The Study of an Operational Definition for Micro, Small and Medium Sized Enterprises in Egypt

George Lerchs

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## Table of Contents

<table>
<thead>
<tr>
<th>Page</th>
<th>Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Executive Summary</td>
</tr>
<tr>
<td>4</td>
<td>Purpose: Why a definition is needed</td>
</tr>
<tr>
<td>5</td>
<td>Characteristics of Useful Definitions</td>
</tr>
<tr>
<td>6</td>
<td>International Experiences with SME definitions</td>
</tr>
<tr>
<td></td>
<td>Canada</td>
</tr>
<tr>
<td>11</td>
<td>United States</td>
</tr>
<tr>
<td>14</td>
<td>European Union</td>
</tr>
<tr>
<td>17</td>
<td>Developing and Transition Economies</td>
</tr>
<tr>
<td></td>
<td>Thailand</td>
</tr>
<tr>
<td>19</td>
<td>Mexico</td>
</tr>
<tr>
<td>22</td>
<td>Turkey</td>
</tr>
<tr>
<td></td>
<td>Other Examples</td>
</tr>
<tr>
<td>24</td>
<td>Russian Federation</td>
</tr>
<tr>
<td>25</td>
<td>South Korea</td>
</tr>
<tr>
<td>26</td>
<td>M/SME’s in Egypt</td>
</tr>
<tr>
<td>28</td>
<td>Stakeholder Mapping</td>
</tr>
<tr>
<td>33</td>
<td>Data resources to support a unified operational definition in Egypt</td>
</tr>
<tr>
<td>34</td>
<td>Recommendations on improving date and on up-dating the definition</td>
</tr>
<tr>
<td>37</td>
<td>Suggestions for a unified operational definition of the M/SME sector in Egypt</td>
</tr>
<tr>
<td>39</td>
<td>An Institutional Mechanism for Verification and Certification of M/SME’s</td>
</tr>
<tr>
<td>41</td>
<td>Conclusions</td>
</tr>
<tr>
<td>42</td>
<td>Bibliography</td>
</tr>
<tr>
<td>46</td>
<td>Websites Consulted</td>
</tr>
</tbody>
</table>
Executive Summary
(The abbreviation SMEs is used throughout this paper and includes micro enterprises - M/SMEs)

Small and medium enterprises are expected to be the engines of economic growth in Egypt over the next several decades and are expected to create the many jobs needed by its growing population.

The SME policy environment in Egypt is complex and inconsistent. In order to improve the policy environment for M/SME development and support Egypt's transition toward a market economy, the Ministry of Economy and Foreign Trade (MoEFT), the Canadian International Development Agency (CIDA) and the International Development Research Centre (IDRC) have established the Small, Medium and Micro Enterprise Policy Development Project (SMEPoL).

The SMEPoL has identified the lack of a unified operational definition of the M/SME sector in Egypt as a constraint on developing a favorable policy environment. Currently, numerous definitions are being used by the various organizations operating in the SME environment. These definitions are not consistent, either in the absolute numbers used to differentiate them, or in the choice of measures used to define the M/SME sector.

This study begins by discussing in detail the need for a definition for policy development purposes, namely to foster better understanding of the sector, provide a consistent method of identifying the sector and target groups within it and to help with the coordination of effort among all groups serving the sector. The study then discusses characteristics of useful definitions before going on to examine international experiences with MSME definitions.

This study examines the context and purpose of SME definitions used in Canada, the United States, the European Union, Mexico, Thailand and Turkey, and:

- identifies commonalities and differences among the definitions used in the noted countries;
- discusses whether or not the definitions have been used effectively for the development of public policy;
- Identifies who is involved in developing or altering the definition, who is responsible and who is consulted;
- examines insights that might be valuable for the development of a definition for Egypt;
- includes other countries' definitions to highlight the full range of possibilities. The range runs from the detailed and complex, as in the United States, to very simple, as in Canada and Mexico, where little effort appears to be expended in developing definitions and where the definitions do not seem to be in widespread use.
The following table summarizes the official or most common definitions of SMEs used in the countries examined.

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<tr>
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<th>Number of employees</th>
<th>Other criteria</th>
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<tr>
<td><strong>Canada</strong></td>
<td></td>
<td></td>
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<tr>
<td>Micro</td>
<td>Not used</td>
<td></td>
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<tr>
<td>Small</td>
<td>Under 500 in mfg, 50 in services Not used</td>
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<tr>
<td>Medium</td>
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<td>Less than $5 million annual sales</td>
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<td><strong>United States</strong></td>
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<td>Micro</td>
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<td>Small</td>
<td>Under 500</td>
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<tr>
<td>Medium</td>
<td>Not used</td>
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<td></td>
<td></td>
<td>-Not dominant</td>
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<td></td>
<td></td>
<td>Generally less than $5 million Annual sales</td>
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<tr>
<td><strong>European Union</strong></td>
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<tr>
<td>Micro</td>
<td>Under 10</td>
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<tr>
<td>Small</td>
<td>Under 50</td>
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<tr>
<td>Medium</td>
<td>50 to 250</td>
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<td></td>
<td></td>
<td>Independent</td>
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<tr>
<td></td>
<td></td>
<td>} less than 7 Million euros sales or 5 Milion assets</td>
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<tr>
<td></td>
<td></td>
<td>-less than 40M sales, 27M assets</td>
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<tr>
<td><strong>Mexico</strong></td>
<td>(two official definitions in use)</td>
<td>None</td>
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<tr>
<td>Micro</td>
<td>Under 10</td>
<td></td>
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<tr>
<td>Small</td>
<td>Under 50 (Under 100)</td>
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<tr>
<td>Medium</td>
<td>Under 250 (under 500)</td>
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<td><strong>Thailand</strong></td>
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<tr>
<td>Micro</td>
<td>Not used</td>
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<tr>
<td>Small</td>
<td>Under 200 in labour intensive</td>
<td></td>
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<tr>
<td>Medium</td>
<td>Under 100 in capital intensive</td>
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<td><strong>Turkey</strong></td>
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<tr>
<td>Micro</td>
<td>Under 10</td>
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<tr>
<td>Small</td>
<td>10 to 49</td>
<td></td>
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<tr>
<td>Medium</td>
<td>50 to 199</td>
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<td><strong>Egypt</strong></td>
<td>(MOEFT 1998)</td>
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<tr>
<td>Micro</td>
<td>1 to 5</td>
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<tr>
<td>Small</td>
<td>5 to 14</td>
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<tr>
<td>Medium</td>
<td>15 to 49</td>
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Based on a literature review, the study discusses the M/SME sector in Egypt and the definitions currently in use. The role of the informal sector (those SMEs that do not pay taxes and are not registered), and the varying prospects for growth of different enterprises are considered. An important key to economic development in Egypt lies in examining the differences between the traditional micro and small enterprises, (which are used as means of alleviating poverty and creating employment) and those micro and small enterprises which have the potential to achieve the high rates of economic growth needed to increase the overall prosperity of the country. Some of the confusion over definitions and terminology arises from the existence of these two sectors. The donor agencies and the NGOs engaged in program delivery are primarily concerned with poverty alleviation...
and employment creation. The MoEFT is primarily concerned with the enterprises that have high potential.

The discussion of the Egyptian situation enumerates the various NGOs, donor agencies, financial institutions and government departments engaged in providing services to the sector and attempts to make sense of a very complex and confusing situation. Clearly, a key part of the policy development process must involve engaging in a constructive dialogue with all these actors with a view to agreeing on a consistent approach. This is one of the recommendations of this study but is also clearly articulated in several of the other documents consulted in the course of the research.

Recognizing the need to differentiate the two types of enterprise, the study examines the existing data resources for useful definitions supported by the data available. (Attempting to do the study from the literature, without being able to examine all the registers, lists and forms used to gather the information is a disadvantage.) Also, a study done in 2000 which looked specifically at the issue of data resources was examined. Based on the information available, it appears that while the data could support a definition based on other variables than just the number of employees only, the data resources are currently difficult to access and cross reference electronically. The study makes some suggestions about how to improve the data.

Finally, the study does not propose a definition to be used in Egypt but suggests the implementation of a process to consider important variables unique to Egypt to be used to formulate a definition. Similarly, the study recognizes that the consultative process needs to be used for arriving at the definition, so that though cooperation and collaboration, the players "own" the definition.

The paper concludes by reiterating that there is no correct definition. Whichever definition is finally selected is probably only as good as the inclusive, consultative process used for arriving at it. In conclusion, a less than perfect definition which can be revised over time as both cooperation and data resources are improved is preferable to waiting until the data is perfect before embarking on the process of formulating a definition.
Purpose: Why a definition is needed.

The government of Egypt wishes to develop and adopt "... a consistent national policy framework for M/SME development which would enable better planning, coordinating, and managing M/SME development efforts." ¹ The same document refers to the need for a "unified operational definition" which would also enable better planning, coordinating and managing of M/SME development efforts. The official operational definition is looked at as a coordinating tool similar to the policy framework. The definition is also needed to develop the framework and the policies that will follow.

A definition is needed to:

1. Identify members of the sector, including target groups, for specific interventions.
2. Facilitate the collection of data on the sector in order to make inter-country, inter-regional comparisons to be used in producing a report card on economic development progress for aid agencies and for the central government. To be used to advise enterprises on opportunities, constraints and trends.
3. Facilitate the development and elaboration of economic policies that encourage growth in general and in the SME sector in particular.
4. Foster a better understanding of the role and impact of M/SMEs in economic growth, contribution to GDP, employment creation, alleviation of poverty, exports, etc.
5. Help coordinate efforts where a multi agency approach is intended so that all players are certain of serving the same sector/client group. This is particularly the case where numerous donor agencies and NGOs are offering program assistance to the sector and the continuation of an uncoordinated approach leads to inefficiency and to programs competing or working at cross purposes with each other. A definition by itself will not solve the coordination problem but the process of getting all the players to agree on a definition may be the mechanism to enable everyone to pull together and talk to each other in an effective manner.
6. Provide a focus of action, if the government intends to do something about the sector, be it direct intervention or regulatory reform; the provision of incentives or the collection of taxes; the reform of apprenticeship schemes or the encouragement of the growth of sector associations.
7. Clarify who is eligible if the intent is to attach some entitlements or rights to M/SMEs. Definition is needed if there is the intent to offer differential tax treatment, for example, to M/SMEs. A clear definition is needed if the business and government environment is such that ambiguity cannot be tolerated on the grounds that it may lead to favouritism or corruption in making decisions.
8. Evaluate and define the sector accurately so that the impact of regulatory reform, procurement policies, financial and non-financial interventions can be monitored and assessed, costs and benefits accurately analyzed and corrective measures proposed.
9. To properly identify the target groups for purposes of developing consultative mechanisms as an input to the policy development process and to assist sub-sectors to become organized into industry associations and advocacy groups.

Characteristics of Useful Definitions

Context
The definition does not exist independently of the uses for which it is intended. If the intent is to treat certain enterprises in the sector differently than others, the definition must allow for those distinctions. Jurisdictions worldwide make a distinction between manufacturing enterprises and service enterprises in their definitions because they wish to provide different services or benefits to each. In Canada, for example, manufacturing enterprises pay a reduced rate of federal corporate income tax on the assumption, perhaps not a correct one, that their contribution to wealth generation is greater than service enterprises.

