



Small and Medium-sized Enterprises: Local Strength, Global Reach

Summary

[Small and medium-sized enterprises \(SMEs\)](#) account for over 95% of firms and 60%-70% of employment and generate a large share of new jobs in OECD economies. They have specific strengths and weaknesses that may require special policy responses. As new technologies and globalisation reduce the importance of economies of scale in many activities, the potential contribution of smaller firms is enhanced. However, many of the traditional problems facing SMEs – lack of financing, difficulties in exploiting technology, constrained managerial capabilities, low productivity, regulatory burdens – become more acute in a globalised, technology-driven environment.

Small firms need to upgrade their management skills, their capacity to gather information and their technology base. Governments need to improve SME access to financing, information infrastructures and international markets. Providing regulatory, legal and financial frameworks conducive to entrepreneurship and small firm start-up and growth is a priority.

Fostering public-private partnerships and small-firm networks and clusters may be the most expeditious path to a dynamic SME sector. Grouped in local systems of production, SMEs can often be more flexible and responsive to customer needs than large integrated firms. They can pool resources and share the costs of training, research and marketing. Clustering facilitates exchange of personnel and diffusion of technology and creates new possibilities for efficiency gains. Importantly, these local networks and support systems can help SMEs meet the challenges of globalisation. Whether alone or in clusters, SMEs are seeking international opportunities through strategic alliances, franchising and joint ventures.

Government policy initiatives should take account of regional and local factors which affect entrepreneurship and build on these particularities to foster small-firm partnerships. Policies should use local institutions, groups of industries and inter-firm linkages to create and strengthen the micro-level bonds which can underpin global competitiveness. Building on local strengths, SME policies need to address the new dynamics of entrepreneurship and small-firm clusters to meet the challenges posed by globalising economies. ■

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What are SMEs?

SMEs are defined as non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across national statistical systems. The most frequent upper limit is 250 employees, as in the European Union. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most ten, or in some cases five, workers. Financial assets are also used to define SMEs. In the European Union, SMEs must have an annual turnover of EUR 40 million or less and/or a balance-sheet valuation not exceeding EUR 27 million. ■

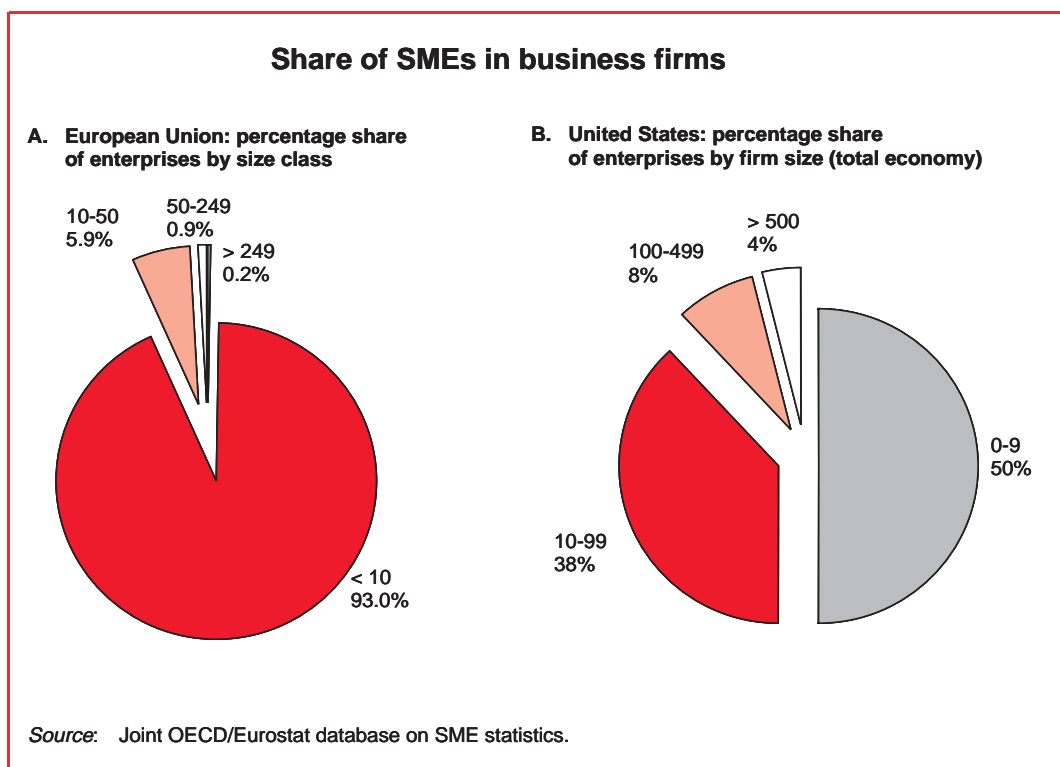
What is their economic contribution?

