.

During the year 2005, inside EU-27 there was almost 20 millions of enterprises as the part of nonfinancial sector, 99,8% of those were SMEs (enterprises with less than 250

employees). Their share in total employment was 67.1%, while their added value was 57.6% of total added value. SMEs in frame of EU-27, during 2005, employed averagely 4.3 person,. This average was strongly variable for different EU countries. Largest average of employees in SMEs was in Slovakia (12 person) and smallest (3 person) was in Czech Republic (this information is from 2004.) and Greece (Schmiemann, 2008). Some of those indicators are available in Table 1.

Importance of SMEs in economics is large, mostly concerning their share in total number of companies. This is why they are called „The spine of economical development“ of EU. Figure 1 is presenting the share of enterprises according their size on EU-27 territory

Table 1. Key indicators for enterprises which are the part of nonfinancial sector in EU-27 group (Schmiemann, 2008)

	Total	SMEs	Micro enterprises (1-9)	Small enterprises (10-49)	Medium enterprises (50-249)	Large enterprises (>500)
Number of enterprises (in millions)	19,65	19,60	18,04	1,35	0,21	0,04
Percentage (%)	100,0	99,8	91,8	6,9	1,1	0,2
Number of employees (in millions)	126,7	85,0	37,5	26,1	21,3	41,7
Percentage (%)	100,0	67,1	29,6	20,6	16,8	32,9
Added value (in billions of euro)	5360	3090	1120	1011	954	2270
Percentage (%)	100,0	57,6	20,9	18,9	17,8	42,4
Work force productivity (1000 euro per employee)	42,3	36,4	29,9	38,7	44,8	54,4
Percentage share over total (%)	100,0	86,1	70,7	91,5	105,9	128,6

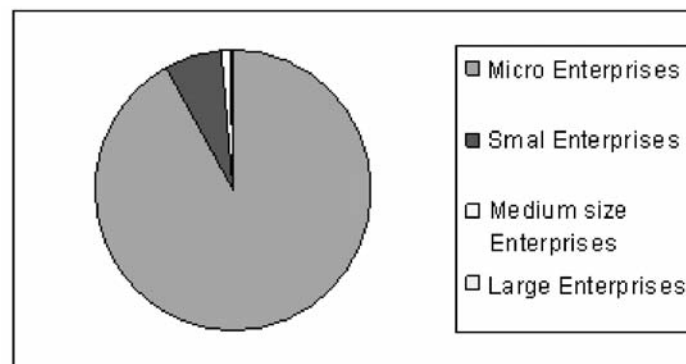


Figure 1. The share of enterprises according to their size in the EU-27 region

The importance of SMEs for entire Serbian economy is also large. In Serbia, there is increase in importance of SMEs economic sector as the part of structural reforming process, especially when considering overall growth of public economy by creating new workplaces. This is the reason why SMEs have large importance for successful implementation of transition process, which is happening in our country, having in mind that economic results of hitherto transition are far from expected.

SME sector in Serbia is most profitable segment of public economy. During 2006, SMEs (including entrepreneurs) participated with 99.7% in total number of utilities while with 63% in total number of employment in Serbia. Also, SMEs facilitated over 40% of total exporting activities and 60% of importing activities. When observed through this prism, it is obvious that SMEs are most vital, meaning most rentable part of Serbian

economy (Jakopin, 2008).

During the year 2007, SMEs (without entrepreneurs) partake with 99.29% in total number of enterprises. This data is without doubt presenting large importance of SMEs in Serbian economy. Some key aspects in SMEs sector are presented in table 2.

Importance of SMEs in Serbian economy is large, having in mind their share in total number of enterprises. Figure 2 is presenting the participation of enterprises according their size in total numbers of enterprises in Serbia.

According to above presented data it is obvious that SMEs sector should be treated as the base for market economy development. This is the reason why great attention should be given on functioning and development of SMEs, accompanied with analysis of key problems which face them during the process of their development.

*Table 2. Key identifies of enterprises performance in Serbia, according to their size (Republics institute for statistics of Serbia, 2008)*

	Total	Microenterprises (1-9)	Small enterprises (10-49)	Medium sized enterprises (50-249)	Large enterprises (>500)
<b>Number of enterprises in Serbia</b>	<b>84109</b>	<b>71065</b>	<b>9874</b>	<b>2572</b>	<b>598</b>
Vojvodina	22001	18317	2755	771	158
Central region of Serbia	62108	52748	7119	1801	440
<b>Number of employees in Serbia</b>	<b>1097913</b>	<b>146307</b>	<b>203091</b>	<b>271543</b>	<b>476972</b>
Vojvodina	275395	37063	57135	83062	98135
Central region of Serbia	822518	109244	145956	188481	378837
<b>Commerce flow in Serbia (in. Millions of dinars)</b>	<b>5079482</b>	<b>886631</b>	<b>1213891</b>	<b>1013667</b>	<b>1965293</b>
Vojvodina	1481784	226035	295316	298651	661781
Central region of Serbia	3597698	660596	918575	715016	1303511
<b>Gross added value (in. Millions of dinars)</b>	<b>1062559</b>	<b>120500</b>	<b>200105</b>	<b>226341</b>	<b>515611</b>
Vojvodina	266777	26988	49023	67984	122782
Central region of Serbia	795782	93512	151082	158358	392830