Linked to the data available in a country or group of countries
The need for accurate and comprehensive data has to be weighed against the need for sensitivity to the paper-burden that it may impose on the sector. Governments gather much data already: the challenge is to be able to efficiently process that data to produce useful information. Requesting additional information often seems easier than using existing information. One-stop business registration centres and single numbers for all dealings with government are useful ways to collect data. Forms from one level of government requiring the same tombstone data as another level should be shared so that the information need be reported once in the lifetime of the venture.

Informative
Definitions from countries such as Japan and the Philippines include over ninety-nine percent of the enterprises in the country. In that case, why make the distinction? In those countries, size and turnover/assets-based definitions lead to quite uninformative data on SMEs. Indeed, the information for those particular countries becomes useful for policy development purposes only when a distinction can be made between low growth domestic SMEs, entrepreneurial fast growth SMEs, international subcontracting or supply industry SMEs and trading (exporting) SMEs. In those countries, a definition based on size is of limited use as a policy development tool.

Simple to understand and easy to use
The definition should not require complicated formulas for its elaboration nor take up pages of lists. The definition must be easily understood by each of the entrepreneur, policy maker, and service provider and must not be ambiguous or subject to multiple interpretations and debate.

Based on the social and economic realities of the subject country
While it may include elements similar to other countries or aggregations of countries, priority should be given to developing a definition that is consistent with national economic realities and objectives.

Dynamic and adjustable as the economy changes
Whether the adjustment process is institutionalized, as in the United States, or is a matter of periodic consultation and review, a mechanism must be in place for changing the definition whenever its usefulness or accuracy is impaired.

International Experiences with SME definitions

This section reviews the definitions used in Canada, the United States, the European Union. Also examined are Turkey, Thailand, and Mexico, which have economies similar to those of Egypt.

There is additional information provided on a number of other countries to illustrate the wide range of definitions where countries are moving from highly regulated and subsidized formal economies with significant state ownership to liberalized, globally competitive, free trading economies.

This survey leads to several preliminary conclusions. The criteria used for arriving at the definitions are variable but are based on a few important principles:

- Number of employees
- Income statement items viz. Gross sales or annual turnover
- Balance Sheet items viz. Total assets, capital assets
- Ownership viz. Independent/owner operated/family owned
- Taxable income/profits

The elegance or comprehensiveness of the definition does not seem to correlate with the effectiveness and is not predictive. Some countries with loose definitions not uniformly used by the various stakeholders have strong, dynamic economies as measured by growth of GDP per capita, while some countries that have evidently devoted considerable time and energy to the task of definition have weak economies.

CANADA

There are approximately 2.6 million SMEs and self-employed individuals in Canada accounting for over sixty percent of private sector employment in 1999. Twenty-six percent of employment is generated by enterprises with fewer than twenty employees while thirty-nine percent is generated enterprises considered large - over 500 employees. The total number of SMEs is probably overstated as a large number of enterprises are comprised of self-employed individuals who may also be wage employees in another entity. Also companies are set up with zero employees for tax planning purposes. In both cases, individuals and companies are responding to a distortion induced by income tax rules making it advantageous to classify themselves in this way.

The term SME is seldom heard in Canada although that is changing. Usually, "small business" is the catchall phrase to describe small enterprises. Numerous definitions of a SME in Canada are used and there is little consistency even within agencies of the federal government. The standard government definition, as communicated to Canada’s trading partners and G8/OECD partners is that “Small is less than five hundred employees in manufacturing and less than fifty employees in services". Unfortunately, hardly anyone uses this definition.

The legislated definition in Canada is contained in the Small Business Financing Act is as follows:

"small business means a business carried on or about to be carried on in Canada for gain or profit with an estimated gross annual revenue
(a) not exceeding $5 million or any prescribed lesser amount for the fiscal year of the business during which a loan is approved by a lender in respect of the business; or
(b) in the case of a business about to be carried on, not expected at the time a loan is approved by a lender in respect of the business to exceed $5 million or any prescribed lesser amount for its first fiscal year that is of not less than fifty-two weeks duration.

*It does not include the business of farming or a business as having its principal object the furtherance of a charitable or religious purpose.*³

The following federal statutes refer to the SME sector:

- Atlantic Canada Opportunities Agency Act
- Western Economic Diversification Act
- Department of Industry Act
- Business Development Bank of Canada Act
- Competition Act
- European Bank for Reconstruction and Development Agreement Act
- Farm Credit Corporation Act.

Although SMEs are mentioned in these pieces of federal legislation, they are not defined.

All the provinces and territories have legislation regarding aspects of the SME sector and all use a variety of ad hoc definitions that are not consistent within a province nor with other provinces or the federal government.

Industry Canada has a Small Business Policy Branch which monitors the performance of the sector and advises on sector needs. In addition, the following federal departments are involved with developing SME policies:

- Department of Finance
- Department of Western Economic Diversification
- Atlantic Canada Opportunities Agency
- Business Development Bank of Canada
- Department of Foreign Affairs and International Trade
- Export Development Bank of Canada

If Canada wanted to change the definition or to investigate any other policy initiative, Industry Canada would consult with the federal departments listed above and also with three private sector organizations representing individual firms, provincial and regional level associations of SMEs. These are the Canadian Federation of Independent Business, the Canadian Manufacturers and Exporters Association, and the Canadian Chamber of Commerce. The provincial governments are normally consulted by Industry Canada through its regional offices.

The following examples illustrate the lack of consistency in the use of the definition in Canada and also demonstrate that this lack does not seem to create problems for entrepreneurs or for the government.

1. Statistics Canada (the federal census and statistical information agency) uses the number of employees in a business for its data gathering, and categorizes the data accordingly: less than

five, five to nine, twenty to forty-nine, fifty to four hundred ninety-nine and five hundred plus. For naming purposes Statistics Canada groups them as follows. Small Businesses, <50 employees, Medium-sized businesses, 50-499 employees and Large businesses, 500+ employees. Statistics Canada produces numerous reports on job creation and employment trends using these categories which tends to influence the understanding people have of small business.

2. Under the Small Business Financing Act (a federal government loan guarantee program) eligibility is restricted to "small businesses" with annual gross revenues of less than $5 million CDN. Number of employees is simply less than five hundred for manufacturing and fifty for services. "A small business enterprise is one with an estimated gross revenue not exceeding $5 million during the fiscal year in which the business improvement loan is approved."

3. Farms are not considered small businesses under the SBFA but are served by the Farm Credit Corporation, a federal crown corporation that provides financial services to farmers.

4. Under the Program for Export Market Development (a program offered by the Department of Foreign Affairs and International Trade) priority is given to firms with annual sales greater than $250,000 and less than $10,000,000 and/or with fewer than one hundred employees in manufacturing and fifty employees in services. On the other hand, the Export Development Corporation considers an SME to be an exporter of capital goods with annual sales of less than $25 million. The sales levels for either of these programs are obviously inconsistent with the SBFA definition but no one seems disturbed by this fact.

5. The Competition Bureau of Industry Canada does not consider definitions based on absolute size criteria (such as annual revenue, personnel or output) to be useful at all in defining a SME for purposes of competition analysis. The Bureau introduces the notion of market dominance or relative market power as the key determinant, a concept also used in the United States. As an example, there is a firm in British Columbia with no more than twenty employees that produces artificial sapphire crystals to be used, among other things, for nose cones for air to air missiles. The Company is the only such producer in Canada and accounts for one hundred percent of Canadian production. Moreover, it accounts for nearly thirty percent of North American production and a measurable percentage of world production. Even though it is very small, it would not be considered an SME for competition policy purposes because of its market share.

6. Much of the regulation of Canadian business comes under provincial jurisdiction. A lack of consistency in definitions exists at the provincial level, even within the same province. In British Columbia, number of employees is frequently used as the formal definitional basis but whenever the definition is actually operationalized there is a proliferation of special purpose definitions, some of which are at odds with the general definition. For example, for purposes of investment eligibility by one labour-sponsored venture capital fund, SMEs are defined as enterprises "...with less than $35 Million in total assets..." no matter how many employees. The definition of a small business for eligibility for the Small business timber sale program of the BC Ministry of Forests is, ‘one that is not more than ten percent owned by a large forest company’ without reference to any other criterion.

7. The number of employees is frequently used to develop provincial regulatory thresholds for Occupational Health and Safety Legislation and Pay Equity Legislation. In Ontario,
enterprises with fewer than five employees do not have to have a formal health and safety committee or employee representatives. An organization between five and twenty employees must have a representative of the employees and one with over twenty employees must have a full-blown committee. In the case of Pay Equity, the legislation applies only to employers with more than ten employees and the posting of a formal plan is optional between ten and ninety-nine, mandatory over one hundred.

8. The Canadian Federation of Independent Business (a private sector advocacy group) defines small business as being less than fifty employees and medium size as being fifty to four hundred ninety-nine. Although they use the term "independent" as part of their client identification, they do not seem to use it in defining SMEs themselves. Independent, meaning "owner-operated, not a franchise, not a subsidiary of a larger firm" is used in other countries' definitions but not in Canada.

9. The Community Economic Development Centre at Simon Fraser University, which is an opinion leader in the academic and volunteer spheres, introduces another dimension. "A small business...is any venture that is locally owned and locally operated and successfully sustains a decent standard of living for at least a family or individual in the community." This definition is used in the context of community economic development and is interesting in that it introduces the concepts of local control and sustainability. The latter may be worth considering later on.

10. Community Futures Development Corporations, NGO's which are the main financial intermediary for SMEs in Canada, do not define micro or small businesses but, as they operate only in rural areas which have few large businesses, seldom need to make the distinction. Community Futures Development Corporation financial products are generally priced above the chartered bank market, which means that only businesses that cannot get conventional financing will apply. There is no incentive for larger companies to attempt to incorrectly identify themselves as there would be if subsidies were involved.

11. The banking community in Canada uses the size of loan as the definition of a "small business". Typically, businesses with credit facilities (term loans and operating lines) of less than $250,000 are considered to be small business clients. [Bank of Nova Scotia, pers. Comm.]

12. For tax purposes, three distinctions are made corresponding to size differences in enterprises. For the Goods and Services Tax (a federal value added tax) enterprises with taxable sales of less than $30,000 per year do not have to register with the government or collect the tax. For purposes of federal and provincial corporate income taxes, "privately held Canadian corporations are eligible for a special, low rate of tax on the first $200,000 to $400,000 (depending on the province) of taxable income. This is called the "Small Business tax rate" though it applies to the first amount of taxable income of even very large corporations. Note that the benefit is restricted to privately owned, as opposed to publicly owned, corporations and that taxable income is the measure. These two variables can be used in developing a definition of SME and, as we will see, have been used in other countries.

13. Finally, the federal government and several provinces levy a "large corporations capital tax" which is a tax on the total assets employed by the enterprise. The federal threshold, which is also used by the provinces, is $10 million. Attentive readers will note that this amount is considerably lower than the $35 million used in British Columbia to define a SME for venture capital purposes.
A search of the literature and federal and provincial acts and regulations in Canada turn up hundreds of definitions of a small enterprise. The preceding examples are intended to simply illustrate the range and diversity of definitions in use and are not intended to be exhaustive. The Canadian case demonstrates that a consistent definition based on number of employees alone may not be useful for all public policy purposes and that other determinants may be more useful, depending on the purpose for which the definition is used and the context. Size based on number of employees seems to be used to determine the level at which the enterprise must fully conform to various rules and regulations while gross sales or taxable income seem to be used for determining eligibility for incentives, subsidies or financial concessions. A business’s total value of assets is used for taxation purposes or securities legislation.

