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## CHALLENGES OF SMALL ENTERPRISES IN TODAY'S GLOBAL ECONOMY

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**Abstract.** The recent economic crises left many SMEs bankrupt while most of the multinational companies survived from tax payer's money that was pumped into the economy by governments of different countries in the EU, the US and other parts of the world. The fact that SMEs provide about 99% all European businesses greatly contributing to entrepreneurship and innovation seemed to have been neglected during the 2008 crises as governments were mainly concerned in bailing out multinational companies. The essence of this paper is therefore to investigate the challenges that small enterprises are facing in today's global economy. The author has focused the research in SMEs in the EU and has identified the factors that could hinder the progress and success of these companies. A summary of these factors are portrayed in a tabularised form. The survey was conducted through relevant materials including journals, magazines, the internet etc. As the SMEs in the EU are divided into three categories, the findings show that all the categories of companies examined face almost the same risks when operating during the business life cycle. However, the micro companies suffer the most during economic crises. After thorough analysis, recommendations were given where certain strategies have to be applied by using management tools.

**Keywords:** insolvency, micro-environment, factors of challenges, management tools, bootstrapping, competitive advantage.

**Jel:** M10

### 1. Introduction

Small Enterprises face many challenges in today's global economy which seems to be dominated by large multinational organizations. The business environment which is divided into the micro-environment and macro-environment is very critical as it determines the decision and success of an enterprise (Besanko *et.al* 2007). Due to the limitations of this paper, the author will be examining the micro-environment into more details as well as other factors including insolvencies and the competition in the EU.

The author has mainly used a qualitative research method by exploiting relevant literatures as well as the author's professional experience as a lecturer in Business Management and Innovation to fulfil this task. On the other hand, quantitative secondary resources were also exploited to portray insolvencies in the EU between 2006 and 2010.

The objective of the research is to identify the challenges facing small enterprises and to generate valuable recommendations that would help these enterprises to gain competitive advantages and overcome the challenges they face.

Before examining the micro environment, it is vital to define and understand the categories into which the enterprises fall. According to the European Commission, 'Recommendation 2003/361/EC' regarding the SME definition was approved on the 6<sup>th</sup> May 2003. This states that, there are basically three categories of enterprises in the EU, medium-sized, small and micro enterprises. The medium-sized has a headcount ceiling of 250 staff with a turnover equal and less than 50 million Euros or a balance sheet total up to 43 million Euros.

Small enterprises fall far below that of the medium-sized with a headcount ceiling less than 50 staff, a turnover less than and equal to 10 million Euros or a Balance sheet total up to 10 million Euros.

The smallest enterprises is the micro with a headcount ceiling less than 10 staff, a turnover less than and equal to 10 million or a Balance sheet total of up to 2 million Euros. The summary of the three categories is shown in table 1.

**Table 1.** Enterprises Categories in the EU: (Source: European Commission Enterprise and Industry)

Enterprise category	Headcount	Turnover	Balance sheet total
Medium-sized	<250	≤ € 50 million	≤ € 43 million
Small	<50	≤ € 10 million	≤ € 10 million
Micro	<10	≤ € 2 million	≤ € 2 million

The EU and national legislation clearly understand the difficulties the SMEs are undergoing, and have therefore provided grants like subsidies giving them some form of competitive advantages.

The importance of SMEs could not be avoided as in the early and mid 2000s, small and medium enterprises (SMEs) contributed in a large scale to job creation in the European Union and even today, SMEs hold more than 99% of all European businesses greatly contributing to entrepreneurship and innovation. To make it more precise SMEs provide 23 million businesses accounting for more than 90 million jobs in the EU.

Nonetheless, it is quite common for it to be assessed that the global economy is dominated by large multinational enterprises with billion of Euros turnover. The recent economic crisis and its impact on businesses did not only dominate the world news but also created the impression that multinational enterprises are the sole players in the global economy. The reality is that SMEs suffered the most as over three million jobs were lost between 2009 and 2010 in the European Union. Hence, it is quite evident that SMEs are too vulnerable to economic crises which also led to the bankruptcies of many SMEs.

