

The Role and Challenges of Small and Medium-sized Enterprises (Smes) in Emerging Economies: An Analysis from Turkey

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Abstract

Small and medium-sized enterprises (SMEs) form a large part of economy. As SME sector has a crucial role in creating new jobs, economic growth and innovation, these economic units are worldwide acknowledged as the key actors of socioeconomic development. In Turkey, significance of SMEs is relatively higher, caused by not only from their huge share in the economy, amounting to 99.9% of all registered enterprises, but also their “backbone” function in the dynamic but turbulent Turkish economy. As Turkey experienced severe economic crises during the recent decades, SMEs became one of the major elements of the growth and development policies of regulatory authorities. This paper aims to address this critical role of small and medium sized companies by investigating factors behind the rising popularity of SME sector in Turkey, while at the same time pinpointing the major advantageous and problematic areas. Turkey is among major emerging economies, therefore the analysis this expected to make a significant contribution to literature about small business sector in developing economies by taking the factors constraining the growth of Turkish SME sector to the spotlight.

Keywords: SMEs, entrepreneurship, economic development, growth, emerging economies

1. Introduction

Small and medium sized enterprises (SMEs) are not only vitally important for the developing economies but also are crucial with their large share in advanced economies as well. Within OECD, more than 95% of all registered enterprises are SMEs and these economic units account for more than half of total private sector employment (Lukacs, 2005). In Eurozone, 98% of all enterprises fall in to small and medium enterprise category and SMEs supply 67% of total employment and 58% of gross value added (EC, 2012). Despite the fact that most of the enterprises in every economy are SMEs (Özdemir, et.al, 2011), the shift of scholarly and practitioner interest from large to small and medium sized companies gained pace only within the last three decades. As the contribution of SME sector in every major macroeconomic indicator became clearer, particularly with respect to the role of these enterprises in creation of new jobs, real GDP growth and development of entrepreneurship, SME sector became the center of socio-economic policies both in developed and developing economies, also causing an acceleration of research in this area.

The share of SMEs in all formally registered businesses in Turkey is 99.9%, therefore the central role of the sector in the economy is evident (Ari, 2013). However, within the growing but fragile Turkish economy, SMEs continue to experience serious challenges, particularly due to the severe economic crises of the last three decades which seriously impaired the economy and forced the Turkish government to take radical steps towards attaining a more stable economy and sustainable growth. The resiliency and flexibility of SMEs in chaotic and changing environments caused them to become one of the key elements of the social and macroeconomic developmental policies in Turkey. As a result, the already high share of these economic units in the overall GDP, new job creation and export volumes rised further, catching the increasing attention of policy makers, researchers and practitioners.

While the economy enjoyed a strong and steady growth particularly after the final domestic crisis in 2001, a number of challenges related with managerial capabilities, financial and human resources and innovativeness of Turkish SMEs emerged as major factors harming the backbone role of these enterprises in the economy. This paper aims to analyze the vital role of SMEs in Turkish economy from various angles, and investigate the major strengths and problem areas of SMEs with a comparative perspective regarding international and local contexts. The importance of this paper is twofolds. First, there are still limited number of academic studies focusing on the SMEs and entrepreneurship in emerging

economies (Bruton, 2013) despite the significant contribution of these economies to local and global GDP by their dynamic growth rates. Thus, the article aims to fill an important gap in the literature by investigating the challenges of small and medium sized businesses in emerging economies, with references from the SME sector of the 16. largest economy of the world. Secondly, as the paper takes a comparative approach by analyzing the SME sectors of both developed and developing economies, it enables to pinpoint the current and major developments in both of these contexts, together with the advantageous and problematic areas. Within the course of the paper, variances about the understanding of the “SME” concept in different contexts and the role of SMEs in economic growth is reviewed in the first section while the second part discusses the role of small and medium sized businesses in Turkish economy. In the third section major factors limiting the growth of the small and medium enterprises in Turkey are discussed and section four concludes.