Canada has a globally competitive, large industrial and service based economy producing high levels of GDP per capita and a high standard of living without a consistent definition of SMEs. Ad hoc or special purpose definitions have enabled the country to “muddle through”. The same could probably be said about the SME policy framework in Canada.

There are other observations that can be made about the SME sector in Canada providing insights for consideration in examining options for Egypt.

Job Creation

In Canada, as in many other industrialized countries, most new employment creation takes place in small businesses. The small business sector wastes no time in taking credit for this fact and associations feel justified demanding various things from government (tax breaks, less spending on social services). However, most job loss also occurs in small businesses as most fail within the first five years of operation. The net contribution to employment by small business in Canada is much less than the gross contribution and is actually not much different than the contribution by large business, a fact that few of the small business associations acknowledge.

Subsidies

The definition of a small business in Canada is based on number of employees and annual sales. This definition includes all sectors of the economy, from software development, to medical devices to metal fabricating, to retail establishments to personal services. Retail establishments, especially restaurants and personal service establishments, are characterized by high failure rates and low rates of graduating into larger enterprises. Their net contribution to employment growth and new job creation is consequently low. Inadequate financing, poor management and/or faulty market information can cause failure and governments may be tempted to meet these deficiencies, often with negative results. After forty years of small business development programs, little evidence exists to justify the high cost of government intervention. Most small retail and personal service establishments continue to fail in the first five years. Most small business owners have failed at least two times. Subsidized inputs are more often the cause of business failure than the cause of its success, because subsidies tend to encourage the start of ventures that are only viable as long as they are subsidized. They also lead to carelessness about costs since the true costs are effectively hidden by the subsidy.
Potential of an Emerging Business

The manufacturing and processing sectors, business and financial services, and emerging technologies, make the greatest contribution to employment and economic growth in Canada. These are the companies that start out as micro enterprises and grow into large firms that drive economic growth through wealth creation rather than through wealth redistribution. Their place in the market is often determined by their use of technology to remain ahead of their competitors. In the Canadian context, government intervention on behalf of small business (if it is needed at all, which many analysts doubt) should target those businesses that have the potential to prosper and grow, to be leaders in their fields, to become exporters and ones which continue to make research and development investments in new products and processes.

A definition that is based solely on number of employees and total sales, as is currently the case, is useless for helping government formulate policies that will address the needs of the businesses that are creating the net employment numbers that the economy demands. A more useful definition for the formulation of a governmental policy response would have a sectoral dimension as well. This acknowledges the different potentials and needs of enterprises in different industrial sectors. The Business Development Bank of Canada has given priority to "Knowledge Based Industries" in its loan and investment policies and has gone to some lengths to define those industries using the SIC (or NAICS) to ensure that both its employees and its customers know who is included and who is not. Accordingly for the Bank, the highest priority for financial services is for SMEs (which they do not define) in "Knowledge Based Industries", (which they do define). Without a sectoral dimension, general initiatives tend to lack relevance for the majority of businesses or would be so diluted that their impact would be negligible.

The United States

The term SME or micro-enterprise is not commonly used in the United States, even though there are numerous services and programs available to the sector. The US economy, while it has many large enterprises providing more than half of the employment in the country, is also home to a large number of small and micro-enterprises, currently between 13.5 million and 24 million depending on how income tax information is interpreted. Small and micro-businesses are estimated to account for sixty percent of all job creation and produce fifty-five percent of all innovations.\(^5\) Even as there has been very rapid growth in the number of SMEs in the US over the last ten years, this period has also seen static incomes for the poorest quintile of the population and increasing inequality of income distribution throughout the society.

Small Business Administration

The US federal government has established the Small Business Administration (“SBA”) (under the Small Business Act) and has a specialized bureau called The Office of Size Standards. This Office is tasked with defining and modifying the definitions of small businesses for purposes of federal government programs. The Small Business Act defines "...a small business concern as one that is independently owned and operated and which is not dominant in its field of operation. The Act also states that in determining what constitutes a small business, the definition will vary from industry to industry to reflect industry differences accurately."

\(^6\) [SBA web site www.sba.gov/size/section]
much effort to the development, evaluation and modification of definitions as has the United States. In terms of policy development, however, it is likely that the US has proceeded down an evolutionary dead end. The definitions of the Small Business Administration, while exact, have thresholds that are too high for policy purposes. In other words, large numbers of businesses that have many of the characteristics of large enterprises are included in the definition of small businesses, which leads to the necessity of developing numerous qualifiers to the definition in order to produce workable policies and interventions.

The process used to develop or revise a size standard is as follows: Only the Administrator, head of the SBA, can approve size standards. She does so on the advice of the SBA’s Size Policy Board, which is made up of ten people, all of whom work for the SBA. There is no institutional mechanism for consultation with any other agencies, other levels of government or with the private sector. However, the request for a change would probably originate as a request from industry, either directly by a company or association or through one of the many lobbying groups approaching congress. The research prepared for consideration by the Size Policy Board in dealing with a determination is expected to address these views. The recommendation to the Size Policy Board is based on economic studies of the industry structure and on issues papers which include industry views.7

Two important themes that are not related to absolute size are elaborated in the definition process, namely independence and lack of market dominance. These are not part of the definitions used in other jurisdictions which deal with absolutes in order to achieve simplicity. These criteria are very important for procurement and competition policy which are the purposes for which the definitions are intended.

Standard Industrial Classification

The SBA defines all enterprises according to their Standard Industrial Classification, (recently changed to the North American Industry Classification System, which standardizes classifications in Canada, the United States and Mexico,) category and sub-category in a document that runs to twenty-nine small print pages. The measures used are number of employees and total receipts and have a large range for both. For example, an aircraft manufacturing firm with fewer than fifteen hundred employees is considered small but a durable goods wholesaler with one hundred one employees is considered large. Similarly, a gasoline station with a convenience store is a small business if it has gross receipts of less than $20 million whereas a gasoline station without a convenience store is small if it has less that $5 million in receipts. The document is easy to use by both the bureaucracy and the clients and requires no interpretation, which is probably a good thing in a litigious society. A transparent process is also provided for dealing with disputes and reclassifications. However, in some sectors virtually all concerns are small businesses and over all sectors the vast majority of concerns are small. If the SBA listed only large businesses that are not eligible for loans and are not covered under the procurement rules, the list would be a lot shorter.

Procurement

These definitions are used to determine eligibility for SBA loans and other services and for federal procurement contracts. With respect to the latter, the US government has indicated a

7 Ibid. Frequently Asked Questions.
target of twenty-three percent of all federal procurement be from small business. “Procurement” is viewed as a means to ensure that federal expenditures are as widely distributed as possible throughout the country and is an important element of the US regional development policy. Procurement is one of the only means used to provide direct financial support, other than SBA loans, to small business. Under law, federal agencies must use the SBA’s size standards to define small businesses for procurement purposes.

The SBA is also involved in the operation of some seven hundred Small Business Development Centres that provide technical and management assistance to new and existing small businesses, special programs for special interest groups and small businesses that have opportunities for exporting. The definition is used for determining access to these services.

Because they include so many establishments, the definitions have not been useful for other public policy concerns. Federal agencies are not obliged to use the SBA’s definition but, in the event that they find the SBA’s definition wanting in some respect, are expected to consult with the SBA’s Office of Advocacy to find a more suitable definition. Definitions have proliferated based on an enterprise being a small business as defined by the SBA plus being something else, such as owned by a Disabled Veteran, or a Visible Minority person or woman, or by someone domiciled in a particular state.

An example from California: to be eligible for California’s “five percent bid preference” in getting government contracts (i.e. an eligible bidder can bid five percent higher than non-eligible, large or out-of-state businesses, and still be awarded the contract), a company must be certified as meeting the following definition:

"A Small Business means:

1. An independently owned and operated business
2. Not dominant in its field of operation
3. The principal office located in California
4. The officers domiciled in California, and
5. Together with affiliates is either:
   (a) a service, construction, or non-manufacturer with one hundred or fewer employees, and average annual gross receipts of ten million dollars ($10,000,000) or less over the previous three years, or
   (b) a manufacturer with one hundred or fewer employees."

Clearly, the federal definitions included too many firms to suit the government of California and did not localize the benefits sufficiently, hence this much narrower definition. Similar regional variations to the definition can be found throughout the United States.

Moreover, even though the US federal government spends a lot of money and effort to develop and maintain these lists and definitions, its own agencies do not always employ them. For example, the EX-IM Bank offers a special facility for small businesses it defines as follows:

"Exporters, together with any affiliates, domestic or foreign, insured through the Small Business Policy must also:

8 [California Office of Small Business Certification and Resources. www.pd.dgs.ca.gov/]
- Have a total annual export credit sales volume averaging $3 million or less in the preceding two fiscal years (excluding goods sold for cash or with a confirmed, irrevocable letter of credit);
- Meet the U.S. small business Administration's guidelines for definition of a small business;
- Have at least one principal of the firm involved on a full time basis;
- Have satisfactory financial condition as evidenced by a positive net worth and at least one year successful operating history."

No doubt there are numerous disputes to resolve because the financial thresholds are different for the two agencies. To choose an example, a tree nut grower with gross receipts over $500,000 is considered a large business and therefore could not qualify under this program.

Outside the realm of procurement and loans and loan guarantees, the definitions are not mandatory for non-governmental entities and are seldom used in a consistent and meaningful manner. Most states (and even counties and cities) have small business development offices but do not use consistent definitions as they are uniformly in the business development field and not just confined to small businesses. There are also numerous micro-credit schemes in operation throughout the country aimed at alleviating problems associated with low incomes and lack of opportunities among minority groups but these also tend to use the SBA definition, if they use one at all, because it is broad enough to catch all sizes of small business.

In the United States (and Canada) a broad definition that uses the number of employees and gross receipts as the measure is an effective mechanism for allocating services and programs. The definition of a small business captures the majority of enterprises in the country and allows add-ons of other factors to suit local circumstances, such as minority status, gender, domicile or active participation of the owner, lower employment thresholds in certain regions. One serious disadvantage is that the size definitions used in the United States and Canada are not consistent with those used elsewhere in the world, making direct comparisons of sector performance difficult.

European Union

The EU addressed the definition issue in 1996 with its "Commission Recommendation of 3 April, 1996 concerning the definition of small and medium-sized enterprises." The preamble to the recommendation outlines the reasons why a definition is needed such as targeted programs, preferential treatment, aid schemes, interest subsidies, lack of coordination, distortion of competition, and discusses the reasoning used to arrive at the definition recommended for adoption by member states and their institutions.

The definition uses number of employees, annual turnover or total assets, and a criterion of independence. A small enterprise is defined as "having fewer than fifty employees and having either a turnover of less than 7Million ecu or an annual balance sheet total (total assets) of less than 5 Million ecu".