## 2. Insolvencies

‘When a business becomes insolvent, it does not have enough cash to meet its interest and principal payments’ (Brigham, Houston 2004). There is no doubt that small businesses suffered the most in times of crises. This statement could be supported by a survey conducted by the Creditreform Economic Research Unit-2010. This survey shows that the total number of insolvencies in the private sector of Western Europe has been on the increase since 2006. Table 2 below shows the insolvencies in Europe between 2006 and 2010.

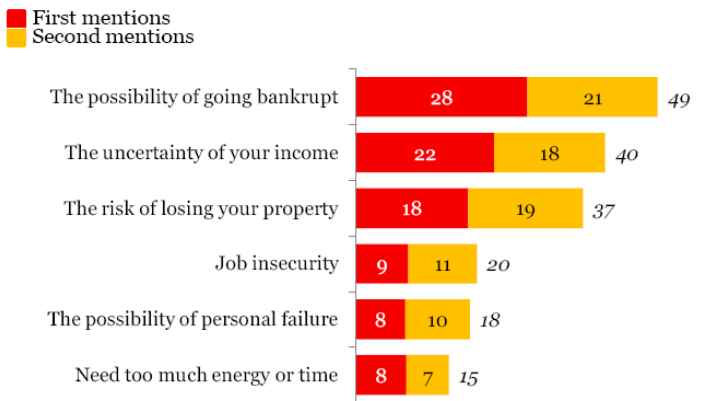
**Table 2.** Private Insolvencies in Europe (Source: Creditreform Insolvencies in Europe, page 9, 2010/11)

	2010	2009	2008	2007	2006	Change 2009/10 in percentage
Austria	10,296	10,245	9,516	8,616	7,583	+0.5
Finland*)	3,040	2,854	2,851	3,038	3,708	+6.5
France*)	44,360	41,045	33,378	27,959	24,190	+8.1
Germany	139,800	129,940	126,330	135,600	127,280	+7.6
Netherlands*)	10,450	8,966	9,206	14,947	14,928	+16.6

Spain	910	995	404	114	52	-8.5
Sweden*)	7,860	6,589	6,528	6,831	3,830	+19.3
Switzerland	5,719	5,691	6,007	6,140	5,840	+0.5
United Kingdom	162,460	159,641	127,241	120,775	120,926	+1.8
<b>Total</b>	<b>384,895</b>	<b>365,966</b>	<b>321,506</b>	<b>324,020</b>	<b>308,337</b>	<b>+5.2</b>

\*) Debt relief plan/restructuring process

The results from the survey given in table 1 show a steady increase in insolvencies from 2006 to 2010. This is a concern to entrepreneurs and potential private business people and that is confirmed in another research findings by the European Commission in 2009 which states that (paraphrasing) the greatest risk that entrepreneurs fear when they consider starting a new business in Europe, is going bankrupt. Figure 1 below shows a summary of the research.



**Q14. If you were to set up a business today, which are the two risks you would be most afraid of? Is it:**  
Base: all respondents, EU27

**Fig. 1.** Greatest risks entrepreneurs fear when starting up a business – EU 27 (Source: Flash Eurobarometer 283, May 2010)

Consequently, insolvencies and the fear of getting bankrupt by entrepreneurs are challenges that need to be dealt with.

### 3. Micro-environment

The internal factors that are very close and have direct impact on the strategy of a company are known as micro environmental factors (Oxford University Press 2007; Marks, Samuelson 2003; Bettley 2006). These factors include the suppliers, distributors, competitors, customers, employees and media that companies have regular dealings with and a brief description is given below.

#### *Suppliers:*

Without a close supplier relationship the enterprise would have difficulties receiving its raw materials and other necessary items for its business to function. For example, increasing production means there has to be an increase in raw materials which should be delivered at an appropriate time. Should in case the suppliers fail to deliver on time or are short of suppliers, this would affect the productivity of the enterprise and that could result in the enterprise falling short off its target.

#### *Distributors:*

This is the channel through which the product reaches the consumers. If this channel is too long, then the profit of the enterprise could be affected negatively.