SMEs play a major role in economic growth in the OECD area, providing the source for most new jobs. Over 95% of OECD enterprises are SMEs, which account for 60%-70% of employment in most countries. As larger firms downsize and outsource more functions, the weight of SMEs in the economy is increasing. In addition, productivity growth – and consequently economic growth – is strongly influenced by the competition inherent in the birth and death, entry and exit of smaller firms. This process involves high job turnover rates – and churning in labour markets – which is an important part of the competitive process and structural change. Less than one-half of

small start-ups survive for more than five years, and only a fraction develop into the core group of high-performance firms which drive industrial innovation and performance. This underscores the need for governments to reform policies and framework conditions that have a bearing on firm creation and expansion, with a view to optimising the contributions that these firms can make to growth. ■

In which sectors are SMEs found?

Most SME jobs are in the service sector, which now accounts for two-thirds of economic activity and employment in OECD countries. Smaller firms are found particularly in wholesale and retail trade, the hotel and restaurant business, com-



munications and business services, and construction. SMEs also account for a high percentage of manufacturing firms in many OECD countries and provide at least half of OECD manufacturing employment. Smaller firms are increasingly present in technology-intensive industries such as information and communications technology (ICT) and biotechnology.

SMEs predominate in the important strategic business services subsector, including services relating to computer software and information processing, research and development, marketing, business organisation and human resource development. Increased outsourcing by major manufacturing firms, combined with new technologies that have allowed SMEs to win market niches, has led to 10% annual growth in these knowledge-based services in recent years. The fact that the average firm size in strategic business services is a fraction of the average size of firms in manufacturing or in the economy as a whole is an indication of the importance of SMEs in this field. ■

Why is entrepreneurship important?

A vibrant entrepreneurial sector is essential to small-firm development. Entrepreneurs are people who sense opportunities, innovate, take risks and develop new goods and services. They drive business dynamics – the birth, expansion, contraction and death of firms – and fuel overall economic growth. The entrepreneurial process, however, remains mysteri-

ous. Social, cultural and political factors in countries influence the availability of entrepreneurial opportunities as well as the degree of risk-taking and the mobility of resources. Factors discouraging entrepreneurship include education and training which is risk-averse and regulations and institutional impediments which discourage the establishment of new ventures or expansion of existing activities.

Entrepreneurship tends to vary across regions. Some regions or locales are known for generating clusters of dynamic firms which benefit from “information spillovers” and other intangible factors. All countries have local “pockets” with extremely high levels of entrepreneurial activity, e.g. Silicon Valley in the United States, Arezzo and Modena in Italy, Valencia in Spain, Nüremberg in Germany, and Gnosjö in Sweden. Culture, social and intellectual capital and local networking influence the development of such firm links. Clustering can be of particular benefit to smaller firms which, because of their size, cannot finance in-house services such as training, research or marketing. And clustering can generate benefits that progressively increase the competitive advantage of the group of firms and enable them to compete globally. Successful districts and clusters are characterised by the continual emergence of new entrepreneurial firms.