2. International context of SMEs

Researchers argue that over 30 different SME categorizations exist in the literature. (Sannajust, 2014). While this is the case, SMEs are “generally regarded as enterprises with a relatively small share of the market, managed by owners or part-owners in a personalized way, and not through the medium of a formalized management structure; and acting as separate entities, in the sense of not forming part of large enterprise or group” (Storey, 1994). Whether an enterprise is an SME or not therefore can significantly differ from one context to another, sometimes even varying between institutions of the same country (Özdemir, et.al, 2011), which is discussed to result from “the differences among industries and among level of development of countries” (Yurtadur and Kaya, 2012).

In SME literature, having a small market share and being independent were addressed as main features of small and medium sized companies (Storey, 1994; Bolton Commette Report, 1971). In categorizing of small and medium sized companies, qualitative and quantitative factors are generally used together (Nguyen,2001). As a major quantitative factor, employee number is commonly used on a global basis, which also helps to facilitate cross-country SME analyses. As OECD reports have stated, “employment of fewer than a given number of employees, which varies across countries” (OECD, 2004) is a major discriminator of these businesses from their larger sized competitors. Throughout Eurozone, Turkey and several other countries, the upper limit of employees for being accepted an an SME is currently 250, while in US and Canada, this number is officially set as 500 (OECD, 2010). In Japan and US, small and medium sized businesses are also categorized differently according to their industries, in terms of employee numbers, capital and annual sales figures (SBA, 2014, Chusho Meti, 2013). In Japan, the upper limits for manufacturing, construction and transportation industries are set as 300 million JPY for capital and 300 for the employee number, whereas for service industries the upper limit for capital is 50 million JPY and workforce limit is 100 employees (Chusho Meti, 2014).

In UK, the criteria for being a small or medium sized enterprise are stated in sections 382 and 465 of the Companies Act 2006. The act defines an SME as “one that has a turnover of not more than £6.5 million, a balance sheet total of not more than £3.26 million and not more than 50 employees”, where “a medium-sized company has a turnover of not more than £25.9 million, a balance sheet total of not more than £12.9 million and not more than 250 employees” (Ervine, 2013). Despite that, the general practice is defining the small businesses with employees between 0-49, a medium-sized business with employees between 50-249, and a large business with employees equal to or over 250. Therefore, small and medium-sized enterprises are broadly defined as enterprises with 0-249 employees.

In the SME definition of European Union (EU) enforced on 1 January 2005 (OECD, 2005) an “independence” dimension, together with the criteria of annual turnover and number of employees are stated, where an independent SME is described as “the one where 25% or more of the enterprise’s capital (or equity) is not undertaken by an enterprise or that its capital is not owned by enterprises that are not defined as SMEs” (Yurtadur and Kaya, 2012). For the enterprises that comply with the independence criterion, the quantitative factors which determine whether a company is an SME or not are,employee number and sales turnover or balance sheet total, as illustrated in Table 1.

Table 1. Quantitative categorization of SMEs in European Union

Company categories	Number of employees	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ EUR 50 million		≤ EUR 43 million
Small	< 50	≤ EUR10 million		≤ EUR 10 million
Micro	< 10	≤ EUR 2 million		≤ EUR 2 million

Source: Muller, et.al, 2014.

In Turkey, the final code determining the categorization of small and medium sized businesses was enforced on 04.11.2012, rising the ceiling of annual sales turnover and employee number criteria, thus further increasing the SME sector share in the economy. The three groups of micro, small and medium sized enterprises with respect to their employee numbers and annual revenues, are presented in Table 2.

Table 2. SME categorization in Turkey

Company category	Number of employees	Annual turnover*
Medium-sized	< 250	≤ USD 17.200.000
Small	< 50	≤ USD 3.400.000
Micro	< 10	≤ USD 430.000

Source: OECD Scoreboard, 2014, * Converted from TL to USD with the exchange rate of Central Bank of Turkey as of 12/15/2014.

