Harmonization process in defining small and medium-sized enterprises. Arguments for a quantitative definition versus a qualitative one

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Abstract. *Harmonization process of the definition and financial reporting of small and medium-sized enterprises is still a challenge for European and international organizations and institutions. Analysing the definitions of SMEs issued by European Commission, World Bank, OECD, the definitions used within a couple of countries and other studies regarding this aspect, it concluded that is not yet a consensus regarding the definition of the small and medium-sized enterprises. The various criteria used to classify the enterprises in the category of SMEs, different thresholds, the economic activity and economic context of each country are the main factors which interfere with the existence of one international available quantitative definition for small and medium-sized enterprises.*

Keywords: small and medium-sized enterprise (SME); quantitative criteria; qualitative criteria, harmonization process, financial reporting.

Introduction

Small and medium-sized enterprises represent more than three thirds of all the companies from the world. These companies are considered to be "real economic engines" which contribute in a great extent to the economic growth of their country (European Commission).

In the European Union there are almost 21 million of small and medium-sized enterprises, which represents more than 98 per cent of all the European companies. For the year 2012 it was estimated that share of the total staff within the SMES was around 67 per cent (more than 87 millions of employees) (ECORYS, 2012). Considering that SMES are the main source of creating and providing workforce, providing revenues to the budget and other economic reasons, it is obviously that SMES has an essential role in economic growth and development of the European Union.

In Romania, until the year of 2008, there was observed an accession of the number of SMES, when due to the effects of the economic crises their number started to diminish. In 2011, according with the estimations of CNIPMMR[1], there was a number of almost 467,883 active SMES. The total share of staff was 65.8% (the media of the European Union being of about 66.9%) and the contribution to the GDP was 50.2% (the media of the European Union being of about 58.4%), values which were closed to the European media, in conclusions, SMES being the main source which create added value (CNIPMMR, 2012).

Table 1. *Number of active Romanian SME and share of total staff*

	2006	2007	2008	2009	2010	2011
Number of active SMES	459972	498014	532688	517870	468561	467883
Large enterprises	1840	1843	1837	1571	1519	1519
Total	461812	499857	534525	519441	470080	469402
Share of SMEs total staff	63.20%	64.90%	65.80%	66.30%	65.90%	65.80%
Share of large enterprises staff	36.80%	35.10%	34.20%	33.70%	34.10%	34.20%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: National Council of Private Small and Medium Sized enterprises from Romania, http://www.cnipmmr.ro/CNIPMMRDespre-Noi/STRATEGIE-CNIPMMR-2012-2016.pdf, the available figures for 2011 are estimation of CNIPMMR, page 39 and www.insse.ro.

Even that European Commission, World Bank, the Organizations for Economic Co-operation and Development (OECD) and other institutions and organizations have made efforts to favour the process of harmonization in defining the SMES, at the moment there is not a general consensus regarding their definition. Hence, a

delay in harmonization of financial reporting of SMES is the non-existence of one single general definition for defining the small and medium-sized enterprises. Naturally, there is not a general consensus about definition and classification of a SME, due to the fact that the definition is influenced by the economy and the type of economic sector of the enterprise.

Considering the main definitions of SMES, the principal criteria according to which are classified SMES are: number of employees, turnover and total balance sheet, so it is difficult to suppose that will be a general quantitative SME definition which could satisfy all the characteristics of SME, regarding the different degree of development of economies around the world. Rather is preferable to use a qualitative definition which could better create the premises for harmonization and comparability of financial reporting of SMES (of course, even though there will be used quantitative criteria for statistical purposes, for access to different founds, classification in different programmes and other advantages).

General aspects regarding the SME definition at the international level

Regarding the definition of SMES, at the middle of '70s, there were over 50 different definitions of SMEs (Auciello et al., 1975). At the moment, on the whole, SMEs are considered companies whose characteristics respects certain criteria and do not exceed certain quantitative limits.

Diversity and richness of the characteristics of SMEs, political strategies and economic conditions are factors which hinder the existence of a common and general accepted definition of SMEs (OECD, 2004). Therefore, whereas in some countries a company is considered to be of a medium sized, in others, the same company is considerate to be large, and thus it would not be included in the category of SMES.