In many OECD countries, the number of women entrepreneurs is rising. Enterprises owned by women now make up one-quarter to one-third of the total business population worldwide. In several countries, notably the United States and Canada, the growth in the number of

women-owned businesses is far outpacing the overall growth of new businesses. Nevertheless, residual barriers exist to the growth of women-owned firms, and improved knowledge and data about female entrepreneurship and its role in society and the economy are needed if policies are to address them effectively. Increased participation of women-owned businesses in the global economy, financing that responds to the needs of women-owned businesses, and education and training that fosters female entrepreneurship should also be developed. ■

How innovative are smaller firms?

Based on survey data, some 30%-60% of SMEs in the OECD area are characterised as innovative in the broad sense. On average, they are less likely to conduct research and development (R&D) than larger firms. But they may be more likely to innovate in other ways – through creating or re-engineering products or services to meet new market demands, introducing new organisational approaches to enhance productivity, or developing new techniques to expand sales. Public policies or attitudes which constrain creativity, competition, risk-taking and adequate returns to investment are inimical to innovative behaviour by smaller enterprises.

There is a subset of high-growth small firms which are exceptional innovators. These SMEs are located in the top 5%-10% of all growing firms. In most countries, their job creation rates exceed those of larger companies. They tend to be technology-based and conduct R&D. Found

mostly in knowledge-intensive sectors and in regions characterised by intense economic activity and clustering, these fast growers are usually integrated into formal and informal networks of firms. High-growth SMEs play a pioneering role in developing new products and markets in sectors such as ICT and biotechnology and are at the cutting edge of the “new economy”. ■

What type of SME financing is needed?

Funding gaps for smaller firms are a major impediment to growth. Wide variance in the profitability, survival and growth of SMEs compared to larger firms brings special financing problems. Owners and managers of smaller firms often lack commercial experience and/or a track record as entrepreneurs. Early stages of growth are marked by uncertainty both in production and marketing. Smaller, innovative firms operate in environments of high complexity and rapid change and rely heavily on intangible assets. SMEs often have trouble obtaining financing because banks and traditional lending institutions are averse to risky ventures.

Expansion of private equity markets is greatly improving access to venture capital for SMEs, but there are considerable differences across countries. Venture capitalists provide more than equity capital to their portfolio companies. They also offer management assistance, performance monitoring and the staged infusion of additional risk capital as the enterprise evolves. Venture capital can be supplied by specialised funds which raise money from a range of

sources: private individuals, corporations, government agencies, pension funds, banks and insurance companies, endowments and foundations. Or it can be provided directly by the same range of investors.

More important than the level of venture funding are the enterprise stages and industrial sectors to which it is directed and the quality of distribution mechanisms. More than three-quarters of total venture capital investment in the United States and Canada finances the early stages and expansion of firms, as compared to less than half in Europe. About 80% of US venture capital is invested in high-technology sectors. This is in contrast to Europe and Japan, where start-ups typically depend on debt financing. A well-functioning venture capital market is not only about financing, it is also about high-quality management of the information and agency problems that arise when innovators, entrepreneurs and financiers try to understand each other and co-operate in the launching of risky ventures. Fostering an adequate flow of financing for small firms is a crucial step in enhancing entrepreneurship and creating a vibrant economy. ■