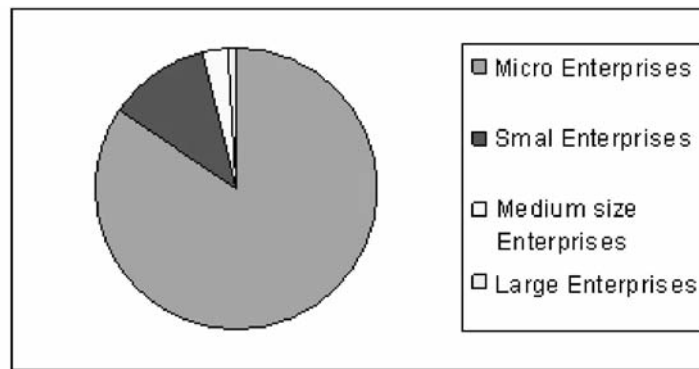


Figure 2. The share of enterprises according to their size in Serbia

## 5. PROBLEMS OCCURRING DURING DEVELOPING OF SMES IN MARKET ECONOMY

There is large number of problems that can occur during development and functioning of SMEs. Considering their particularities, those enterprises are largely reactive on local active crises development compared to large scale ones, this is why it is important to point out at most common problems facing them. When familiar problems occur, and when their origin is well known, decision making process toward selection of set of adequate actions for problem solving or sanitation is quite much easier.

Large scale of investigations revealed the fact that two primary reasons for SMEs collapsing are lack of adequate managerial skills and lack of financial resources (Watson, 2003). Those are two basic problems facing SMEs in their market economies, this also sustains the fact that SMEs requires external support in the form of outsourcing, especially in the form of knowledge and information related to different aspect of enterprises functioning (management, financials, marketing, production, etc). In other words, in modern business environment, SMEs are often left

without possibility for independent development or marketplace acting. They had to have own core of competence that have to be developed continuously making them competitively superior in their field of operations. During this process SMEs must be engaged in different forms of cooperative relations with other enterprises or organizations, this way achieving common preset goals.

On the other hand, investigation carried out during November and December 2006 in 27 EU countries, on the population of 16339 SMEs revealed different results. This investigation lead to conclusion that limited purchasing power of the people (46% of the sample), inadequate legal regulations (36% of the sample), deficiency of working force (35% of the sample) as well as high working force costs (33% of the sample), are most common problems facing SMEs. Inadequate infrastructure was at the fifth position (23%), while lack of financial resources was at sixth place (21% of the sample). This was considered highly atypical considering development problems of the SMEs. List of the problems continued with implementation of new technologies (17%), implementing new forms of organization (16% of the sample) and shortage of qualified managers (11% of the sample) (The Gallup

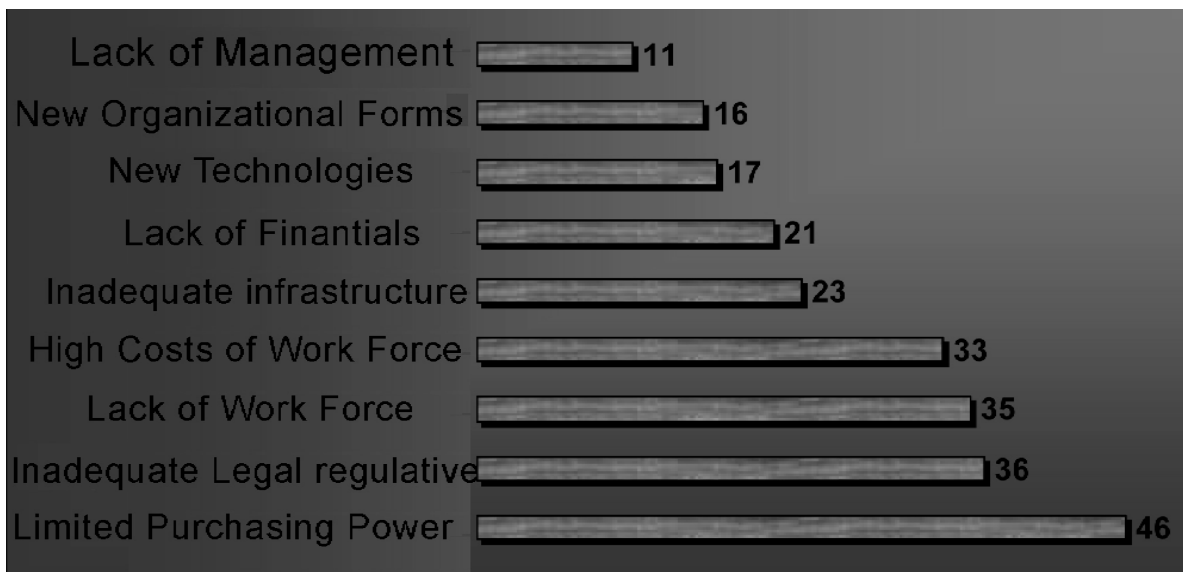


Figure 3. Obstacles during development and functioning of the SMEs (The Gallup Organization, 2007)

Organization, 2007). Those results are presented in Figure 3.