Besides various SME categorizations across different contexts, another important limitation in small and medium sized company research is using only formal SME statistics. Particularly in developing countries, informal small and medium sized business sector often exceeds the formal one multiple times. According to International Finance Corporation (IFC) reports, informal SMEs in India are 17 times more than the total of formal SMEs. This problem does not only exist in developing economies but is also evident in advanced ones as well. Business statistics of UK revealed that there were an estimated 2,740,000 unregistered businesses as of 2013, representing 56.0 percent of all private sector businesses (UK Department for Business Innovation and Skills, Statistical Release, 2013).

SMEs and entrepreneurship are accepted as “a key source of dynamism, innovation and flexibility in advanced industrialized countries, as well as in emerging and developing economies” (OECD, 2006). The role of SME’s in social and economic development has been “widely recognized in developed countries as well as developing economies” (OECD,2006), particularly after 1980’s. SMEs account for over 50% of GDP in high income economies (Ayyagari, et.al, 2007) and two-third of total employees in OECD members and emerging market economies (Stein, et.al, 2013; Ardic, et.al, 2012). SMEs are also called as the “backbone of the European economy” as they constitute 98% of all enterprises (20.7 million businesses in total) within European Union region (EC, 2012).

As Ardiç, Mylenko and Saltane (2011) stated, SME development is “closely linked with growth”, in their referrals to Beck, et al. (2010) who found “a robust, positive relationship between the relative size of the SME sector and economic growth, even when controlling for other growth determinants” (Ardiç, et al., 2011; Beck, 2010). Apart from their positive impact on growth, SMEs also have significant socio-economic characteristics, such as contribution to new job creation and reduction of poverty.

Despite various support programs and measures taken for strenghtening the SME sector, small and medium sized enterprises still face serious challenges, in both in developing and developed economies. While some of these problems are structural in nature, other challenges can be attributed with the changes in the environmental contexts SMEs operate in.

In EU, significant amounts of grants and financial support are provided to SMEs, for protecting the flexible and innovative structures and competitiveness of SMEs. However, despite these supportive policies, statistical data shows that, SMEs in EU are still struggling to overcome the challenges of the crisis period between 2007-2009, which caused a sharp decline in SME number, employment and value added. While the number and employment provided by SMEs in EU did not show a recovery between 2009-2012, the value added of SMEs started to increase, which was the only positive indicator among three (Arı, 2013). Among the 27 member states of EU, only few countries presented signs of recovery within the post-crisis period. In terms of labour productivity, the highest recovery was undertaken by SMEs in industries of high-tech manufacturing and involved in high-tech knowledge intensive services.

The global financial crisis not only had a negative impact on EU member states, but caused a damage on every economy. In US, the number of SMEs and the workforce provided by SMEs incurred a sharp decline in 2008 and 2009, even more so than the SMEs in EU. In US, all size-classes of SMEs decreased in terms of number and employment in 2008 and 2009. However, the recovery of US SMEs was more robust than the SMEs in EU region. Among the three indicators of performance, the gross value added of SMEs showed the earliest signs of recovery, starting in 2009. The contribution of large corporations to the growth trend of US economy was also significant, taking the economy out of recession.

Apart from the post-crises syndromes of the recent global turmoil, SMEs possess major structural advantages and disadvantages, compared to their large sized competitors. Hallberg (2000) quoting Snodgrass and Biggs (1996) noted that, SME’s are “often viewed as being more innovative than larger firms”, as in both developed and developing economies, SMEs often follow “niche strategies”, taking actions towards high product quality, “adopting flexibility and responsiveness to customer needs as means of competing with large-scale mass producers” (Hallberg, 2000). Semerciöz and Sözüer (2012) argued that, the major advantages of small businesses with respect to their large-sized competitors are their close relations with their customers which enables them to react and meet the needs of their clients faster, together with their cost advantage resulting from their small number of employees and low fixed-costs.