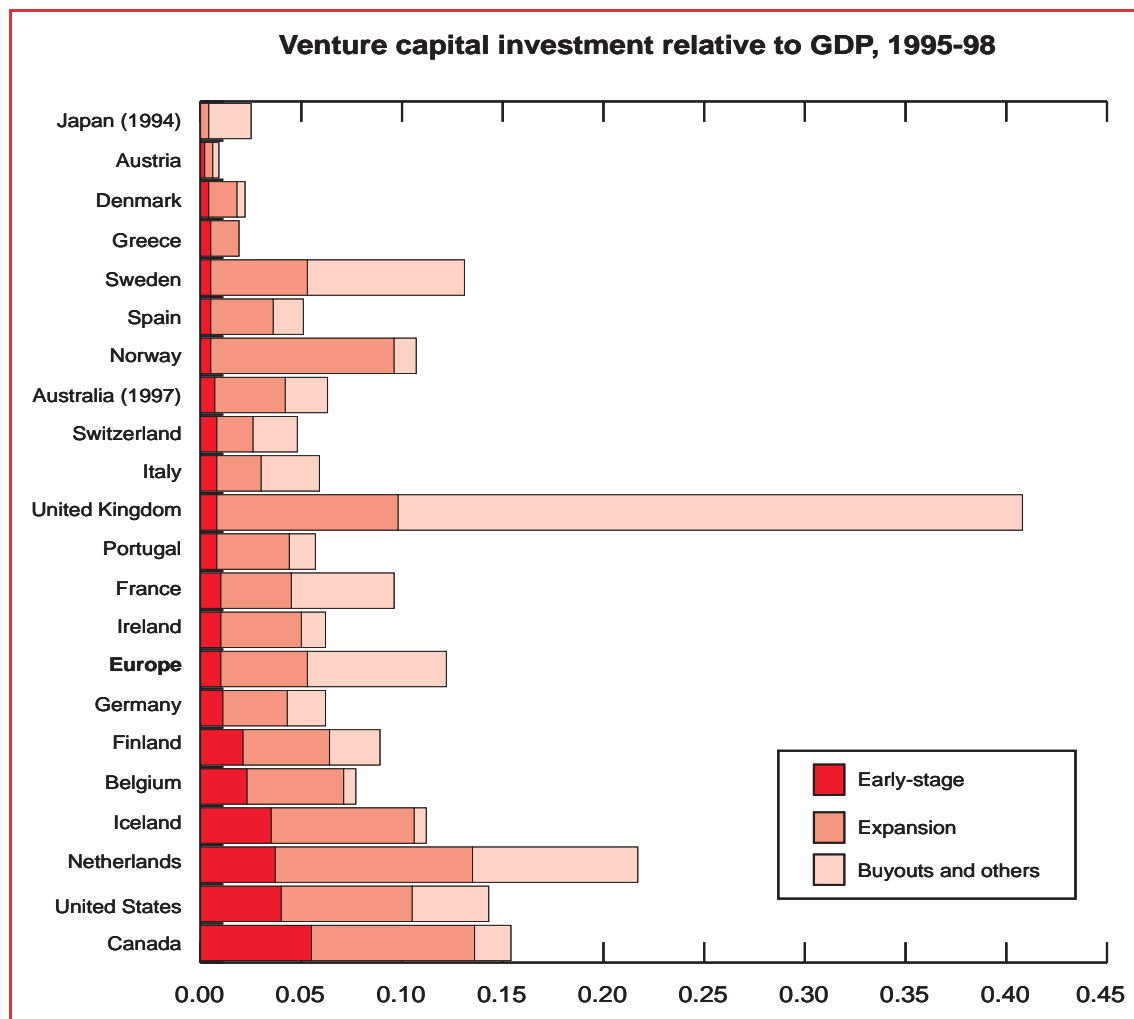
Are SMEs active in global markets?

Smaller firms have traditionally focused on domestic markets and many will continue to do so. But others are becoming increasingly globalised, often on the basis of inter-firm linkages and clusters. About 25% of manufacturing SMEs are now internationally competitive and this share should increase. About

one-fifth of manufacturing SMEs draw between 10%-40% of their turnover from cross-border activities. At present, SMEs contribute between 25%-35% of world exports of manufactures and account for a small share of foreign direct investment. These internationally active SMEs are generally growing faster than their domestic equivalents.

Networking allows SMEs to combine the advantages of smaller scale and greater flexibility with economies of scale and scope in larger markets – regional, national and global. Relative to larger firms, SMEs can better respond to changing market conditions, evolving consumer preferences and shorter product life cycles by customising and differentiating products. New communication tools make it easier for small firms to reach foreign partners. As a result, SMEs are becoming more involved in international strategic alliances and joint ventures, both alone and in groups. Larger multinationals are partnering with smaller firms with technological advantages to economise on R&D, minimise the lead-time for new products and serve emerging markets. And SMEs are reaching across borders to form international alliances and ventures composed of globalised small firms.