Generally, the enterprise has to make its channel-design decision especially when it branches into new markets. This decision is greatly affected by the size of the market. For example, the enterprise might sell directly to the retailers in smaller markets, but needs to sell through distributors in larger markets (Kotler 2003).

#### *Competitors:*

Companies operating in the same or similar industries that are dealing with similar products or services are known as competitors. The increase in competitors in a particular industry can yield to a reduction in prices due to the scramble for larger market share. If an enterprise fails to analyse and monitor its competitors' activities, it might also fail to sustain or enhance its position within the market (Best 2001; Chakravorti 2010; Hamel, Prahalad 1990).

It is therefore important for small businesses to adapt appropriate strategies in order to reduce cost and gain larger market shares as this would lead to competitive advantages over their rivals.

#### *Customers:*

Customers are the people who usually buy goods and services but the people who consume the goods and services are the consumers (Pickton, Broderick 2005). To elaborate on the customers and consumers, it is necessary for businesses to be able to influence the deciders, buyers and influencers when it comes to marketing their product or services. For example, a child can influence the parent to buy a particular toy. The

parents are the deciders and the buyers or customer in this case while the child is the consumer.

Hence, if an enterprise fails to identify the customers and consumers demand, it might be running out of business with a failed strategy.

#### *Employees:*

Every organization needs employees to fulfil its tasks and goals. Employment planning is one of the key issues the enterprise faces and it is defined as ‘the process by which management ensures it has the right number and kinds of people in the right places at the right time, who are capable of helping the organization achieve its goals’(Robbins, DeCenzo 2005). Employment planning is an integral part of a firm’s strategic and HR planning process (Dessler 2003).

The planning process could be divided into two steps:

1. Conducting an employee assessment.
2. Determining future employee needs.

Conducting employee assessment is done by generating a human resource inventory which is not difficult in most organizations as potential employees have to fill in forms containing their names, education, skills and other sensitive information. The other parts are the job analysis, description and specification.

Determining future employee needs, have to be determined and forecast by the top management according to their strategies. After an estimated number of employees have been defined, a program has to be developed that matches the estimates (Robbins, DeCenzo 2005).

This is quite a challenge for smaller enterprises when they start to grow as many of these enterprises lack the HR department which is quite expensive.

Another hindrance is when the labour market is experiencing labour shortages. This could be quite expensive for companies as they may have to recruit their potential employees abroad. A very good example could be seen in the construction companies in Latvia between 2006 and 2008. As many Latvian labourers migrated to Western Europe, the construction companies had to employ labourers from Bulgaria and Romania.

#### *Media*

Undoubtedly, the media is a major player to the positive or negative publicity of a business. Large multinational companies like Coca Cola spend millions of dollars dominating the media portraying positive images and sending appropriate messages to the customers resulting into a capture of a large percentage of the market share. ‘For organizations with small budgets operating in large markets, marketing communication

dominance is something they are not in a position to contemplate’ (Pickton, Broderick 2005). Unfortunately, small enterprises lack the financial resources to ‘push’ their images and messages intensively.

#### 4. Factors of challenges facing SMEs

The author has identified seven factors of challenges and the way they affect SMEs. These factors and their influences on SMEs have been tabularised in table 3 given below.

**Table 3.** Factors of challenges in SMEs (Source: The Author)

Factors of Challenges	Challenges facing SMEs		
	Small	Medium	Micro
Insolvency	High Risk of insolvency	High Risk of insolvency	High Risk of insolvency
Suppliers	Suppliers tend to supply better quality raw material to larger firms	Suppliers tend to supply better quality raw material to larger firms	Suppliers tend to supply better quality raw material to larger firms
Distributors	Inefficient distribution channel	Inefficient distribution channel	Difficulties getting direct sales to retailers
Competition	Larger firms tend to dominate the market	Larger firms tend to dominate the market	Larger firms dominate the market
Customers	Difficulties in influencing the	Difficulties in influencing the	Difficulties in influencing the deciders, buyers and influencers



	deciders, buyers and influencers	deciders, buyers and influencers	
Employees	Experienced employees being head-hunted by larger firms	Inadequate capabilities to attract skilled workers	Inadequate capabilities to attract skilled workers
Media	Large multinational companies dominate the media	Insufficient financial resources for marketing activities	Insufficient financial resources for marketing activities

According to the research results conducted by author, the challenges facing the three categories of enterprises from the given table above are quite similar except that of the distributors, employees and media.

