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41st Congress of the European Regional Science Association

**SME SUPPORT POLICY IN EUROPEAN
UNION AND BALTIC STATES: PRINCIPLES
AND PROBLEMS**

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Abstract

Small and medium-sized enterprises have an important role to perform in a country's economic development: they ensure free competition, decrease unemployment and balance the development of different regions. But SMEs cannot exist without a special support system. In this article, the SME support systems in the Baltic States are analyzed (with the main stress placed on Estonia), and their weaknesses are defined. As the Baltic States intend to join the European Union, it is also important for their SME support systems to be compatible with the overall SME support policy of EU. This issue will also be analyzed in the article, and the main differences between the SME support policies in EU and the Baltic States will be brought out to suggest an advisable course of SME policy development in the Baltic States.

Introduction

From economic policy's point of view the entrepreneurship sector can be divided into two segments: big enterprises from one side and small and medium-sized enterprises (SMEs) from the other side. Both segments have their specific features and problems.

Statistics of developed countries shows the big role of SMEs in public economy. In specific literature, three aspects have been brought out, pointing to the importance of small enterprises and the probable expansion of their role in a country's economy (Pleitner 1993, p. 13):

- The structure changes in economy have made the service sector more important, and with that, the role of small enterprises also gains importance;
- There are a lot of fields where small enterprises are more profitable than the big ones;
- Many human needs (need for communication and pleasant working environment, need for acknowledgement) can be better met in small enterprises.

Still, small enterprises cannot exist without a special support system, as for the unequal competition terms they would lose to big firms. That would mean the deepening of monopolization tendencies in an economy and the growth of contradictions between the employees and employers, that can finally lead to the perishing of market economy system.

The term of small and medium-sized enterprises appears in many economical writings, but it does not have a unique definition. Depending on the purpose of the definition, SME-s are defined by both qualitative and quantitative criteria.

The qualitative specifications bring out features that differentiate a small enterprise from a big one. For example:

- The management is independent, as the manager of the enterprise is usually also the owner;
- The enterprise is in the possession of one or a small number of persons;
- The enterprise operates mainly in one place, though the market does not have to be local;

- The enterprise is small, compared to the biggest competitors in the industry.

The qualitative criteria for defining SMEs are undoubtedly more informative, but they are difficult to use. Therefore, usually quantitative criteria are preferred, such as the number of employees, turnover, value of balance sheet etc. EU's common management policy defines a SME as an enterprise that corresponds to the following criteria:

- The number of employees does not exceed 250;
- Enterprise's annual turnover is under 40 million ECUs *or* the value of balance sheet is under 27 million ECUs;
- Not more than 25% of the enterprise is owned by firms not corresponding to the criteria listed above.

Among the Baltic states, only Lithuania has officially defined the term of small and medium enterprises. The Lithuanian Law of Small and Medium Business Development defines a small enterprise as an enterprise with the average annual number of employees on the pay-roll not in excess of 9 and a medium-sized enterprise as an enterprise with the average annual number of employees on the pay-roll not in excess of 49 (Small and Medium Business Development in Lithuania 1999/2000).

In Estonia, there is no official definition for small and medium enterprises. For the insufficiency of empiric data, the number of employees is the only criterion that can actually be used. In this article, SMEs in Estonia are defined as enterprises that employ 0-249 workers.

Small and Medium-sized Enterprises in Estonia

The number of operating enterprises in Estonia has grown from year to year. Faster changes took place at the beginning of the 90-s. During the years 1994-1997 the amount of small and medium-sized enterprises grew slowly. At the end of the year 1998, there were over 28 200 enterprises in Estonia. 99.4% of them were small and medium-sized enterprises, among which more than a half (51.6%) were firms with 0-4 workers. Only

0.6% enterprises in Estonia in 1998 had more than 250 employees (Ettevõtete majandusnäitajad 1998, 2000).

Between the amount and size of SMEs there is an inversely proportional correlation: when the size of enterprises is growing, the number of enterprises decreases. 21% of the total amount of SMEs in Estonia was formed by enterprises with 5-9 workers; approximately 23% were enterprises with 10-49 workers. At the same time the total number of Estonian enterprises is constantly decreasing, but this decrease is characterized by the following tendency: the smallest decrease has occurred in the number of enterprises with 10-49 workers and the only one which has grown is the number of enterprises with 1-4 workers. Especially sharp decrease in the number of start-up enterprises appeared in 1995-1996, it was caused by the enforcement of new business law that established higher minimum capital requirements for the limited liability companies. This made the starting of enterprises more expensive and difficult. In 1996, the number of newly registered enterprises was the lowest after the year 1991 (5 353 enterprises). In 1997 this figure rose 210% (11 217 enterprises), but was still lower than in the years before the decrease.