Medium-sized enterprises have more than fifty but fewer than two hundred fifty employees and have either a turnover of less than 40 million ecu or an annual balance sheet total of less than 27 Million ecu. Micro enterprises are small enterprises that have fewer than ten employees. The criterion of independence is that same for all and is as follows: "independent enterprises are those that are not owned as to twenty-five percent or more of the capital or the voting rights by

one enterprise, or jointly by several enterprises, falling outside the definition of an SME or a small enterprise, whichever may apply."

The rationale for a uniform definition for EU members is partly based on the recognition that the previous situation, in which, "… various community policies were targeted at SME's, each policy using different criteria to define them; whereas a number of community policies have developed gradually with no joint approach or overall consideration of what, objectively, constitutes an SME; the result being a diversity of criteria used to define an SME and thus, a multiplicity of definitions currently in use at the Community level in addition to the definitions used by the European Investment Bank (EIB) and the European Investment Fund (EIF) together with a rather wide range of definitions in the Member States;" was not desirable " in a single market without internal frontiers,". The EU recognized that it had to harmonize definitions or move towards a single definition because, "…the existence of different definitions at the community level and at the national level can create inconsistencies and can also distort competition between enterprises".  

The definition the commission recommended has been adopted, with modifications, by most Member States. As an example, Italy uses the size and turnover/balance sheet criteria but adds a dimension to distinguish "industrial " enterprises from "service" enterprises. For the latter, the size thresholds are under twenty employees for small and twenty-one to ninety-five employees for medium. Over ninety-five is considered large. Italy also includes a category of "craft enterprises" which are all enterprises producing a certain kind of goods, regardless of the other criteria.  

The United Kingdom Small Business Service, on the other hand, uses only the number of employees in its definition, in which it is otherwise consistent with EU categories.

Some non-EU countries have also adopted these definitions, either as an alternative to developing their own, or because the bulk of their trade is with the EU or because they wish to eventually join the EU.

Moving away from the definitions, even a cursory search of the literature shows that in addition to EU SME programs (which are so numerous as to require over one hundred forty pages to discuss) many member states have continued to operate national programs for SME development using the EU definition or a close variant.

The recommendation of the European Commission on a new definition to be used by the EU and the member states arose out of a European Council decision to implement an integrated programme in favour of Small and Medium Sized Enterprises and the Craft sector in 1994. In implementing the programme, the problem of multiple and incoherent definitions became obvious and led to the process of arriving at a new definition. This process is complex and includes many layers. The Commission takes the lead in developing recommendations to the European Council and its sub-councils, Research and Industry. There is a legal obligation to consult and at the European level, this includes around forty private sector organizations, including UNICE (Union of Industrial and Employers Federation of Europe), UEAPME (European Association of Craft and

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12 [Commission of the European Communities. "Creating an entrepreneurial Europe. The activities of the European Union for small and medium-sized enterprises (SMEs)" Brussels, 01.03.2001]
SMEs), CEEP (European Centre of Enterprises with Public Participation), ETUC (European Trade Union Confederation), Eurocommerce (Association of Commerce of the European Community), and COPA (Committee of Agricultural Organisations in the EU), just to name a few. Moreover, each of the member states has consultative mechanisms in place at their own country-level which feed into the process. Recommendations are developed over time with policy documents, discussion papers and drafts presented to the European Council for feedback and direction prior to the formal recommendation being put forward. What finally comes forward for adoptions represents a consensus of opinion of all stakeholders.
Developing and Transition Economies

Thailand

Thailand has made exceptional progress in economic development and poverty alleviation in the last thirty years with rapid growth in per capita GDP and a large drop in the numbers of people living in poverty. Even before the Asian financial crisis began in 1997 there were troubling trends in increasing gaps between per capita incomes between Bangkok and the rural parts of the country and between the lowest and highest quintiles of share of GDP by household. The financial crisis had dramatic effects on employment as two thousand one hundred seven firms with more than ten employees closed their doors and one million Thais were pushed below the poverty line as economic growth fell to negative eight percent.

Among the measures adopted by the Thai government and various donor agencies was the promotion and support of M/SME development as a means of achieving national and regional economic development goals, employment creation, alleviating poverty, facilitating the transition to a market economy, promoting equity, democracy and the development of civil society. 13

Considerable funds were subscribed for programs sponsored by the World Bank, the Asian Development Bank, the European Commission and the numerous Special Financial Institutions of the Thai Government to promote M/SME development. One of the first issues these groups faced was to define the sector. This almost immediately caused a debate. The debate is summarized in a paper commissioned by the ILO/UNDP. "Micro and Small enterprises (MSE's in Thailand - definitions and contributions." 1999. This paper provides an analysis of the various criteria used in defining SMEs and also provides recommendations regarding an operational definition, precisely the same issue that is being addressed in this report. As well, the paper provides a useful review of the definitional issues and problems that arise out of the use of different data sources (National Statistical Office vs Ministry of Industry) and a useful approach to dealing with informal enterprises. These features will be discussed further in the section dealing with options and recommendations.

It may be useful to examine the reason for the ILO becoming involved in this issue. The government of Thailand appealed for international assistance to deal with the financial crisis of 1997. The ILO considered the three most affected countries in the region (Thailand, Indonesia, Korea) to be very high in priority for technical cooperation and advisory services because of the serious employment losses taking place. Employment loss and the absence of social protection in the regions meant that the social and economic hardships of the crisis fell on individual workers and their dependents. In the case of Thailand, the government identified SME development as a way of working its way out of the financial crisis.

ILO has four chief means of action:

- research and collection of relevant information;
- dissemination and exchange of information leading to cooperative decision making;
- technical assistance to governments in the form of policy advice;

13 [From ILO/UNDP "Creating an enabling environment for micro and small enterprise (MSE) development in Thailand. 1999]
programmes and projects aimed at building institutional capacity.

In carrying out the first two actions noted above, in consultation and dialogue with constituents and stakeholders, the ILO and the government of Thailand, concluded that there was a need to review and adjust the current classification of enterprises. They established a working group within the Ministry of Industry to develop a new classification. This task force took over the work completed by an inclusive group in 1998 who had come up with an unusable definition.

Thailand had been unique in developing and adopting an official definition of SME that did not use number of employees as one of the criteria. Although statistics on the number of employees and gross receipts are collected and are readily available, an expert committee made up of representatives of all stakeholders recommended a classification based solely on the value of fixed assets, including land.

Table: SME's in Thailand (Baht converted to USD @ 40 B = $1)

<table>
<thead>
<tr>
<th>Value of fixed assets</th>
<th>Medium-sized enterprises</th>
<th>Small-sized enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>&gt;$500,000</td>
<td>&gt;$125,000</td>
</tr>
<tr>
<td>Services</td>
<td>&gt;$500,000</td>
<td>&gt;$125,000</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>&gt;$250,000</td>
<td>&gt;$125,000</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>&gt;$150,000</td>
<td>&gt;$75,000</td>
</tr>
</tbody>
</table>

The Thai cabinet approved the adoption of this classification recommended by a committee that included the following entities:

- Ministry of Industry
- Ministry of Finance
- Ministry of Commerce
- Bank of Thailand
- Bank for Agricultural and Cooperative
- EXIM Bank
- Government Saving Bank
- The Small Industry Finance Corporation
- The Small Industry Credit Guarantee Corporation
- The Industrial Finance Corporation of Thailand
- The Federation of Thai Industries
- The Thai Chamber of Commerce.

The list is provided to demonstrate the inclusiveness of the consultation process that led to this definition. Even though the classification scheme was only adopted in December 1998, by July 1999 there was a perceived need to develop a new definition that dealt with two important issues not adequately addressed when using value of fixed assets alone. These issues involved the continuing need to have sufficient size classes into which enterprises could be separated to reflect their need for policy and program attention (i.e. micro enterprises may have need for skill development different than other small enterprises) and the problem that widely differing enterprises would be included in the same size class on the basis of value of fixed assets. An example is a wooden furniture manufacturing company with a very simple capital structure, using
primarily hand tools, with a large number of employees, perhaps more than five hundred, being in
the same size class, for public policy purposes, as a small, highly automated, circuit board
manufacturer with twelve employees. Both may be small-sized enterprises using the asset based
definition but their needs and their potential contribution to the economy and employment creation
are vastly different.

The ILO study recommends that a new definition be adopted using two criteria at the same time.
For manufacturing: number of employees and registered capital (fixed assets). For trade and
services: number of employees and gross receipts.

The ILO study further recommends a four-tiered size classification on the grounds that most other
countries have four tiers. The tiers would be micro, small, medium and large and would be
deefined on the basis of the two criteria yielding eight classes. Unfortunately, the study notes, the
available statistics in Thailand do not support easy classification along these lines and therefore
the study recommends using data from both the National Statistics Office, which includes all
enterprises, and the Ministry of Industry, which does not break down data so as to enable a
distinction to be made between micro and small enterprises. Moreover, it recommends changes
to the statistics collected by these agencies to facilitate the future analysis and refinement of the
deinition.

One interesting element of definition introduced in this study is the notion of “value of registered
capital or fixed assets per employee” as a way of distinguishing enterprises which would otherwise
be in the same class. Although it does not mention it explicitly, gross receipts per employee
might be worth examining (provided the information was available) as a way of distinguishing low
intensity from high intensity enterprises for policy development and intervention purposes.

In any event, Thailand has now moved to a two criteria definition and SMEs are defined as having
fewer than two hundred employees in labour intensive industries and less than 100 million Baht
($2.5 million US) in total assets in capital intensive industries. This definition is not likely to last
any longer than the previous ones as it does not seem to adequately reflect national realities. The
debate on definitions will continue.

Mexico

SMEs in Mexico account for ninety-six percent of all enterprises and employ forty-nine percent of
all employees.\textsuperscript{14}

Mexican SME development is interesting because of Mexico’s economic evolution over the last
forty years and the institutional responses that have been undertaken. Mexico has moved from a
state-controlled economic structure with numerous state-owned enterprises (particularly in the
banking and energy sectors) to a liberalized, private sector economy. The country is signatory to
several free trade agreements and experiencing dynamic growth, especially in the export of
manufactured products and more especially in the \textit{maquiladores}, which are factories along the
border with the US that produce goods, usually from imported materials, for export back to the US
and Canada.

\textsuperscript{14} [OECD, “Small business, job creation and Growth: Facts, Obstacles and Practices, no date.]
Mexico is a relatively poor country and has been so since before independence in the early nineteenth century. It also continues to have severe income distribution disparities between the highest and lowest quintiles of the population that seem to be more or less intractable. Analysts continue to observe that the increased wealth generated by recent economic growth tends to accrue mainly to upper income earners living in urban areas.\footnote{[OECD Economic Surveys: Mexico. 2000]} High inflation and interest rate disadvantage SME borrowers and corruption remains a major concern. Indeed, it has been noted that Mexico, based on its resource endowments, should have been as well off economically as its northern neighbours, the USA and Canada, but has been unable to achieve its potential because of a succession of corrupt governments who concentrate the nation's wealth in the hands of a small number of individuals. COPARMEX, a Mexican employers' association founded in 1929, sees corruption as the major impediment to SME development and growth and states that, "we need an integral reform of the State through which we could design new rules, definitive ones,….in an effort to overcome a long history of paternalism, authoritarianism, and their undesirable aftermath characterized by a sense of individual discretion, corruption, impunity and a lack of respect for the law."\footnote{[COPARMEX's Proposals for 2000-2010. www.coparmex.org]}

Mexico has largely ignored SMEs as a policy issue and, "there is no awareness of the concept of "SME" as an independent economic phenomenon and target group of business promotion". \([www.sequa.de]\) There has only been discussion of the interests and role of SMEs since the liberalisation of the economy started in the 1980's and this discussion is not promoted by government but by private sector groups such as COPARMEX, the World Bank, the Interamerican Development Bank, and APEC. Services and programs for SMEs are integrated with general trade and industrial development policies although there is (since 1995) a National council for Micro, Small and Medium-sized Enterprises.