Moreover, the author’s findings shows that all the categories of SMEs face a high risk of insolvency as a consequence of constraints in debt and equity as well as access to finance (Freel 2000). These constraints are due to the fact that in most cases, it is very demanding for SMEs to acquire long-term loans from banks and other financial institutions because of the increase in insolvencies between 2006 and 2010 as shown in table 1, resulting in the perception that SMEs have higher risk in insolvencies than multinational enterprises.

Another significant challenge the SMEs face is in trying to get close relationships with suppliers. This is quite complicating because the suppliers tend to supply better quality raw materials to larger firms or export them in order to increase their profit margins.

Distribution which is vital in the delivery of products and or services is of enormous importance and therefore appropriate strategies have to be addressed and developed by SMEs, according to their competencies, in order to breakthrough.

It is certain that small and medium companies lack efficient distribution channel to supply their products to more customers which is a hindrance to their profitability as the more buyers they have the better chance for them to increase sales and more important, the risk is spread among the multiple channels.

Without doubt, the Competition is being dominated by larger firms with better financial resources and capabilities. These multinational companies actually rule the market with their strong marketing promotions on TV and other effective media channels. As a result, the SMEs could not push their messages and images into the market effectively, as they lack the strengths and resources to compete with these larger firms.

Dealing with the customers in today's competitive economy is very challenging as many customers are price sensitive and search for discounts and better deals. Large firms are able to push the price down gaining competitive advantage and placing the SMEs out of balance as they could not compete because of high operational costs. Consequently, SMEs will find their customers switching over to the stronger competitors.

Many experienced employees have a propensity for jobs in larger firms because of higher salaries, better facilities and benefits offered by these large multinational organisations. On the other hand, highly skilled employees from smaller enterprises are being headhunted by job agencies leaving the SMEs to struggle in looking for and hiring skilled workers.

As already discussed earlier, effective media channels are dominated by larger firms and SMEs are deficient in financial resources to muddle through.

## **5. Recommendations**

The US governments and some governments in the EU like the UK and Germany actually pumped in billions of tax payers' money into large financial institutions and multinational companies to save them from getting bankrupt during the financial crises of 2008.

Unfortunately many SMEs were left to struggle and most of them got bankrupt as they lacked long-term loans in the form of debt and equity and had negative cash flow.

The author is therefore recommending that SMEs should practice and implement a 'Bootstrapping strategy' where they have to lower costs drastically and grow only on profits. This can only be achieved through leadership and training the staff in cost cutting procedures. Although there are some drawbacks like slow to capture an opportunity as the budget is limited, the advantages outweigh the drawbacks by far as the SMEs will still be able to manage positive cash flows even during economic recessions. The bootstrapping strategy is elaborated in the proceeding stages of this recommendation.

Researches and case studies have shown that getting only one supplier is a critical mistake made by many SMEs. It would therefore be to the advantages of the SMEs if they could have at least three suppliers as they would be able to play one against another in bargaining for prices. Hence, according to one of the Five Forces Model of

Porter (Porter 1980; Hill, Jones 2004), SMEs will have a high bargaining power that will push down the prices of the competitors. However, there is a dilemma here as suppliers tend to supply better quality raw material to larger firms. In this case, building close relationships with the suppliers by social means etc should be high on the agenda.

There are basically three types of distribution strategies (Kotler, 2003), namely the exclusive, intensive and selective.

I. The Exclusive distribution appoints only one intermediary distributor in the territory. The advantage is that it promotes dealers loyalty and maximizes control, but on the other hand it is only appropriate for high price and low volume products.

II. The Intensive distribution has many intermediaries as possible. This is characterised by broader customer recognition and sales increase. However, it is difficult to control huge quantity of distributors.

III. The Selective distribution hires many intermediaries but not all. This has a lower cost and better control than the intensive distribution, and its market coverage is much better than that of the exclusive distribution. On the other hand, hiring the appropriate distributors to meet with the SMEs requirements is a complicating task.