However, both small and medium-sized enterprises possess several challenges particularly with respect to management

and finance (Çetin, et. al, 2011; Semerciöz and Sözüer, 2012). While insufficient access to finance, problems in using new technologies, lack of business-related training, inadequate managerial capabilities, high rate of taxes and other bureaucratic problems are reported as the most common problems of SMEs (Abdulsaleh and Worthington, 2013; Ardiç, et. al., 2011), Zimmerer and Scarborough (2005) advocated “managerial mistakes, failure to develop a strategic plan and poor financial control” among the most important reasons of business failures in small businesses, ranking “poor management” as the primary cause.

3. The role of SMEs in Turkish macroeconomic context

Turkey is a “large, upper middle-income country, with relatively few natural sources” (Karpak and Topçu, 2010), and is the world's 16th and Europe's 6th largest economy as of 2011 (KOSGEB, 2012). Turkish economy is mostly dependent on manufacturing, construction and tourism revenues. Top industries of the country are textiles, food processing, autos and electronics. (Naqellari and Qurku, 2014)

After the serious political struggles and the military coups in 1960, 1971 and 1980 on the way to becoming a modern democracy, Turkish economy was transformed from import-substitution to an export-oriented market economy. During the transition period, government authorities targeted to increase the role of private sector by reducing the government involvement and the share of public sector in the economy (Ercel, 2006). This shift from “mixed capitalism” to a “free market economy” was marked by the announcements coming from the government publicly known as “24 January 1980” decisions, which aimed to make the Turkish economy more competitive in international markets. Following that, Turkish economy, particularly export volumes, grew at substantial rates (5.8 percent between 1981 and 1988, averagely). Foreign trade volume, which was 7.33 billion USD in 1979, rose to 243 billion USD in 2009, while the proportion of imports covered by exports which was 44.6 % increased to 72.5% during the same time period (TURKSTAT, 2014).

Following that fast-paced expansion period, the economy was hit by severe macroeconomic turbulences in 1994, 2000 and 2001, which are argued to be caused by “currency substitution, open positions tendency in the banking system, the boom in demand through conjuncture”, but most importantly, “political instability” (Şakar, 2010). The crises periods resulted with huge outflow of funds, high rates of inflation and serious fall in GDP (Rodrik, 2009). After the final turbulence in 2001, in which the interest rates changed daily and reached to incredible heights of 1500% p.a., Turkish authorities were forced to take serious macroeconomic measures, including a new monetary policy to be implemented by an independent central bank with the objectives of lowering hyperinflation, declining public-debt-to-GDP ratio, restructuring banks' balance sheets and tightening the supervision of the monetary system (Rodrik, 2009).

The outcomes of the restructuring macroeconomic program were significantly positive, as the economy once more enjoyed a high and steady growth in GDP while the inflation and interest rates continued to decrease together with rising export and tourism incomes. Between 2002-2007, the average growth rate of Turkey was 6,0%, which is regarded as “one of the highest sustained rates of growth in the world” (MSU, 2013), as shown in Figure 3.

As Table 3 illustrates, while the global economic turmoil of 2008 caused the country's growth rate to fall to 0.7% in 2008 and to -4.8% in 2009, the growth rate again rose to 9.2 % in 2010 and to 8.8% in 2011, reaching to a highest among OECD countries. Mainly as a result of this growth trend, Turkey is regarded as a potential “regional and global business hub” for the coming decades. However, as the economic growth is heavily dependent on external energy sources, current account deficit in the balance of payments constitutes the most important factor causing the fragility of the economy.