In any event, it comes as no surprise that the definitions of SMEs in Mexico are used primarily for statistical rather than program or policy reasons. The definitions are not readily comparable between the two government agencies responsible for the collection of the information (INEGI, the national census department and SECOFI, the department of commerce and industrial development) and are seldom used. Both agencies use number of employees as the only measure. INEGI uses 6 six categories, 1-10, 11-50, 51-100, 101-250, 251-500, and 501+ while SECOFI uses 4, 1-15, 16-100, 101-250 and 251+. Reports generated using these definitions are quite unsatisfactory for understanding the sector since the data collected by the two agencies is sufficiently different to make a complete picture impossible to see. One data set that is very interesting however, provides information on net income per employee and net income per establishment. The net income per employee in micro industries in most industrial sectors in Mexico is just over half of what it is in medium and large size firms and is not much above the poverty level. While there is generally a progression of net incomes per employee with increasing firm size, the big jumps statistically are between micro and small enterprises and between medium and large, where the income doubles.

Mexico has a very large informal economy which is not included in the above data. It is estimated that as much as thirty percent of economic activity is informal and that over twenty percent of employment is in enterprises that are not formalized. It is assumed that most of this activity takes place in micro and small businesses which avoid formalization to evade taxation and regulation. The regulatory reforms being undertaken by the new government are aimed at reducing...
corruption and the current prohibitive cost of compliance with the law. These reforms should move more of this economic activity into the formal sphere. Indeed, almost the entire thrust of current policy toward business in Mexico is focused on the regulatory environment and is a complete overhaul of the laws and regulations affecting business in the country. This emphasis has come about as a result of the new President's commitment to reform, modernization and to meaningful consultation with the business community.

In 1999 the President established the Business Coordinating Council as an advisory body to the government on business issues. It includes virtually all private sector business entities in Mexico as represented by the following organizations:

- CONCAMIN - Confederation of Industrial Chambers of Mexico
- COPARMEX - Confederation of Employers of Mexico
- AMIS - Mexican Association of Securities Institutions
- CMHN - Mexican Council of business men
- CAN - National Council of Agrifood processors
- ABM - Bankers Association of Mexico
- CANACO - Mexico City Chamber of Commerce
- CACACINTRA - National Chamber of Industrial Development
- AMIB - Mexican Stockbrokers Association
- COMCE - Mexican Exporters Council

This council advises the Federal Regulatory Approval Commission (COFEMER) (a part of the Ministry of the Economy) and has a direct link to the Cabinet and President. The COFEMER has been put in charge of supervising the implementation of the presidential decree regarding regulatory improvement for business. The decree requires that twenty percent of all business formalities must be eliminated or simplified within three months. It also requires that all agencies identify their five most requested or highest impact formalities and do the following:

(a) provide a rationale and justification for the formality within three months of the decree.;
(b) propose measures to eliminate or simplify them, including legislative measure.;
(c) submit a plan for improving all the rules and regulations that were not eliminated in the previous two steps.

The entire process is based on consultation with stakeholders and on public scrutiny of the results. All of the proposals from agencies and the analysis done by COFEMER are made available to the general public.

To ensure all public agencies fully participate in the process set out in the decree, severe penalties (including dismissal or one year suspensions) are waiting for public servants failing to comply.

This regulatory reform process has nothing to do with a definition of SME's in Mexico. However, the definition is not an issue at this time; regulatory reform is. The radical process being undertaken in Mexico for changing the SME environment may provide useful insights for Egypt.

In any event, Mexico is an example of an economy experiencing rapid economic growth and SME growth through liberalisation without any formal policies other than regulatory reform being directed towards the SME sector and unfortunately, without fully addressing the serious poverty
issues in the country. Even as the country’s macroeconomic performance soared, the incomes of the poorest thirty per cent of the population actually declined.\textsuperscript{17}

\textbf{Turkey}

The Turkish economy is fourth after Austria, Germany and Norway, among OECD countries in terms of the proportion of large enterprises in its economy. The Turkish government has nevertheless concluded that its greatest opportunities for employment and GDP growth lie in the SME sector. Like other economies in the region, it passed through a period where it was primarily a state-directed economy based on large, state-owned enterprises and import substitution. National social benefits were given priority over competitiveness and high tariff barriers encouraged inefficiency and low productivity. By the late 1970's oil price shocks, accelerated inflation, foreign exchange and liquidity problems forced Turkey to reassess this statist policy and has since shifted toward a free market economy development strategy with privatization of state-owned enterprises and an emphasis on SMEs as the economic growth engines of the country. The new policy was, "...to confine the role of the state in the economy to areas like health, basic education, social and national security, large scale infrastructure investment and provide (sic) the suitable legal and structural environment for free enterprise to operate..." \textsuperscript{18} That being said, the rate of privatization and conversion to a private sector dominant economy has not been rapid.

SMEs in Turkey account for ninety-nine and one half percent of enterprises in the manufacturing sector and sixty-one percent of all employees. The vast majority of firms are considered to be micro enterprises with less than ten workers (usually owner operated sole proprietorships) and are heavily concentrated in the following sectors: textiles, wearing apparel and leather, fabricated metal products, wood products including furniture and food, beverages and tobacco.

Turkish SMEs are organized through two large and powerful unions or confederations: TESK (Turkish Tradesmen and Craftsmen Confederation) with two million members, represents all crafts and professions. TOBB (Turkish Union of Chambers and Commodity Exchanges) has seven hundred thousand members including three hundred twenty-five Chambers of Commerce and Industry. These organizations act as advocacy and lobby groups on behalf of their members, become involved in training and in the formation of industrial estates and foster technology development in Turkish Industry. On paper, at least, they appear to be an effective mechanism for influencing government SME policy.

Government agencies providing service to SMEs are KOSEB (Small and Medium Industry Development Organization) and HALKBANK, a state-owned bank, which provides a variety of financial support services to small and medium enterprises through a number of specialized funds. A large number of other agencies are directly or indirectly involved in providing services to SMEs, including the following:

- Ministry of Industry and Trade- Industrial policy, industrial zones and estates
- Patent Institutes- patents and trademarks
- Ministry of National Education- apprenticeships, other training
- National Productivity Center-
- Turkish Standards institute

\textsuperscript{17} [IADB. "Latin American Economic Policies", Vol 14, 2001]
\textsuperscript{18} [UN-ECE, "Experience in Promotion of SME's in Turkey" 1997]
No unified definition of an SME exists in Turkey in spite of the existence of these strong industry advocacy groups which have a representative committee acting in an advisory role to government and in spite of a fairly coherent policy approach to the sector. The existing agencies and organizations have set up different criteria for entitlement to their services. They are as follows:


⇒ KOSEB Small-sized Industrial Enterprises: one to forty-nine workers Medium-size Industrial Enterprises: fifty to one hundred fifty workers: Large: more than one hundred fifty workers.

⇒ HALK BANK (value of assets revised periodically) Small: less than one hundred workers and $25,000 US total assets. Medium: less than two hundred fifty workers and $125,000 US total assets. To qualify for a loan, a business must meet both criteria so it is possible to have a small business based on the number of workers be considered a medium business based on the value of assets. In fact, it would appear inevitable, as the total asset threshold is very low.

⇒ DIE (The State Institute of Statistics) uses only number of workers and defines Micro-sized Scale Establishment as one to nine persons, Small as ten to forty-nine, Medium as fifty to one hundred ninety-nine and Large as over two hundred. This classification is used to generate statistics on enterprises as a whole. Because the size ranges used do not correspond (even when two sizes are added together) to any of the ranges used by other entities, comparing different sets of data is difficult.

⇒ The Undersecretariat of Treasury defines SMEs as, "Businesses that employ a maximum of one hundred fifty workers and the net value of machinery and equipment, plants, vehicles, tools and appliances, furniture and fixed inventory including land and buildings recorded in their legal books and documents is at most fifty billion TL" 19 This definition is used to qualify...

19 [ibid, p16]
enterprises for exemptions from VAT, customs taxes, stamp and duties and tax holidays and is one of the legislated definitions of an SME in Turkey. It is part of the "State Aids for Investment to SMEs Decree issued in respect of the Undersecretariat.

⇒ The Undersecretariat of Foreign Trade defines SME's as, "Businesses that employ a maximum of two hundred workers, the net value of [assets as above] is at most $2,000,000 US." This definition is used to qualify businesses for a variety of export development and promotion programs. This definition is also given the force of legislation by being part of a decree relating to state aids for exporting enterprises. It is not known why the two definitions from the two government ministries are not the same.

The legislated definitions are used specifically to define who is qualified for financial benefits. The lack of consistency provides confirmation of one analyst's observation that the Turkish legal system is weak\textsuperscript{20} in allowing contradictory laws to exist. Moreover, it seems to indicate that there are not strong consultative mechanisms built into the government. The Turkish Grand National Assembly SME Working Group is an institutionalized entity studying the problems of SMEs for discussion at the Turkish Grand National Assembly. That Working Groups is dealing with regulatory reform but could also deal with the definition issue, if it were to come to the fore.

In the above legislated definitions, there is a process by which the value of assets is adjusted periodically to take into account the high rate of inflation. There is no distinction made among industrial sectors or value-added or non-value added industries.

The Turkish experience allows development of institutional level and enterprise level activities and support systems without having a consistent and coherent national policy. On the world scene, a lack of policy seems more the rule than the exception as a large number of countries seem to soldier on without a strategic policy framework to guide their SME development programs.

Other examples

In the research there are numerous ways of defining the SME sector in different economies, presumably reflective of national differences and aspirations. Examples from several countries follow to demonstrate the wide range of possibilities available in developing a definition for Egypt.

Russian Federation

Russia has embarked on massive structural economic changes towards an economy based on small and medium-sized enterprises. To facilitate support for SMEs it has developed a definition of "small businesses that compose the small business sector" being:

1. Commercial organizations, legal entities, in which:
   • The share of Russian Federation and federal subjects ownership, municipal ownership, ownership of public and religious organizations, charity and other funds does not exceed twenty-five per cent of the authorized capital…..
   • The average number of employees (including part-time workers and persons working under sub-contracts) does not exceed the following maximum levels
   • In industry, building and transport: one hundred people

\textsuperscript{20} Sogut, UN-ECE, 1997. P.10
• In agriculture, science and technological fields: sixty people
• In retail trade and consumer services: thirty people
• In other fields and activities: fifty people

2. Farms
3. Persons who perform entrepreneurial activities but are not legal entities.²¹

Russia’s definition is one of the few found that included farms and the reason it has been included here. Most countries have developed farm policies that are quite different from their SME policies, but from Russia’s example one can see that it does not have to be invariably so.