Governments recognise that the size of SMEs often prevents them from going global. A wide range of financial and risk-management services, including insurance, bank guarantees and advice, is available to SME exporters through government export credit and promotion agencies. Information on foreign markets



and export opportunities is disseminated through SME homepages and other electronic means. Support is increasingly provided to help smaller firms participate in foreign exhibitions and trade fairs, prepare marketing tools in foreign languages and circulate advertisements abroad. At the same time, it is crucial that governments do not provide support in such a way as to replace the development of a private market for information services. Governments should focus on the public goods aspects of information. ■

Will SMEs be a factor in electronic commerce?

The advent of Internet-based electronic commerce offers considerable opportunities to SMEs to expand their customer base, enter new product markets and rationalise their businesses. Smaller firms can use e-commerce to customise products and services, manage supply processes and inventories, and reduce the time between order and

delivery. SMEs generally adopt technologies more slowly than the average firm, and this also applies to the adoption of Internet technologies. This may be because of remaining internal barriers to SME adoption of e-commerce, including limited understanding of the complexity of electronic operations, inadequate skills and high initial investment required to develop a viable e-commerce strategy.

Other impediments to small-firm use of e-commerce are external, such as infrastructure access and costs.

Governments in OECD countries need to continue to liberalise telecommunications markets and ensure competitive ICT infrastructure, prices and services. Also, the difficulty of building a reputation and establishing consumer trust and confidence in their activities make SMEs more vulnerable than larger firms to problems linked to authentication and certification; data security and confidentiality; and the resolution of commercial disputes. The needs of SMEs should be specifically addressed in creating an effective business environment for e-commerce. Despite these barriers, an impressive number of start-ups have been created to operate in electronic markets and existing small firms are migrating to electronic commerce – highlighting what can potentially be achieved by SMEs in this area. ■

How can SMEs contribute to sustainable development?

Much is being done to improve the environmental performance of industry through policies which induce reductions in harmful emissions and encourage energy and resource efficiency. Smaller firms, however, tend to be less aware than larger firms of environmental externalities and of the legislation that governs their activities. They have fewer resources to invest in environmental improvements and management tools that could make their operations more sustainable. On the other hand, SMEs can fill market niches in the development and sale of environmental goods and serv-

ices. Involving the full range of SMEs in working towards sustainable solutions is a formidable challenge. With ICT advances, the means for governments and other stakeholders to reach, inform and influence smaller players are at hand, but an effective government environmental strategy is needed, together with heightened awareness in small firms of the need for firm-level environmental strategies. ■

What should governments do?

In view of the SME role in economic restructuring, governments should above all promote entrepreneurship, facilitate firm start-up and expansion, and improve access to venture capital and other types of financing. To this end, governments are now fostering the development of secondary stock markets to allow easy entry and exit for venture investors; easing taxes on capital gains and other dividends; and allowing greater use of stock options as compensation in small firms. Governments are also fostering business angel networks which bring together small companies and prospective investors.

Reducing the regulatory burden on smaller firms can be one of the greatest spurs to entrepreneurship. Problems stem from regulatory systems developed to serve the needs of large firms and the cumulative pressure of regulatory requirements. SMEs identify high compliance costs, extensive and complicated paperwork, and economic regulations that prohibit certain activities as the most onerous burdens they face. Countries are now reducing paperwork and bureaucracy,

minimising administrative burdens, streamlining procedures and reducing compliance costs for SMEs, including setting up “one-stop shops”. At the same time, the relatively weak bargaining power and generally poor liquidity of SMEs make them strongly dependent on regulatory frameworks that guarantee the reliability of transactions and secure orderly playing rules in the economy.

Promoting enterprise clusters can also enhance SME performance and competitiveness. Small firms working in clusters can attain the advantages of large firms while retaining the benefits of specialisation and flexibility. Local, regional and national governments can foster small-firm linkages through providing the frameworks for public/private and inter-firm partnerships. The government role in building clusters is generally indirect and concerned with supporting skills development and freeing up resources while overcoming constraints to greater enterprise interaction.