On the global context, rankings of Turkey are:

- The 16th place for the size of GDP (PPP)
- The 90th place for the GDP / capita (PPP)
- The first place in the production of nuts, fruits, and dried cherries (figs, raisins, apricots)
- The 6th place in the production of cement,
- The 2nd place in the production of glass wool,
- The 2nd place in the export of jewelry
- The 6th place in the export of clothing

Compared with EU member states, Turkish economy has:

- The first place in the production of television sets,
- The 4th place in the production of parts for automobiles,
- The first place in the production of fertilizers,
- The 3rd place in the production of steel,

- The 3rd place in ceramics products,
- The 6th place in the fabrication of refrigerators,
- The 4th place in telecommunications market,
- The 3rd place in the production of yachts,
- The 8th place in ship production (Naqellari and Qurku, 2014)

Table 3. Turkey's macroeconomic indicators between 2008-2012

BASIC	2008	2009	2010	2011	2012
MACROECONOMIC INDICATORS					
GDP (000 000 \$)	742.094	616.703	734.929	766.400	789.300
GDP per capita (\$)	10.438	8.559	10.067	10.363	8.462
Exports (billion \$)	132	102	113	134	153
Imports (billion \$)	201	140	185	240	237
Unemployment Rate	11	14	11,9	10,5	9,2
Inflation	10,1	6,5	6,4	7,8	6,16
Growth	0,7	-4,8	9,2	8,8	4,1

Source: KOSGEB, 2013; Worldbank, 2012.

Despite the remarkable growth trend and a young workforce, Turkey has a considerable public and private sector debt ratio and a high current account deficit, thus, Turkish economy is considered as “strong and vulnerable” by many economists. Within this turbulent and fragile economic context, Turkish SMEs “play a particular role in Turkish economy because of their number and because of the large share of the workforce involved” (OECD,2004). SMEs are the most significant tools for economic development, gross domestic product and workforce in Turkey (Nurrachmi, et.al, 2012).

As of 2009, there are 2,295,554 small and medium-sized enterprises in Turkey and the SMEs are dominated by the micro enterprises with less than 10 employees (OECD, 2014a).

Table 4. Distribution of firms in Turkey (2009)

Company categories	Number of firms	%
All enterprises	2.294.554	100
SMEs	2.291.904	99.9
Medium	12.338	0.5
Small	20.504	0.9
Micro	2.259.062	98.5

Source: OECD Scoreboard, (2014a).

SMEs are considered to be the backbone of Turkish economy, which is reflected by their percentage shares in major indicators of the economic development. Despite the negativities caused by the 2008 global financial crisis, 2009 and 2010 statistics indicate that the growth trend in terms of number and significance of SMEs is back. The percentage of SME share in total value added in the economy, rose from 55% to 65% between 2009 and 2010, while the share in total exports increased to 60% from 56%, as shown in Table 5 (KOSGEB, 2012).

Table 5. SME sector share in Turkish economy (2010)

Macroeconomic factor	% share
Workforce	78
Value-added	55
Investments	50
Exports	56

Source: TOBB, The Union of Turkish Chambers and Exchange Commodities, 2014.

According to findings of the most recent survey of KOSGEB, the formal authority for SMEs in Turkey, 78% of the total workforce of Turkish SMEs is comprised of males (KOSGEB, 2012), illustrating a huge gender gap within SME employees. In this research, 69% of all SMEs were found to be managed by their owners, and 36% of the owners of SMEs had a primary or middle-level education while 29% are high-school and 28% were university graduates. Median age of SME owners in Turkey was 41, and 81% of SME owners were below the age of 50 (KOSGEB, 2012).

4. Factors hindering growth of SMEs in Turkey

Despite the problems experienced in the implementation of governmental support policies, the number of SMEs in Turkey rose between 2002-2009, from 1.720.598 (Özdemir, et. al, 2012) to 2.294.554 (OECD, 2014a). Macroeconomic

developments such as the reduction of fluctuation of the domestic currency, lowering of the hyperinflation and record breaking interest rates and implementation of export-oriented policies hugely contributed to the rise in the number of existing and new small and medium sized businesses, as the recent phenomenon of entrepreneurship became a major driving force in the economy.