South Korea

SMEs are considered the driving force for sustaining growth in the economy and for social stability through employment creation. They are defined as follows;

<table>
<thead>
<tr>
<th></th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining, Manufacturing</td>
<td>fifty or fewer employees</td>
<td>fifty-one to three hundred employees</td>
</tr>
<tr>
<td>Transportation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>thirty or less</td>
<td>thirty-one to two hundred</td>
</tr>
<tr>
<td>Commerce, services</td>
<td>ten or less</td>
<td>eleven to twenty             ²²</td>
</tr>
</tbody>
</table>

Labour intensive businesses are classified as small no matter the number of employees and capital intensive businesses are classified as large even though they have a small number of employees. Korea illustrates the possibility of capital intensity being used as a qualifier to an employment based definition, much as was the case in Thailand.

Indeed, assets as criteria for the definition are used in most Asian countries. Japan, Malaysia, Philippines, Singapore and Taiwan all use the asset criterion for manufacturing industries and either number of employees or gross receipts as the criterion for service industries in their SME definitions. Moreover, Japan uses value of assets of less than a certain amount (depending on the sector) or less than a certain number of employees while Malaysia uses less than a certain value of assets and fewer than a certain number of employees.


²² [Govt of Korea.  www.smba.go.kr]
M/SME’s in Egypt

According to the Ministry of Economy definition, SMEs account for ninety-nine percent of all non-agricultural private enterprises in Egypt, provide eighty percent of the total value-added businesses in the Egyptian private sector, and account for the employment of more that sixty-six percent of the total labour force.  

Egypt is faced with a daunting employment creation problem between now and 2017 and is counting on SMEs to provide at least sixty percent of the needed jobs. The government desires these jobs be sustainable (i.e. not requiring subsidies) and provide their holders with an acceptable standard of living. Egypt has recognized that the previous state oriented approach to management of the economy has led to a static economy and a deterioration of the efficiency and competitiveness of industry. This approach included subsidies, protective tariffs and non-tariff barriers, national ownership of major industries and financial institutions, a relatively large and expensive public sector and a dependency on rents from oil exports, Suez traffic and remittances from overseas workers rather than productivity of business. The only way to achieve the established employment and GDP goals seems to be through trade liberalization and encouragement of growth of the SME sector.

In terms of the characteristics of the sector bearing on the definition issue, the DEPRA project study on Financial Reform for SME Development provides some analysis based on interviews conducted with a stratified sample of entrepreneurs in 1997. (173 entrepreneurs were randomly selected and interviewed. They represented the textile and garment manufacturing, furniture and wood processing, shoe making, artisanal craft production, carpet weaving sectors as well as tourism companies, hotels and restaurants, service companies and wholesale and retail trade.)

In terms of ownership, two thirds of micro and small scale enterprises are proprietorships and one third partnerships. Medium sized enterprises are two thirds partnerships. Eighty-eight percent of medium size enterprises fully complied with regulations regarding business registration, licensing, taxes and social security while just a little more than half of the micro enterprises complied.

The average value of physical assets, exclusive of land and buildings, ranged from LE twenty-six thousand (median LE six thousand) for micro enterprises, LE six hundred thirty thousand (median LE eight thousand) for small enterprises to LE three million three hundred thousand (median LE two and one half million) for medium sized enterprises.

Micro enterprises in the sample have experienced little growth in employment and zero median growth in production in the year previous to the interview. Small enterprises, on the other hand, have experienced thirty-four percent annual growth in number of employees while medium enterprises employment grew at thirty-eight percent. Production increases were in line with employment growth.

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23 [MOE: Draft National Policy on SME Development in Egypt.]

24 [All info from DEPRA report: in that report “micro” means one to nine employees, “small” means ten to forty-nine employees and “medium” means fifty to one hundred employees.]
Rural enterprises are generally smaller and have a lower average value of physical assets than do urban enterprises.

Female operated enterprises generally started as micro enterprises and stayed in that size class, while male operated enterprises more often started as small enterprises.

In terms of sub sectors, an important observation is "The annual growth rate for enterprises measured by change in number of employees over the number of years the enterprise has been in operation indicates that services have experienced the highest growth rate followed, second, by manufacturing enterprises, and third, by traders." 25

The DEPRA report makes a recommendation that is worth keeping in mind when discussing definitions. "Third, efforts should focus primarily on providing financial and non-financial services to small and medium scale enterprises with growth potential. Findings of the study support that small and medium scale enterprises are the growth engines of the economy rather than micro-enterprises which are more typically income generation vehicles. This does not imply that initiatives focusing on providing financial and support services to micro-enterprises are not worthwhile, however it is important to recognize the limitations of the expected outcome of these efforts." 26

While the DEPRA report suggested that few microenterprises are likely to be growth engines, some will become so. The challenge is to devise definitions and policies that will enable government to identify and encourage the ones with growth potential. These two segments of microenterprise have been described as: "productive small-scale activities with the potential for growth and technical upgrading, on the one hand, and dead-end survival activities, on the other." 27

25 [ibid. p.36]
26 [ibid. p.67]  
Stakeholder mapping

Definitions currently used by agencies in Egypt

This section provides a list of various entities engaged in the provision of services or interventions to the SME sector. Since so many of the SME programs in Egypt are donor funded, we begin with a discussion of definitions used by donor agencies in general. Next follows a list of agencies currently operating in Egypt and the definitions they use, if a definition is used at all. Most of these entities do not define SMEs in their publicly available literature or websites, even though they constantly use the term. If they do define the term, the definition is so vague as to not be useful for analytical purposes. This is particularly the case with the donor agencies and NGO’s they assist.

The co-chair and the secretariat of the Committee of Donor Agencies for Small Enterprise Development is provided by the World Bank but the Committee reports through the ILO. This Committee includes most of the major donor agencies and is intended to provide guidelines for program design and intervention strategies and a consistent and coordinated approach to donor funded interventions. This Committee has deliberately not become engaged in a discussion of the definition of SME. The 1997 Report to the Donor Committee on Small Enterprise Development [ILO] observes that, "there is no definition of SME’s which commands universal agreement and it is certainly not the intention of this Committee to add another definition to an already considerable list.” The following is the Donor Committee’s own broad definition: “The term small enterprise has never been explicitly defined. The Committee considers this term to include formal and informal non-agricultural enterprises ranging from micro to medium size.”

In the Committee’s 2001 report entitled “Business Development Services for Small Enterprises: Guiding Principles for donor Intervention: 2001 Edition” a somewhat different though no more illuminating definition is provided. “Small Enterprises (Ses) include micro-enterprises as well as small and medium scale enterprises. These categories are usually defined by the number of employees or by assets, but these definitions vary by country, institution and objective; no precise definition is adopted here.”

Donor agencies tend to use an imprecise definition or the definition used in the specific country in which they are working. This accounts for the lack of definitions or the use of more than one definition by a donor.

For example, USAID in its Small Enterprise Credit program in collaboration with the National Bank for Development, uses number of employees and fixed assets to determine eligibility for loans. "Eligible Borrowers: Generally small entrepreneurs in the greater Cairo area with less than fifteen employees, and less than LE 25,000 in fixed assets, excluding land and buildings.” This definition is not used by the NBD for its own purposes, however.

29 ibid
30 [www.usaid.gov/countries/eg/proj/]
The USAID funded Small and Micro Enterprise Development programs uses the following NGO’s for delivery of its services:

- ABA Foundation (Alexandria)
- ESED Foundation (Cairo)
- SEDAP Foundation (Port Said)
- ASBA Foundation (Assiut)
- Sharkia Business Association

This agency has a different definition for eligibility based on number of employees and ownership while the loan size appears to be used as a definition by the service provider:

"(1) Eligible borrowers are generally existing, owner-operated small (six to fifteen employees) and micro (one to five employees) enterprises.

(2) Loans range in size from LE 500 to LE 5,000 for micro enterprises and LE 5,000 to LE 15,000 for small enterprises." 31

The Social Fund for Development, which receives most of its funding from donors, is the major source of institutional micro finance in Egypt. The Fund’s definition of an eligible enterprise relates only to the ownership and eligible borrowers are unemployed individuals or partnerships. Eligible loans are for any business purposes other than land reclamation. A great deal of controversy is found in literature over the effectiveness of this Fund and critics argue that its subsidization of interest rates is decreasing the amount of credit available for SMEs.

The following institutions deliver the Social Fund program:

- National Bank of Egypt
- Principal Bank for Development & Agricultural Credit
- Banque du Caire
- Misr Bank
- Bank of Alexandria
- Industrial Development Bank of Egypt
- Some Private and joint venture Banks
- Egyptian Association to Support Small Producers
- Development of Small Enterprises Association in Fayoum

The Credit Guarantee Company (CGC) is a joint venture between nine banks and an insurance company providing loan guarantees on behalf of SME clients, which are defined as being in any sector except trade and total assets, excluding land and buildings, of between LE 40,000 and LE 5 million. The average loan size places the recipients far above the micro level. Moreover, nearly twenty percent of the guarantees are for loans to health care professionals to set up private practices.

31 [ibid. Note that the figures for loan size are different in the DEPRA reports and in Dichter, Tom. “Case Studies in Microfinance, Egypt, The Alexandria Business Association Small & Microenterprise Project.” World Bank, 1998. The ABA website is different still and states that loans from LE 350 up to LE 3000 are micro while small is from LE 5000 to 25,000. www.alexandria2000.com/aba-sme/]
The following entities with SME related operations or projects in Egypt did not employ a definition of SMEs in their literature or website. This is by no means an exhaustive list.

- Centre for International Private Enterprise [www.cipe.org/]
- Netherlands Development Finance Company (FMO)
- CARE
- Catholic Evangelical Organization for Social Services [www.ceoss.org]
- Near East Foundation [www.neareast.org]
- Institute of Cultural Affairs (MENA) [www.icaworld.org.mena/]
- CARITAS (part of five agency Swiss consortium)
- Freidrich Ebert Stiftung [www.fes.de]
- Konrad Adenauer Stiftung [www.kas.de]
- Ford Foundation [www.fordfound.org]
- American Chamber of Commerce in Egypt [www.amchm.org.eg/]

Federation of Egyptian Industries [www.fei.org] has as an objective support for small and medium-sized enterprises and includes in its vast membership numerous SMEs, but has no published definition. However, a definition is attributed to them by Freidrich Ebert Stiftung [Freidrich Ebert Stiftung, Directory for Governmental and Non-Governmental Organizations Supporting Small and Medium Scale Enterprises in Egypt.] which is less than ‘total investment cost of LE 500 thousand and not more than 100 workers’.

- Egyptian Small and Micro Enterprise Association (ESMA) - site not operative.
- Egyptian Society for Economic Journalists has plans to prepare, but has not yet done, a glossary of commercial terms and a directory of economic journalists.
- Cairo Times [www.cairotimes.com] A search of their database did not yield a definition of SME’s.
- The following research organizations use definitions in the reports they publish but do not seem to use a consistent definition amongst them.
- Egyptian Centre for Economic Studies [www.eces.org.eg]
- Economic Research forum for the Arab Countries, Iran and Turkey (ERF) [www.erf.org.eg/]
- International Development Research Centre (IDRC) [www.idrc.ca]
- Development Economic Policy Reform Analysis Project(DEPRA)
Finally, the Government of Egypt. The following ministries and organizations are involved with SME development in one manner or another.