On the other hand, investigations conducted in our country, revealed that lack of financial resources is one of the basic problems in SMEs development. As the example we can discuss investigations realized by the Agency for Small and Medium Sized Enterprises development, focused on determination of biggest problems in SMEs operations in Serbia. This investigation included 1404 examinee (entrepreneurs) in whose enterprises 14485 of people are employed, that is 13 employees per firm. Results of investigations revealed that most important problems, according to the examinees are: lack of financial resources (38.5%), legal regulations (27.5%), lack of marketplace information (9.4%), lack of qualified workforce (9.4%), incompatibility with the standards (7.1%), lack of adequate technology related information (4.1%) (Ministry of economic and regional growth, 2007). Those results are presented in Figure 4.

According to the presented results of above discussed investigations, it can be stated that problems facing SMEs are numerous, and at the same time, those problems are generic in nature, meaning that those problems are immanent with nature of SMEs.

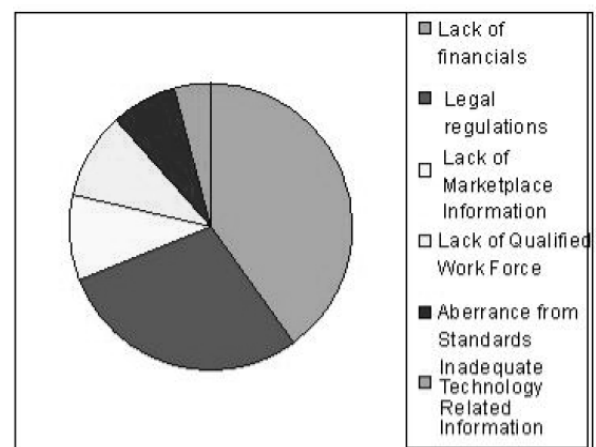


Figure 4. Share of most influencing problems of the SMEs operating in Serbia during 2006

## 6. CONCLUSIONS

According to the broad social and economic importance of the small and medium sized enterprises, governments of the states have to take their role in creating economic environment which will serve development of such enterprises. State shouldn't be directly engaged in their operations, as this is the case in as agreed economy countries, which was the case in our country not so long ago. The state has to have the regulatory role. It should create adequate legal – economic frame and to establish basic economic mechanism within it. On the other hand, this role of the state shouldn't be considered as something absolute and unchangeable. The state isn't there to guarantee the survival of the SMEs. This would lead to paternalistic cognition of the government's role. Bad examples of such attitudes and their consequences could be found in large number of ex socialistic countries (Former Yugoslavia, China, Former Soviet Union, etc), as well as in other country with totalistic regime (Chile, Peru, etc). The survival and further development of the enterprises has to be remitted to the market conditions, previously arranged according to the market economy principles. The manner in which the enterprise will be organized and functioning should be left exclusively to its owner or management team.

SMEs are extremely important internationally, because they can become competition to large multinational and transnational corporations in some segments of their operations. Because of their size, smaller size enterprises are usually more flexible and in line with fast changes in the environment. Because of their closeness to the market, it is much easier and faster for

them to obtain relevant information. This enables them for fast reacting to the changes in their organization or way of operating, compared to their competition.

On the other hand, small scale isn't always the advantage. It can present large obstacle in attaining high profitable jobs, access to lucrative markets, favorable banking credit lines, large investments in their growth and development, etc.

Nevertheless, today it is more than ever obvious that without strong SMES it is practically impossible to achieve solid economic position internationally. Because of their distinct entrepreneurial role, they present solid base for expediting of full scale economy of a country, after attracting direct foreign investments, decrease of unemployment rate, increase in gross added value, exporting activities, etc.



## ЗНАЧАЈ И ПРОБЛЕМИ РАЗВОЈА МСП-А У САВРЕМЕНОЈ ТРЖИШНОЈ ЕКОНОМИЈИ

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### Извод:

Мала и средња предузећа (МСП) представљају основу целокупног економског развоја. Због својих специфичности, она су далеко флексибилнија, а самим тим и респонзивнија на честе промене, које су основна одлика савременог глобалног окружења, него што је то случај са великим предузећима. У овом раду је анализиран значај МСП-а за економију ЕУ и Србије, при чему се дошло до закључка да је он изразито велики, с обзиром да МСП чине преко 95% од укупног броја предузећа. У раду су такође анализирани и основни проблеми са којима се МСП суочавају на тржиштима ЕУ и Србије. Чињенице показују да су ови проблеми обично генеричке природе, а да се као најважнији могу истаћи: недостатак финансијских средстава, немогућност трансфера технологије, непостојање капацитета за перманентни развој нових производа и услуга, немогућност изласка на међународно тржиште, неадекватан менаџерски кадар, неодговарајућа законска регулатива, ограничена куповна моћ, итд.

*Кључне речи:* МСП, проблеми развоја, развој, економија.

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