Nevertheless the existence of the definitions provided by European Commission, World Bank, OECD or other organizations, with the purpose to be adequate to more economies, sought to facilitate comparability and the internationalization in defining SMES, and moreover to create new opportunities like: access to the SMES to niche market, to technologies, know-how, access to capital, workforce, new market and products (OECD, 2005).

Table 2. *Examples of SME definitions suggested by CE, WB and OECD*

	Micro-entities	Small enterprises	Medium-sized enterprises
European Commission	a. Average number of employees < 10; b. Annual turnover < 2 millions Euros or c. Total balance sheet < 2 millions Euros;	a. Average number of employees < 50; b. Annual turnover < 10 millions Euros; or c. Total balance sheet < 10 millions Euros;	a. Average number of employees < 250; b. Annual turnover < 50 millions Euros or c. Total balance sheet < 43 millions Euros;
World Bank	a. Less than 10 employees; b. Annual turnover < 100.000 dollars c. Total balance sheet < 100.000 dollars	a. Less than 50 employees; b. Annual turnover < 3 millions dollars c. Total balance sheet < 3 millions dollars	a. Less than 300 employees; b. Annual turnover < 15 millions dollars c. Total balance sheet < 15 millions dollars
OECD	1. Between 1 - 4 employees (small micro) 2. Between 5 - 19 employees (micro-entities)	Between 20 - 99 employees	Between 100 – 500 employees

Source: Recommendation no. 2003/361/CE, World Bank definition, Organization for Economic Co-operation and Development (OECD) definition, Fitch (2006).

However, even inside one country could be more institutions and associations which differently define and classify SMEs like: statistical institutions, banks, governmental agencies and others (Kushnir, 2010). Therefore, in the study carried on by Kushnir (2010), from 120 analysed economies, in 26 economies there were more than one available definition to classify SMEs.

The existence of various definitions is a consequence of the fact that there are a multitude of criteria which could be considered when defines a SME, like: turnover, number of employees, capital, ownership independence, profit, assets, total value of imports and exports etc. Nonetheless, as it could be observed from the above table, there are some criteria which were used more often and considerate to be more adequate, so they were used preponderantly in definition of SMES, such as: number of employees, turnover and total balance sheet. But in some economies are set upper limits of assigning value to SMEs compared to other economies, even if the classifying criteria are the same.

Quantitative criteria in defining the SMEs

Overall, SMEs could be defined and classified taking into consideration: quantitative, qualitative, and both quantitative and qualitative aspects.

Quantitative criteria are more often used in defining SMEs, because these criteria allow a clear delimitation between different categories of SMEs, such as: micro-entities, small and medium-sized entities. The most common used quantitative criteria according to which the SMES are classified into categories are: number of employees, turnover, total balance sheet or a combination of the last two. There are other criteria like: net assets, initial capital, return, invested capital, industrial

classification combined with number of employees, total produced quantity and their value, added value etc., but there are seldom used (Filion, 1990).

Indeed, number of employees is the most frequent criterion used when classifying an entity as a SME. Why is the number of employees most common? Because, predominantly, number of employees is one of the criterion which enterprises discloses easily, and not al least is very easy to control it (Filion, 1990). Likewise, number of employees does not vary with consideration to inflation rate compared to other criteria like sales (Ganguly, 1985). There are opposite opinion which consider that number of employees do not reflect the real picture of a small enterprises (Osteryoung, Newman, 1993) and could incorrectly suggest the fact that if an entity is bigger it would need more employees, and for developing it has to employ more people, which could mislead to the idea of inefficiency of the SME (Gibson, van der Vaart, 2008).

Turnover is considered to be the more realistic and significant criterion in defining the SMEs due to the fact that generally it is available and it could be easily to extrapolate it (Gibson, van der Vaart, 2008).

Anyway, turnover together with the number of employees are not sufficient criteria to define small and medium-sized enterprises, and could not provide an equitable comparability because turnover varies considerable with the economic sector were the enterprise activates (d'Amboise, 1991), so beside these criteria when defining SMES it should be taken into consideration the type of economic activity as a separate criterion (Hauser, 2005).