Figure 2 below, shows an example of a channel of distribution in accordance with the author’s findings.

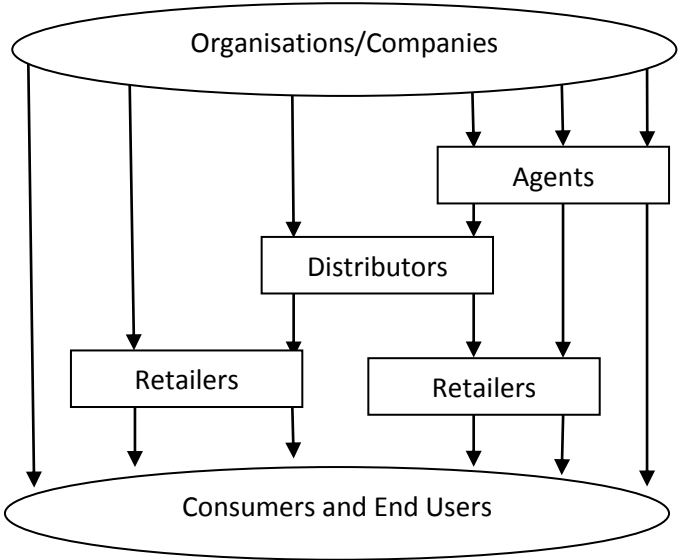


Fig. 2. Channel of Distribution (Source: The Author)

From the figure above, a company could adopt any of the channels according to its strategies. Having a long distribution channel going through the agents, distributors, retailers before getting to the consumers and end users is lengthy and by the time the product reaches the end user, the cost would have increased and it is obvious that the product reaches the end consumer at a slower pace.

SMEs would be in a disadvantage if they have a long channel distribution as they have lower volume of products and limited financial resources compared to larger companies.

From the above distribution channels, after careful examination, the author is recommending the Selective Distribution for SMEs to implement. This would lead to lower cost and augmented market share as the retailers are limited to two or three and the company will be contacting a certain percentage of the end-users directly through the internet website and direct mail shots. Furthermore, there will be less control problems because of the limited number of channels.

Most SMEs struggle with the competition as they lack the financial support and in some cases the capabilities to compete with large multinational enterprises that dominate the market. In order to succeed management tools like SWOT analysis (Hodgetts, Rugman 2003; Kulikova, 2010) and Porters Five Forces Model should be applied as they would yield to an increase in competitive advantage. In the SWOT analysis, SMEs should be able to convert their weaknesses into strengths and threats into opportunities while at the same time diligently exploiting their strengths and opportunities (Porter 1998a, b).

Porter reflected on the increased competition, lower barriers to entry (Kassalis 2010), large number of substitutes, and increased bargaining power of customers as being a threat to the survival and sustainability of enterprises. As a result, by utilising this management tool, SMEs would be able to analyse the major competitive forces in a market and evaluate the strength and importance of each one (Wickham 2004) as this would put them on a path to fulfil their mission and goals through competitive advantage and at the same time embracing the 'Bootstrapping strategy' as elaborated earlier.

Employing and retaining highly experienced employees is not an easy task for SMEs as many employees leave for better paid salaries and facilities to multinational companies after gaining three or more years experiences in a particular field.

The author recommends that SMEs should encourage their employees to buy shares as this would not only increase their loyalties but they will be also highly motivated as they perceive themselves as shareholders.

Should in case an enterprise does not favour the idea of selling shares to the employees, then a culture has to be developed where enticement motivational strategy is

practised by giving compensation for high performance and promising rewards for innovative and creative ideas.

As the media, especially the TV and radio, is already dominated by large multinational organizations, trying to compete through these channels is extravagant and most SMEs lack the financial resources to even attempt it.

However, a simple and good marketing strategy should be structured where a USP (Unique Selling Point) should be developed by exploiting the strengths and opportunities in the SWOT analysis of the company. Getting a great USP is important as this will tell the potential customers why the company's product or service is unique, relevant and valuable to them as this will be the main reason why a company's product or service would be chosen over its competitors.