- Ministry of Economy and Foreign Trade
- Ministry of Industry and Technological Development
- Ministry of Local Development
- Ministry of Finance
- Social Fund for Development
- Ministry of Social Affairs
- Ministry of Planning
- National Bank for Development
- Industrial Development Bank

The Ministry of Economy and Foreign Trade (MOEFT) is the lead agency for SME policy development and the one identifying the need for a unified definition. MOEFT, in its 1998 draft policy document proposes a definition based on number of employees. “Micro” enterprises are one to five employees, “small” are five to fourteen and “medium” are fifteen to forty-nine. Numerous other definitions are in use among the other agencies (we have already noted the definitions used by SFD and NBD).

The following information is from the Freidrich Ebert Stiftung directory, which appears to use different names for some ministries from what are currently used:

- Ministry of Industry. SMEs have less than LE 500,000 in fixed assets and between 10 and 100 workers
- Ministry of Planning. SMEs have less than LE 50,000 in fixed assets including land and buildings.
- Ministry of Rural Development and Ministry of Local Administration. Definition does not use economic criteria.
- Institute for National Planning. SMEs are projects employing 10 to 49 workers in manufacturing
- Central Organization for Mobilization and Statistics (CAPMAS). SMEs are enterprises employing between 50 and 100 workers.
- Industrial Development Bank. Uses value of fixed assets, adjusted periodically.

The DEPRA project used the following definitions in the two SME related papers:

Micro = one to nine employees and /or loan size of LE 500 to LE 19,000
Small = ten to forty-nine employees and/or loan size of LE 20,000 to LE 99,000
Medium = fifty to one hundred employees and/or loan size of LE 100,000 to LE 250,000

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Several observations can be made about these numerous definitions currently in use.

Value of fixed assets, either by itself or combined with number of employees, is the most common criterion. The range of variation of measures is vast. Most definitions used do not permit useful distinctions to be made for intervention purposes. This problem is particularly acute in the small size classes where some of the M/SME interventions (SFD and some other donor funded programs) concentrate on employment creation through self-employment programs. Since the programs serve firms with roughly the same number of employees, confusion arises as to the criteria for eligibility. Startups become confused with low growth or static enterprises (dead-end survival). Sorting out this confusion between startups and low growth enterprises is important because the common experience in most countries is that micro enterprises started through self-employment/poverty alleviation schemes seldom graduate into small and medium-sized enterprises because the owner-operators are “reluctant” entrepreneurs. These businesspeople are not exploiting some market or technological niche and are likely to abandon the business for wage employment if an attractive opportunity presents itself.

Lending to “start-ups” or to youth, women, displaced agricultural workers, etc., that traditionally have not deliberately chosen entrepreneurship, is quite different from lending to well educated, trained individuals who see an opportunity to become successful by doing something they enjoy and who may have already started their business using savings and family sources, and now need additional funds in order to expand or capitalize on an opportunity.

Using a definition based solely on the number of employees does not allow service providers and governments to make these valuable distinctions in the M/SME sector.

Another issue ineffectively addressed is the so-called “informal sector”. The Freidrich Ebert Stiftung directory notes that government authorities do not include the informal sector in their definitions. The question is: “Where is the line between formal and informal?” The analysis provided in the DEPRA study [Nathan Associates, “Financial Reform for Small Business Development in Egypt”, GOE/USAID 1997] observes that a significant number of businesses of all sizes, but especially micro enterprises, do not comply with all governmental requirements for registration, licensing, possessing tax cards and making social security payments for their employees.

However, this analysis is based on informality being defined as “not having satisfied at least one of the requirements” which tends to make the number of non-complying businesses too high. Moreover, if government authorities only consider enterprises that meet all criteria as being SMEs, as the FES directory suggests, they are probably missing a great deal of the economic activity of the country.

Informality would be more usefully defined as “enterprises that did not meet any of the requirements or that did not report business income”. To use an example from Canada, most self employed people or business owners report business income on their annual tax returns even though they may not have a registered business, have the proper sales tax registrations, have legal employees for whom they make various payroll taxes, have municipal or provincial licenses, etc. The reason is that the penalties for income tax evasion are severe while the penalties for not complying with the other requirements are not. The number of tax filers is a more useful measure of the number and size of businesses in Canada than any other number produced by the other agencies that keep track of businesses. This may be the same in Egypt.
Data resources to support a unified operational definition in Egypt

This paper has examined data gathered by CAPMAS in the 1996 census, by the Labour Force Sample Survey conducted in 1988, by the DEPRA reports and the evaluations of the ABA micro-lending program and the SFD loan programs. All of these groups conducted interviews with entrepreneurs thus permitting a ground truthing of the statistical information. In addition, it has noted the commentary on data resources in the documents prepared by the Ministry of Economy and Foreign Trade and by the various research organizations, particularly ECES.

In addition, there is an August 2000 paper by Magued Osman, entitled "Review and Assessment of Data Sources on MSMEs" which provides a detailed analysis of all the relevant data sources in Egypt. The paper makes the following conclusions:

"the following conclusions can be derived from the review of data sets on MSMEs:

i. There is a large number of data collection activities related to MSMEs. Three data sets have been collected on a full enumeration basis between 1996 and 1998 (the establishment census, the economic census and the industrial and handicraft study) by CAPMAS.

ii. Data sets collected through CAPMAS have limited accessibility.

iii. Data sets on credit beneficiaries are more accessible especially in the case of NGOs and business associations. However, these data sets are not representative of MSMEs.

iv. Non-traditional data sets such as social security, commercial registration and electricity accounts are designed for other purposes but might have valuable information.

v. There is a need to improve data collection activities. Lack of compatibility and non-accessibility are two major problems.

vi. A gap that needs to be closed is the lack of coordination between data collection activities. Traditional and non-traditional ways of networking are needed.

vii. Another gap is the absence of any electronic media for users with need for direct and indirect access to data on MSMEs.

viii. With few exceptions, the level of data accuracy and coverage are adequate."

The CAPMAS establishment and economic censuses and the CAPMAS and Social Fund for Development small industry study have collected an impressive amount of detailed information on the MSME sector which could be used to support an operational definition of the sector. One major problem, however, is that the three surveys collect different data at different time periods, leading to the need for interpretative analysis. The performance of the latter is hampered by the lack of access to the data in electronic form which makes cross referencing and tabulation difficult.

33 Osman, Magued. "Review and Assessment of Data Sources on MSMEs." Copy provided by IDRC.
Based on this less than complete picture, the evaluation of the data resources in Egypt is that, in their current form, they support only a rudimentary classification and definition of SMEs based on number of employees by industrial sector of the economy. The census data could also be used to generate information on rural vs. urban location, which is valuable information for distinguishing types of micro and small enterprises. Information on gross receipts, total assets, export sales, characteristics of owners and employees and so on has also been collected by various agencies but exists in a number of unlinked data base files and is therefore not practical to use at the present time.

Moreover, little of the longitudinal data that is needed to evaluate policy interventions and to understand the dynamism of the sector is available. From census to census, the number of SMEs and the number of people employed may grow by a certain percentage but hidden in this number is the possibility that few of the firms in a size class may have survived from one census to the next. They may have closed their doors, gone bankrupt, downsized by a size class, or may have graduated to the next larger size class. The new enterprises that came into existence since the previous census make up for these losses and add the growth. But the dynamics of the SME sector remain hidden from view. Registration ledgers and electricity accounts, if they could be linked to the other data sets, could provide some insights on the dynamics of the sector.

Similarly, a net employment gain of one million jobs is good but may hide the fact that in order to get the one million jobs, it was necessary to create five million and lose four million. Most gross job creation takes place in one size class of enterprises and is true in most OECD countries. But is the size class to which firms are allocated the size class they were in the base year, or is it the average size over a period of years, or is it the size they are at the time of the survey or census?

The current data in Egypt does not permit analysis of the dynamics of job creation in SMEs yet the GOE wishes to develop policies that encourage high rates of employment creation by SMEs. Without this micro-level tracking at the level of the establishment, how will the GOE know whether or not policies are working?

In most countries, growth in exports of goods and tradable services are considered to be an essential component of overall economic growth. Large firms generally account for most (sixty-five to seventy-five percent) world manufactured direct exports but most of the growth in exports is by SMEs. Exporting enterprises operating in a market economy without subsidies are, by definition, competitive. They have the opportunity to be high growth, high productivity enterprises. These are the enterprises likely to make the greatest contribution to wealth and employment creation. The same data base must be used to track export performance of enterprises as well as other characteristics of the enterprises to enable effective design and evaluation of policy interventions. Current data resources do not allow for a sophisticated or useful definition. If a better definition is desired, better data would seem to be necessary.

Recommendations on improving data and on up-dating the definition

One preliminary recommendation for improving the data sources in Egypt is for the government to implement a single business registration number (perhaps as part of a move towards one-stop service centres for business) for each enterprise. This single number would be used in all data

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34 [OECD, 1997, “Globalisation and Small and Medium Enterprises”]
collection and transactions with government agencies. The number would be used to collect and cross reference all information supplied by the enterprise, including:
  - a simplified industrial classification (modeled on the NAICS/SIC system of Canada or a European model)
  - various measurements of size
  - assets employed
  - gross receipts
  - locational information
  - information on the owners/managers

Once this data is collected (most of it has already been collected but does not appear to be readily accessible) in the routine course of processing business registrations, tax returns or social security payments or any other ways in which enterprises come into contact with governments, it could be used to generate periodical surveys to provide longitudinal information and a means of evaluating different approaches. Without solid baseline data and a method of evaluating impacts of various policy changes, it is difficult to make any kind of cost benefit analysis of different programs. In Canada, most of the data mentioned above is regularly collected by the federal income tax authorities. It can be used to generate very useful statistical information on the whole business sector or any one part of it. Unfortunately, privacy laws prevent it from being linked to any other data base such as a provincial companies registry, for example. The same restriction may prevail in Egypt or it may not.

The SME database developed for the European Union by EUROSTAT is a useful document, particularly the publication "Enterprises in Europe" issued by EUROSTAT and EC Directorate General XXIII in 1992.

In considering ways to compose useful definitions for the sector in Egypt, it may be appropriate to make distinctions based on the following additional factors:

**Industrial Sector**

Manufacturing vs Services vs Trade vs Construction

The size classes should be different depending on the sector. Retail establishments or restaurants can probably be safely classified in the same group no matter how many employees they have, as just one example.

Exporting or Non-exporting

Exporting firms are likely to have high potential. Export performance offers a good way of targeting policies for firms in a size class that includes a lot of low potential firms. For example, a micro-enterprise that exports tradable services is likely to have different needs and potential than one that does not export.

**Age of the Enterprise**

New firms have higher rates of net employment creation than older firms while older firms have lower employment volatility than newer firms. New firms are most often small but not all small firms are new. An enterprise that is still micro or small scale after more than five years may be going down a dead end street or be simply supporting a lifestyle.

**Balance Sheet Items**
Value of fixed, physical assets, excluding land, is a better measure of capital intensity than total investment, which was used by some of the agencies and which could include items such as inventory and good will.

**Income Sheet Items**

Gross receipts alone or the ratio of gross receipts to raw materials or the ratio of gross receipts to direct labour can provide valuable information to distinguish members of similar size classes and, if done by industrial sector, can also be used by firms for benchmarking.