Major challenges experienced by SMEs in Turkey stated in the literature are as follows:

Innovation and technology: Insufficient know-how and low levels of technology are common in most Turkish SMEs. A majority (89%) of manufacturers operate in medium-low and low level industry sectors, which prevent them from benefiting low cost advantage. Lack of innovativeness, due to high costs of R&D, is a major cause for the unsatisfactory levels of modern technologies of SMEs. Smaller sized businesses are faced with various challenges when conducting R&D projects and realizing high tech business ideas which can be turned into business opportunities. Funding challenges limit industry -university cooperation. Despite the positive trend of SMEs which undertake R&D activities, the share of SME sector in total R&D costs is still around 40% (KOSGEB,2012).

Financial limitations: The obstacles related with financing of SME differ according to the development level of economies. Results of a survey conducted in over 100 countries revealed that, while SMEs in OECD countries do not face any serious problems in obtaining loans from external sources, most non-OECD economies, by contrast, report “a widespread shortage of small business finance” (OECD, 2006). The challenges of small and medium sized business related to financial resources, which is represented by their low share of credit utilization and are reported mostly by the officials in developing and emerging economies, is in contrast with the large share of SMEs in total number of enterprises, workforce and output. The low credit utilization of small businesses is often regarded to be closely linked to the financial management problems and “informality” issues, as most small business owners do not wish to be transparent in their regulatory, taxation and financial transactions, thus “operate outside the formal system” (OECD,2006). Reports indicate that, most external financing problems of SMEs are caused by the insufficient range of products and services in domestic financial markets and challenges in borrower/lender relationships as a result of asymmetric information, monitoring, transparency and collateral problems (OECD, 2004).

In Turkey, collateral, personal and financial statement-related problems and low levels of equity reportedly cause SME credits to remain at a low levels of around 23-25%, which are important factors behind the low technological capacity and out-of-date production facilities. Alternate sources of finance such as angel investors, credit guarantee funds and venture capital companies are insufficient and most of the time, inaccessible for small businesses.

Internationalization issues: Limited information about foreign market opportunities, financing alternatives and international trading techniques, low levels of competitiveness in products and services rendered and insufficient sources of financing cause many SMEs to target the domestic market.

Entrepreneurship: With its young demographic structure, Turkey has a significant but unutilized potential for entrepreneurship. The refraining from launching a new business usually stems from lack of technical knowledge about preparing business plans and difficulties in finding the start up capital needed to cover the high costs of launching a new venture, thus entrepreneurship is generally regarded as a desired but challenging route for young novice entrepreneur candidates.

Start up costs and bureaucratic problems: The complexity and costs of bureaucratic transactions and associated with launching a new business are also among the major challenges of small and medium sized businesses in Turkey. While significant developments have been made regarding the attainment of a more SME-friendly business climate and “simplified legislative procedures” in many countries, reduction of red-tape is still an important issue for new venture launches and encouragement of entrepreneurship.

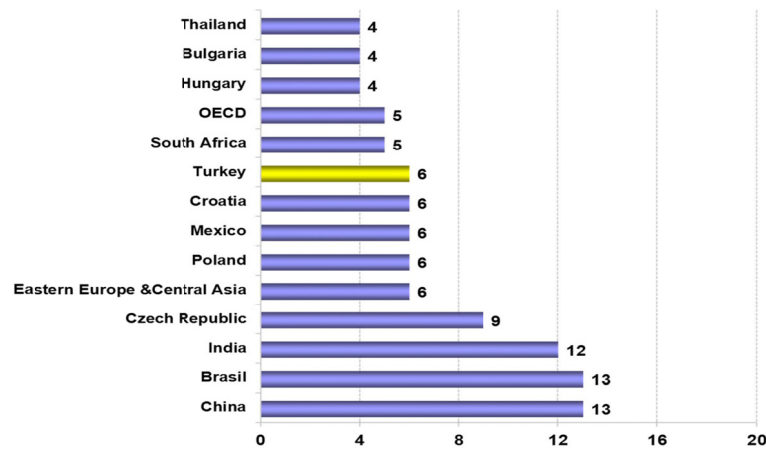


Figure 1. Number of procedures in starting a business

Source: Undersecretariat of Treasury, Republic of Turkey, 2014

Turkey is ranked as the 63rd in the “World Bank Doing Business Report” in terms of ease of starting a business, in 2012. Figure 1 and 2 illustrate a cross-country comparison of related bureaucratic procedures and the approximate cost of founding a new venture, with regard to other developing economies. While duration and number of transactions are positive for Turkish entrepreneurs, cost of launching a new business in Turkey is among the highest, causing a significant negativity.