To implement these SME initiatives and reforms, governments are mounting specialised services and action plans. In most OECD countries, SME units or agencies are charged with promoting small business development by providing capital, reforming fiscal practices, reducing administrative burdens, providing management and skills training, improving information dissemination and increasing access to markets. Programmes to increase the technology base of SMEs include R&D tax credits, loans or grants for innovative activities, and technology diffusion schemes. Concurrently, more OECD countries are adopting an “evaluation culture” whereby pro-

SME Internet Homepages

- Australia – www.smallbusiness.info.au
- Austria – www.bmwa.gv.at
- Belgium – www.cmlag.fgov.be
- Canada – www.strategis.ic.gc.ca
- Czech Republic – www.mpo.cz
- Denmark – www.em.dk
- Finland – www.vn.fi/ktm
- France – www.pme-commerce-artisanat.gouv.fr
- Germany – www.ihk.de/BMWi/g7-sme
- Greece – www.eommex.gr
- Hungary – www.gm.hu
- Ireland – www.enterprise-ireland.com
- Italy – www.minindustria.it
- Japan – www.sme.ne.jp
- Korea – www.smba.go.kr
- Mexico – www.siem.gob.mx
- Netherlands – www.minez.nl
- New Zealand – www.med.govt.nz
- Norway – www.nhd.dep.no
- Poland – www.cup.gov.pl
- Portugal – www.iapmei.pt
- Spain – www.ipyme.org
- Sweden – www.smelink.se
- Switzerland – www.pmeinfo.ch
- Turkey – www.kosgeb.gov.tr
- United Kingdom – www.dti.gov.uk
- United States – www.business.gov
- European Union – www.europa.eu.int
- Global/G7 – www.gin.sme.ne.jp

grammes are reviewed on a regular basis to determine their relevance and effectiveness. Evaluation of SME programmes is essential to justify their cost and to assist in the design of future programmes.

The challenge of enhancing conditions for SME competitiveness goes beyond the bodies directly responsible for SME policies: the provision of an appropriate regulatory, legal and financial framework conducive to small-firm start-up and growth depends on a wide range of institutions at all levels of government – local, regional, national and international. ■

What is the role of the OECD?

The officials of the 29 OECD Member countries who comprise the

OECD Industry Committee Working Party on Small and Medium-sized Enterprises meet twice a year to discuss SME performance and policies. Employment and growth of small firms are compared, based on OECD indicators. Analyses are prepared on entrepreneurship, clustering, high-growth firms, management training, electronic commerce and other topics to highlight current trends and draw attention to the difficulties which SMEs confront. Policy approaches and programmes in specific areas such as SME financing and technology diffusion are explored in order to identify best practice policies.

The OECD is also working to improve SME statistics. International comparability of firm-level data is weak due to divergent size-class definitions and sector classifications. In

most countries, no single source covers enterprises in all size classes, their respective share of employment and their turnover. Current statistics may omit the smallest firms and certain industries, tend to undercount the number of new business units, and are often collected at irregular intervals. To identify the population of SMEs demands a business register with full sectoral and size coverage and frequent updating. Enterprises should be followed to measure survival rates and to document patterns of entry and exit across industries and over time. The OECD hopes to expand the collection of comparable cross-country data on smaller firms, including women-owned businesses, particularly through more comprehensive business registers, without creating additional administrative or paperwork burdens for these enterprises. ■

For further reading

- [The OECD Small and Medium Enterprise Outlook: 2000 Edition](#), *Forthcoming*
ISBN 92-64-17656-X, US\$48, 223p.
- [Regulatory Reform for Smaller Firms](#), 1999
Free on Internet: www.oecd.org/dsti/sti/industry/indcomp/prod/reg-ref.pdf
- [Strategic Business Services](#), 1999
ISBN: 92-64-17123-1, US\$48, 256p.
- [Women Entrepreneurs in Small and Medium-sized Enterprises](#), 1998
ISBN 92-64-16040-X, US\$16, 280p.
- [Fostering Entrepreneurship](#), 1998
ISBN 92-64-16139-2, US\$29, 288p.
- **Internet**
www.oecd.org/dsti/sti/industry/smes/

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