Looking at Estonian enterprises by sizegroups, it can be noted that the furthest number of workers (30.4%) is occupied in small enterprises, 27.7% in medium-sized enterprises and 25.4% in big enterprises. Thus, in 1998 the employment in SME sector reached 58.1% of overall employment in the entrepreneurship sector (for comparison: in EU this figure is 66%) and SMEs` export formed 72% of Estonia`s total export. The tendency in recent years has been that in the entrepreneurship sector, the percentage of people occupied in micro and small enterprises gradually grows and the percentage of people occupied people in medium-sized and big enterprises gradually falls. (Eesti majanduse ülevaade 1998)

The rate of SMEs is very different in different branches. In such branches as agriculture and forestry, construction, trading, accommodation and catering, the percentage of SMEs is over 99% and over 90% of workers occupied in these branches work in SMEs. The biggest changes in 1998 occurred in fishery where the rate of people occupied in SMEs has risen from 42% to 63%. This change was caused by the fact that some big fishery enterprises closed their operation and some decreased the number of workers so

that they are no more considered big enterprises. To smaller extent the percentage of SMEs has risen also in mining and manufacturing industries, that is caused foremost by diminishing the number of workers in big enterprises. Considering SMEs, the decrease of employment in agriculture and secondary sector can be noted. As formerly the trading enterprises represent the biggest group of SMEs (24.5%).

Small and Medium-sized Enterprises in Lithuania

The division of Estonian and Lithuanian enterprises into sizegroups is proportionally similar. In both countries there is a big domination of enterprises with up to 10 employees (72.6% in Estonia and 85.4% in Lithuania of the total number of enterprises). 22.2% of enterprises in Estonia and 10.5% in Lithuania have 10-49 employees, 50-249 workers are accordingly in 4.6% and 3.5% of enterprises and with over 249 workers there are only 0.6% of enterprises in both countries (Ettevõtete majandusnäitajad 1998, 2000; Small and Medium Business Development in Lithuania 1999/2000). A conclusion can be made that both in Estonia and Lithuania SMEs are the main source for employment and an important economic force in the whole Baltic region.

SME support in EU and Baltic States

There is no unique SME support policy in Estonia; not enough attention has been paid to small enterprises and their positive role in the society. There is no systematic approach to this problem. Therefore there exist resource-wasting dualities and some important fields have been left with no support at all. But in a transformation economy like Estonia, a carefully planned SME support system is especially needed, because the market economy structures and regulations have not been wholly formed out yet.

The Estonian government has recognized this problem and the process on formulating an SME support policy has already been started. An important part of the Entrepreneurship Policy will be the SME support policy that is meant to take into account the actual needs of small and medium enterprises.

Considering the integration into the European Union as an important political goal of Estonia, Latvia and Lithuania, European SME support principles should also be taken into account when forming a SME support policy.

The problems of SMEs in Baltic states are similar to those of European enterprises: irrespective of the fact whether we are dealing with a firm operating on international or internal market, the consideration of a state's administrative and fiscal policy, and carrying along technological innovations are linked to very big expenditures. When in big organizations it is possible by the redivision of work to employ an extra person for dealing with specific legislative changes, for small enterprises it is connected with big expenditures that can have a big impact on the firm's competitiveness. Therefore the simplifying of legal and administrative regulations connected with the creation and operation of enterprises is the field where communication and co-operation can be of especially big importance.

The co-ordination of SME support in EU has two goals (Activities in favor of SMEs):

- To guarantee that the interests of SMEs are taken into account when working out EU's general policies and to enlarge the role of SMEs in carrying out EU's general policies;
- To enlarge SMEs' participation in different programs.

To achieve these goals, European Commission has offered two possible groups of activities (EU initiatives for SMEs):

1. Improving the environmental conditions for SMEs:

Participation of organizations representing SMEs in EU's law formation; creating favorable market conditions (SLIM project - Simpler Legislation on the Internal Market; Single Market Programme).