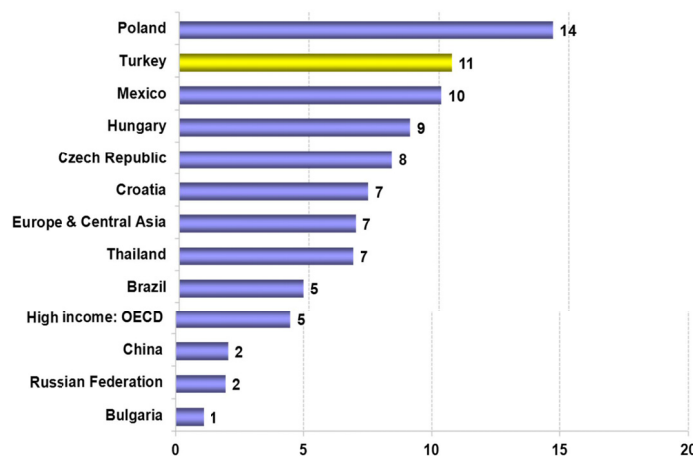


Figure 2. Cost of starting a business (% of GDP per capita)

Source: Undersecretariat of Treasury, Republic of Turkey, 2014

Green technologies: In Turkey, as in most parts of the world, demand for environmentally-friendly products and services is increasing. However, the complexity of environmental legislation and the height of costs to comply with related regulations can discourage SME owners and entrepreneurs from realizing existing opportunities.

Labor: High percentage of social security premiums raise the cost of skilled labor in Turkey, in comparison to other developing economies. This, combined with low levels of education and technical capabilities of employees, create a major disadvantage for improving competitiveness of SMEs.

Information and communication technologies: Educational and technological limitations cause Turkish SMEs to experience serious problems in utilizing higher levels of information and communication technologies.

5. Conclusion

Albeit recently appreciated, the significant role of small and medium sized businesses in the economy is a worldwide phenomenon. In Turkey, SME sector is acknowledged as one of the major drivers of the high growth Turkish economy. However, growth is challenging and there are many obstacles SMEs in Turkey are facing, such as financial resource problems, qualified human resources and low levels of technology. As literature states, there is a still a lack of research in the areas of small and medium businesses and entrepreneurship in emerging and developing economies. Thus, despite the

difficulties in accessing formal reliable and up-to-date sectoral databases regarding SMEs in these contexts, further conceptual and empirical studies are needed. As for policy implications, increasing the performance and enhancing the competitiveness of SMEs are within the core of most developmental macro economic policies both worldwide and in Turkey, causing an increase in the support of government for strengthening the critical position of SMEs in the economy as the largest providers of GDP growth and workforce. However, to date, as financial concerns of SMEs are regarded to dominate other and several challenges of SMEs, these support programs have mainly targeted financial resource constraints and provision of sufficient funds with lower costs and less collateral. However, while financial resources are vital, increasing managerial capability of SME owner/managers, as well as other factors addressed in this paper have to be taken into consideration, as unless the overall management skills and understanding of the SME owners and entrepreneurs and the environment that SMEs operate in are improved, the low cost funds provided by governmental bodies such as KOSGEB, would not be efficiently utilized. This clearly indicates the importance of entrepreneurial and small business management education in colleges, universities and in other providers with a broader coverage of the basic managerial skills related with major functional areas such as human resources, finance and marketing, apart from focusing only on “finding ways of financing” for new and existing business ventures, together with the continuation of efforts in facilitation of new venture creations.

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