**Ownership/Characteristics of the Owners**

Many countries stress that SMEs should be independently owned rather than include subsidiaries or branches of large firms. Age, gender, education, and previous employment of the owner for owner/operated enterprises can be useful in defining program interventions. In Canada and the United States, native or other visible minority status is frequently used as part of the definition of SMEs targeted with enhanced or special program initiatives.
Suggestions for a unified operational definition of the M/SME sector in Egypt

Too many people and agencies exist that provide services to the M/SME sector to simply present them with a definition. An effective definition will evolve from engaging in an inclusive, consultative process. All the players in this arena must take ownership and buy-in during the policy development process. This process could start with developing the definition.

Accordingly, the following definitional options are put forward for consideration.

Size class according to employment

Using the 1996 CAPMAS census data, we see that fifty-one percent of establishments have only one employee and account for twenty-one percent of private non-agricultural employment. These establishments could be considered in a single class. This size class would include most of the proprietorships with limited potential, as this class includes many artisans, petty vendors, personal service providers and the like. The very fact that they are self-employed entrepreneurs who have no employees suggests that they may not be the answer to the employment creation problem. A separate class allows policy makers to deal with the fact there are at least two different kinds of micro-enterprises with different needs and goals.

This means splitting the current micro-enterprise class into two: those with one employee and those with more. The current MOEFT definition calls all enterprises employing one to four workers “micro”. Micro enterprises account for ninety-four percent of establishments and sixty-five percent of employment. If the definition for “micro” were changed to two to four, the size class would then include forty-three percent of establishments and forty-four percent of employment. The remaining size classes could stay the same, for the time being, at five to fourteen for “small” and fifteen to forty-nine for “medium”.

Although these are rather small compared to other countries, it seems to fit the structure of the Egyptian private sector. However, this size structure can be reviewed periodically with the intent of moving closer to the size classes used by the EU. There are two reasons for the review. First, Egypt's major trading relationships will eventually be with the EU and these relationships will eventually be formalized by a customs union or other trade agreement, which will contain rules about SME policies that would be easier to harmonize if the definitions were closer to being the same. Second, having similar definitions make comparative analysis of performance and benchmarking easier, which are vital for policy development and evaluation.

The stakeholders may wish to consider going to the EU size classes for micro businesses (less than ten employees) and small businesses (less than fifty employees) now. Medium sized could be from fifty to ninety-nine employees (in contrast with the EU, which has a maximum of two hundred fifty in this class) until such time as new census data supporting this latter number became available. If this option is used, segmenting the micro category to have a class for enterprises with less than two employees is important.

Neither of these options on size classes introduces any untoward distortions.
Total Physical Assets.

If the data resources can support such a definitional measure, a definition including a qualifier related to capital employed would be useful. Such a qualifier would distinguish capital intensive from labour intensive enterprises, as a number of Asian countries have attempted to do. The reason for doing so is to clearly understand who will be affected by interventions related either to access to capital or cost of capital.

Current discussion is about capital market failures being one of the obstacles to SME growth, as if all enterprises had an equal demand for capital. The remedies for these market failures are different depending on whether the need is to access capital to finance fixed assets like machinery or the need is to access to capital to finance inventory and accounts receivable related to export markets. The solutions to the latter problem are quite different from the solutions to the former. Moreover, enterprises that employ many physical assets have those assets available as collateral for loans.

The cost of capital access is frequently described as a problem of access to capital. The two issues are distinct, although one may contribute to the other. Marginal or uncompetitive enterprises with poor profitability are concerned that they are unable to get access to capital (or any other inputs) at a price low enough to allow their businesses to remain viable. If the capital market is prepared to offer them capital at a risk-adjusted price that is necessarily high, these enterprises are really asking for subsidies when they identify access to capital as one of the constraints they face.

This data, if available, would make it possible to set thresholds of total physical assets by size classification to better understand this issue. Looking back at the DEPRA paper on financial reform, one recalls that the range of value of physical assets for each size class was quite large and that the median value was towards the bottom of the range. For example, small enterprises (ten to forty-nine employees in the DEPRA study) had an average value of physical assets, not including land, of LE 630,000 and a median value of LE 80,000. Those enterprises with physical assets worth less than the median probably were more like micro enterprises in their capital structures and needs, even though they have a greater number of employees than the micro classification. Of course, there are sector differences to consider as well in establishing an asset threshold.

Consideration of capital as part of the definition has merit because it may assist to segment the sector according to need for financial interventions or policies in a way that simple number of employees does not. Secondly, it once again moves the definition closer to that of the EU, with all the benefits of that move as described.

Independence

A definition of an SME should include a qualifier related to independence. The one adopted by the EU, namely that no more than twenty-five percent of the voting shares may be owned by a large corporation, is an appropriate one and this paper recommends such a clause for consideration by the stakeholders. It is further recommended that franchises of large national or multinational corporations should not be considered SMEs for policy and program purposes even when their share of ownership is negligible or non-existent.

Dominance
Although this factor does not appear to be a factor in the Egyptian market, the stakeholders should give consideration to domination. If there are only one or two SME suppliers of a good or service in the country, this paper recommends a qualifier that states when an SME controls more than ten percent (or twenty-five percent, the number can be debated) of the production of a particular good or service, it not be considered an SME for purposes of meeting a procurement quota or satisfying a bid preference, where one is offered to SMEs as a development policy. This is similar to the manner in which the U.S., SBA and many of the states handle this issue. Except when related to strategic industries, whether or not such bid preferences or quotas are in the public interest continues to be subject to debate.

Characteristics of Owner/operator

This is an area to be approached with caution. It may be useful to classify some enterprises using such criteria as gender, educational attainment, previous work experience or membership in some minority group in certain specific instances. For example, it may be the case that self-employed individuals with a university or technical college education have high potential to grow their enterprises as opposed to self-employed individuals with low educational attainments whose enterprises will mainly remain static and marginal. The evidence from a variety of studies suggests that this is true and that policies ought therefore to reflect these differences.

The caution applies to using membership in some ethnic, linguistic or visible minority group as a criterion as has happened in Canada and the United States where this has been done for political purposes and eventually leads to poor economic policy, not to mention a perception of unfairness and other such divisions in society.

An Institutional Mechanism for Verification and Certification of M/SME's

This question revolves around the issue of who will be eligible for entitlements or benefits. Separating eligibility from entitlement is important. The Government of Egypt may wish to carefully consider the implications of making policy measures and programs into entitlements. Entitlement leads to dependency, lack of competitiveness, non-entrepreneurial attitudes and a host of other problems best avoided at all costs. Eligibility, on the other hand, merely states that the enterprise is eligible to apply or to compete and has to demonstrate that it’s application meets all the criteria and is worthy of receiving a particular procurement contract or loan through a process of self-identification.

Canada relies on self-identification and leaves the onus on the enterprise to demonstrate eligibility. This policy works well because most of the benefits in relation to access to capital, for example, are related to access rather than price. No incentive exists for a firm to misidentify itself, as loans and loan guarantees to SMEs are generally priced slightly higher than the same products for larger enterprises. Since most studies suggest that access to capital is paramount for SMEs and price of capital is secondary, consideration of this issue is important. Moreover, by eschewing subsidies completely, sustainability issues are addressed along with eligibility.

In the case of procurement, to use the United States as an example, firms that meet the eligibility criteria from the SBA list are simply eligible to bid on contracts, knowing only that they will be
competing against firms of the same size and not against all firms. The firm provides easily
verifiable and simple information to demonstrate that it fits in the size class of firms eligible for a
particular contract and that is that. The publication of such awards ensures that there is no
misidentification or lack of diligence by bribe-seeking officials, as the identity of the successful bidder
becomes public knowledge and the unsuccessful bidders and the media have an opportunity to
state their dissatisfaction if improper practices were used. Auditors also conduct regular audits on
these contracts
These approaches are simple, inexpensive to implement, and do not require a large effort on the
part of government once the definitions are clearly enunciated. This should be the preferred
approach, especially as reduction of the role of government in regulating the sector is
simultaneously being contemplated.

Furthermore, while the US Small Business Administration has developed an elaborate set of
definitions of small business by sub-sector and spends a great deal of money modifying and
maintaining these definitions, the same results can be achieved by simply stating the principles and
criteria employed. Few other countries in the world have developed such detailed lists yet manage
to have vibrant economies.

Another approach is to have government (or an private sector body such as an industry association)
develop a system of certification of status for eligibility for entitlements or benefits. A highly
bureaucratized organization may do this for all enterprises using registration, tax information, etc.,
even though the vast majority of enterprises may never seek to avail themselves of the particular
benefits offered. The result would be a certificate for each enterprise in the country. The task of
maintaining all this paperwork and amending certificates as firm size or other criteria change is
daunting and does not seem to be an optimal use of resources.

The SBA, while it uses self-certification for procurement contracts, access to loan guarantee
programs and other services, does maintain lists of small, disadvantaged businesses and
HUBZone35 businesses. Both of these programs are aimed at disadvantaged minority groups or
areas of severe economic disparity and the certification process is used to market the programs and
to allow these small, marginal businesses to complete the paperwork once and then follow a simple
bidding process after that. As a method of reducing paper burden on disadvantaged businesses in
rural areas, this approach has merit, particularly where literacy levels are low.

If the government wishes to set up and maintain a register, the easiest way is through a single
number referenced to tax returns. The information for verification of eligibility would be available on
the tax return and could easily be checked if there is any doubt on the part of the agency conferring
the benefit. In fact, one way to encourage enterprises to formalize themselves is the requirement to
file tax returns to obtain any financial incentives such as refundable tax credits. This method can be
used for interest buy-downs, research and development or market development assistance and for
cost-sharing in the hiring of various kinds of expertise. To receive the incentive, the enterprise must
file a tax return. This is a suggestion of one way to do it.

For these reasons, an ad hoc approach is suggested that relies on self-identification subject to a
simple verification process, with appropriate modifications to account for Egyptian circumstances.

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35 HUBZone means ‘historically underutilized business zones’ and refers to distressed areas of the
country with at least 20% lower per capita income or 40% higher unemployment than the national
average and to Indian reservations.
Separating the task of verifying that an enterprise meets the criteria for a contract from the task of granting the contract between two different agencies is all that may be needed.
Conclusions

Many lessons can be learned from a review of practices in other countries, the most important being there is no correct definition. Each economy must develop a definition that suits its circumstances, needs and its data resources. Some economies function quite well with a multitude of definitions. None of the countries examined exhibited a clear link between definitions, and even SME policies, and the rate of economic growth. An economic environment that encourages entrepreneurship seems to be the most significant contributor to economic dynamism in the SME sector.

If an external model is needed, the definition adopted by the European Union has much merit. The system the United States uses is far too complex and expensive for consideration elsewhere.

The conclusion for the Egyptian situation is that the process of arriving at a definition may be as important as the definition itself. The policy environment is complex and has many actors who do not always appear to be working together. The fact that starting a business requires months to fulfill all the legal requirements and that one must go to numerous different agencies to do so suggests that the system is not working as well as it could. The consultative process suggested for the development of a definition could bring the players together improve the working of the sector as a whole.

In all the countries surveyed, and particularly in Egypt, the difference between interventions made for poverty alleviation and those made to encourage industrial and business development is not well articulated and leads to confusion among the various agencies involved in those interventions. Perfect clarity on this issue is a must if useful policies are to be developed for M/SME development in Egypt and clarity should be one of the outcomes of the consultative process.
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