2. Measures and programs for supporting SMEs in the following fields:

- benchmarking;
- obtaining financial means and credits;
- programs of regional development;
- SMEs in specific fields (for example agriculture, fishery);

- internationalization of small enterprises (for EU member states also meeting European requirements);
- improving the competitiveness of small enterprises (including the support for research and training);
- promotion of entrepreneurship and supporting special groups (female entrepreneurs, micro entrepreneurs, non-profit organizations).

As the factors restricting SMEs` operation are similar in different countries, it would be useful to consider EU`s experience in forming the SME support systems in Estonia and other Baltic States.

In Estonia, SMEs are supported in the following fields:

- Support and consultation for start-up enterprises;
- Advising and consultation in different fields;
- Financing business projects, including special regional policy programs;
- Promoting export and business contacts;
- Loan guarantees;
- Organizations representing SMEs, for example Small and Medium Entrepreneurs Association, Estonian Chamber of Industry and Trade, Estonian Industry and Employers` Central Federation.

The support is mainly financed by Estonian republic and international organizations. In 1997, 553 million EEK (36,9 million EUR) were used to support Estonian SMEs, out of which 32% came from the state budget, 9% from enterprises` federations and 59% from international donators (Väikeettevõtluse olukorrast Eestis 1999).

The process of forming an overall SME support network has already been started. Estonian Entrepreneurship Policy (including the SME support policy) will be formulated by the Ministry of Economic Affairs by autumn 2001. Merge agreements of the Estonian Investment and Trade Development Foundation and the Foundation of Estonian Innovation Fund with the Enterprise Development Foundation have been signed 05. September 2000. Merge agreements have been also signed under which the existing Foundation of Estonian Residence, Export Credit and Guarantee Foundation

and Entrepreneurship Credit Foundation shall be merged to the Foundation of Guarantee for Entrepreneurship and Residential Loans.

Signing of these merge agreements is a step toward implementation of the Foundations' Reform. Transformation is conducted under such a plan that the foundations being subjected to transformation will be merged to two new foundations established - the Foundation of Guarantee for Entrepreneurship and Residential Loans and the Enterprise Development Foundation. Merge of the Estonian Regional Development Foundation, Estonian Infrastructure and Transport Development Foundation to the Entrepreneurship Development Foundation is currently under preparations.

The mission of Enterprise Estonia is supporting of Estonian enterprises by applying approved and effective public measures. Essentially, Enterprise Estonia has acted under common management system since January 1, 2001. The purpose of foundation's activities is to support the development of Estonian business through the common and efficient application of national policies. The structural units of Enterprise Estonia include Estonian Trade Promotion Agency, Estonian Regional Development Agency, Estonian Technology Agency, Estonian Tourist Board and Estonian Investment Agency. Estonian Regional Development Agency has North-Eastern and Southern Estonia's Bureaus and Estonian Tourist Board has its representations in the form of Tourist Information Centers all over Estonia.

Enterprise Estonia is financed from the state budget and from the revenues of privatization activities. According to Privatization Act, different foundations are given 25 % of the sums coming in from privatization. The foundation's budget in 2001 with the supplementary budget is 328,7 million EEK (21,9 million EUR).

Transformation of the Enterprise Estonia within which Estonian Investment and Trade Development Foundation, Estonian Regional Development Foundation, the Foundation Estonian Innovation Fund, Estonian Infrastructure and Transit Development Foundation and Tourist Board will be merged, shall be completed at the beginning of the year 2001. Transformation of these foundations is aimed to increase the operating efficiency of the institutional structures established for the development of entrepreneurship. In the

capacity of Enterprise Estonia structural units, the Trade Promotion Agency, Technology Agency, Tourist Board, Regional Development Agency and Investment Agency will continue the development of entrepreneurship.

Comparing the SME support systems in EU and Estonia, several differences can be brought out:

- There is no unique SME support policy yet formulated on the government's level in Estonia that would determine overall priorities in the development of this field. In EU, a unique approach has been worked out for this problem.
- In Estonia, the co-ordination mechanism between different support programs and institutions is still in the process of being formed.
- EU pays much attention to simplifying legislative and administrative regulations for starting and operating of enterprises; Estonia offers only minimum support in this field.
- The benefit of benchmarking has not yet been recognized in Estonia. By sharing experiences and learning from each others' mistakes, it is possible to increase the competitiveness of the whole country. SMEs would need support also in benchmarking.

Researches carried out in Estonia show that small entrepreneurs do not find the support system sufficient enough and that information about possibilities of getting different forms of support is limited.