A low-cost promotional strategy should then be utilised to transmit the USP message into the marketplace. A combination of all or some of the promotion methods given in bullet point below should be exploited in order to convey the USP message to the customers and consumers.

- Word of mouth
- Free newsletters
- Handouts (flyers)
- Direct mail ads
- Internet Website
- Personal selling
- Point of sale ads
- Giveaway items
- Press releases
- Newspaper ads

From the above methods of promotions, the Word of Mouth is the most powerful method as the information (USP) transmitted is created and controlled by the company.

The USP backed by a well written recommendation from people with experiences with the company, product or service should then be shot out through free newsletters, flyers and direct mails while at the same time being advertised on a local internet website.

The next move is to employ sales people to conduct personal sales with their salary and or commission depending on the volume of sales. Point of sales ads and or giveaway items come next which would be backed up by a press release passing on positive information about the company, product or service to the public.

The news paper ads should only be implemented if there is enough financial revenue especially for new businesses.

## 6. Conclusions

The author has analysed the challenges faced by SMEs in today's global economy with reference to SMEs in the EU and also given recommendations to these challenges.

Three categories of companies, according to the European Commission, 'Recommendation 2003/361/EC' namely, medium-sized, small and micro companies were examined. In addition, the author identified seven factors of challenges facing SMEs and these include insolvency, suppliers, distributors, competition, customers, employees and the media. These factors and the effect they have on SMEs were then scrutinized and as a result, the author discovered that they are all of equal importance. Therefore, SMEs have to pay attention and treat them equally in order to survive the competition especially in times of economic crisis.

According to the findings, the three categories of companies examined all face almost the same risks when operating during the business life cycle. The main concern, however, is managing micro businesses during economic recessions as they are very vulnerable to insolvencies and it is also difficult for them to acquire long-term loans in the form of debt and equity. Nevertheless, this can be avoided if micro companies as well as medium-sized and small companies practise and implement Bootstrapping Strategy including the effective means of distribution and marketing etc. as given in the recommendation.

Finally, as the factors identified are just a part of the challenges facing small enterprises, it is necessary to investigate the macro-environment and its effect on SMEs as it also plays an important role in determining the decision and success of an enterprise.

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## MAŽŲ ĮMONIŲ PROBLEMOS GLOBALIOS EKONOMIKOS SĄLYGOMIS

**P. Mensah**

Santrauka

Pastarųjų metų ekonominė krizė lėmė daugelio smulkių ir vidutinių įmonių (SVĮ) bankrotą. Tuo tarpu dauguma multinacionalinių kompanijų, remiamos mokesčių mokėtojų lėšomis, kurias nukreipė ES, JAV ir kitų šalių vyriausybės, išliko. SVĮ sudaro apie 99% viso Europos verslo ir didele dalimi prisideda plėtojant verslininkystę ir inovacijas. Tačiau 2008 m. vykusios krizės metu šis faktas buvo beveik ignoruojamas, kadangi šalių vyriausybės daugiausia dėmesio skyrė multinacionalinių kompanijų gelbėjimui. Šio straipsnio tikslas yra išanalizuoti SVĮ problemas, su kuriomis įmonės susiduria globalios ekonomikos sąlygomis. Straipsnio autorius tiria ES šalių SVĮ ir identifikuoja veiksnius, kurie gali riboti šių įmonių progresą ir sėkmę. Šie veiksniai yra apibendrinami lentelėje. Tyrimas atliktas remiantis mokslinių straipsnių, žurnalų ir internetinių šaltinių pateikiama informacija. Kadangi ES šalyse SVĮ yra grupuojamos į tris kategorijas, gauti rezultatai rodo, jog visoms kategorijoms priskiriamos įmonės susiduria su panašia rizika verslo ciklo etapuose. Kita vertus, mikro įmonės labiausiai veikia ekonominė krizė. Atlikta analizė leidžia pateikti rekomendacijas, įgalinančias taikyti tinkamas strategijas bei taikyti tinkamus vadybinius metodus.

**Reikšminiai žodžiai:** nemokumas, mikroaplinka, iššūkių veiksniai, vadybos metodai, konkurencinis pranašumas

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