According to the research carried out by EMOR at the end of 1998, 66% of small enterprises evaluate government's action in shaping the enterprising conditions either bad or rather bad. It came out that only 12% of SMEs had turned to state financial programs to get a loan.

Thus is shown that enterprises are not sufficiently informed about different support programs. Another problem is the insufficient co-ordination between different institutions and programs.

SME support systems in Latvia and Lithuania

All the three Baltic countries have a net of Business Advisory Service Centers. Also, the SMEs are supported by institutions implementing the regional policy. All the Baltic States receive substantial support from the EU PHARE program.

Lithuania

Lithuanian Government has approved a SME development program with the aim to initiate and finance business development projects as well as establish a supportive SME development environment. This national program is co-ordinated and monitored by the Ministry of Economy of the Republic of Lithuania. Also involved are the Lithuanian Development Agency for Small and Medium Sized Enterprises and the Inter-Institutional Board for SME Problems and Adjustment of Interests.

The main objectives of the SME development program are the following (SME development program 2000):

- To set up a consistent SME development technical and financial assistance system, which could:
 - initiate and support the establishment of business incubators;
 - create favorable conditions for SME-s to get access to information; consulting and training services;
 - design credit guarantee mechanism for SME-s;
 - design taxation loan system.
- To establish supportive business environment for SME development.
- To stabilize legal environment and eliminate bureaucratic barriers.

Lithuania has a central SME support co-ordination body – the Lithuanian Development Agency for Small and Medium Sized Enterprises (SMEDA, founded in 1996).

Latvia

The Cabinet of Ministers of Latvia has accepted the National Program for the Development of Small and Medium Sized Enterprises to achieve the following objectives (Report on the Development of Economy of Latvia 1999/2000):

- development of organizations of support to small businesses;

- creation of a favorable legal environment and simplified administrative procedures;
- devising and implementation of development projects (business plans);
- support to development of technologies,
- training programs.

To achieve those objectives, Latvian Development Agency has been created.

So, in all three Baltic states there has been created a central institution with the goal to improve the entrepreneurial environment in the country.

The problems of small enterprises

According to the research carried out by the Association of Small and Medium Enterprises in 1998, Estonian SMEs` biggest problems are (Väikeettevõtlaste olukorrast Eestis, 1999):

- high taxes on wages;
- high interest rates for loans;
- high income tax rate for firms;
- bureaucracy and paper work;
- accessibility of investment loans.

Depending on the size of an enterprise, the main problems are different in some aspects: for firms with up to 9 workers the high tax rate on wages and the high interest rate for loans appear to be the main problems; the enterprises with 10-49 workers are more concerned with the income tax rate and the accessibility of investment loans. For the firms with 50-249 workers, the main problems are finding skilled labour force and coping with the high interest rates for loans.

According to the same research, small and medium-sized enterprises wait for the government's support primarily in the following fields (Väikeettevõtlaste olukorrast Eestis, 1999):

- Tax concessions. Taxes on wages are the main problem.
- Access to information.

- Loans – interest rates, accessibility of loans, warrant problems.
- Export support.
- Support for the renewal of technology.

The main problems hindering the development of SMEs in Latvia (Report on the Development of Economy of Latvia, 1999/2000):

- insufficient financial resources for the start-up and development of entrepreneurial activity;
- limited possibilities to take credit and receive credit guarantees;
- lack of information about markets and possible co-operation partners;
- lack of adequate knowledge on management and marketing;
- non-encouraging for business taxation system and administration of taxes.

In Lithuania, SMEs consider their main problems to be the following (Small and Medium Business Development in Lithuania, 1999/2000):

- High taxes;
- Constantly changing legislation;
- Bureaucracy;
- Clients` low purchase power;
- Deficiency of circulating capital.

Conclusions

As from one side, small business has an important role to perform in a country's economic development and from the other side, entering EU, the Baltic states have to assimilate their economic policy with that functioning there, an overall SME support policy and its implementation network should be worked out to ensure free competition, decrease unemployment and balance the development of different regions.

In Estonia, the process of forming an overall SME support network (matching that of Lithuania) has already been started. Estonian Entrepreneurship Policy (including the SME support policy) will be formulated by the Ministry of Economic Affairs by autumn 2001. Additional information on the needs of SMEs will be gathered with the help of

several PHARE projects; this information will be used to continuously develop the support system. Also, some adjustments have been made to the legislation to create a more favorable environment for enterprises: for example, the income tax for firms has been removed. So the first steps have been made to facilitate the development of SMEs and thus the economic growth of the entire country.

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