To compensate the lack of specification of the activity sector where enterprises activate, European Commission, according to Recommendation No. 2003/361/CE, besides mandatory compliance regarding the threshold of the number of employees, allows the option of choosing between the turnover or total balance sheet threshold. So European Commission classify a SME as an entity winch hire less than 250 employees and has a net turnover less than 50 millions Euro and/or has a total balance sheet of less than 43 millions Euro. Through this definition, European Commission want to treat and classify equitable all the SMEs, no matter the type of the economic sector of the entity (European Commission, 2005).

Total balance sheet criterion is most criticised (Hauser, 2005, Gibson, van der Vaart, 2008). One of the main arguments for this is considered to be the fact that despite that in the total assets is included: fixed assets, intangible assets and accrued expenses, not in all the economies all these components are taken into considerations.

Examples of quantitative definitions of SMEs

In some countries like United States, Canada and Japan, the type of activity represent a clear criterion when defining and classifying SMEs, together with other quantitative criteria.

Table 3. *Example of criteria used when define and classify SMES in country like: USA, Canada and Japan*

SUA	Canada	Japan
a. Type of activity: manufacture, wholesale, mining, constructions, agriculture etc. *b. Number of employees* (maximum 500 employees) depending on the type of economic activity; *c. Value of sales;*	*a. Type of activity:* manufacturing or services; *and* *b. Number of employees* (maximum 500 employees) depending on the type of economic activity	*a. Type of activity:* manufacture, constructions, transportation, wholesale, retail sales, services; *b. Number of employees* (maximum 300) depending on the type of economic activity; *c. Capital Value*

In United States, the definition is regulated by the US Small Business Administration's Office of Size Standards (SBA). The limits provided by SBA are according with the type of economic activity: manufacture (maximum 500 employees), commerce (maximum 100 employees), mining (overall less than 500 employees) and other specific activities and number of employees. For the other domains, definition is based on revenues, for example: constructions (less than 31 million dollars), retail trade (less than 6.5 millions dollars), architecture, engineering (less than 4.5 million dollars), agriculture (less than 750,000 dollars) and others[2].

As it could be observed, because of the variety of specific activities developed by SMEs, in the USA there is not a standard common dimension model for a SME.

In Canada SMES are considered to be those entities which have less than 500 employees. Small entities are the one which has less than 100 employees (for manufacture) or less than 50 employees (for services). Medium-sized enterprises are the one which exceed the maximum threshold of small entities, but do not exceed the maximum limits of 500 employees. In the category of micro-entities are included the entities which their employees number are less than five.

Moreover, definition and classification of SMEs differ according with the source[3]:
- The Canadian Council of Ministers of the Environment[4] classify the enterprises considering the number of employees, according to the above definition;
- Canadian Industry Profiles[5] classify a small enterprise as an entity of whose revenues are between 30,000 dollars and 5 million dollars. A medium-sized

enterprise is an entity of whose revenues are between 5 million dollars and 25 million dollars;
- Canadian Institute of Statistics classify SMES according to the number of employees and value of revenues, so the number of employees must not exceed 500 employees and the annual revenues be less than 50 millions dollars.

Thus, in also Canada there is not a standardized definition of small and medium-sized enterprises (Yunke et al., 2008).

In Japan[6] definition and classification of SMES is according with the capital value, number of employees, and type of activity. For an entity to classify as SMEs must:
- for: manufacture, construction and transportation, the value of the capital be less than 300 millions Japanese yens and number of employees < 300;
- for whole sales, the value of the capital be less than 100 millions Japanese yens and number of employees < 100;
- for services sector, the value of the capital be less than 50 millions Japanese yens and number of employees < 100;
- for retail trade, the value of the capital be less than 50 millions Japanese yens and number of employees < 50.

Overall, regarding the definition of the three country is was observed a more complex definition comparing with the one provided by the European Commission, considering that the first criteria of classification is the type of activity of the enterprises.

Considering a manufacture enterprise, for example, with a number of 299 employees. The enterprise will fall into the next categories, considering the specific SME definition used within the country:
- In European Union it will be classified as a large enterprise, no matter the type of the its activity;
- In USA and Canada, the enterprise will be included into SME category;
- In Japan, the enterprise will be included into SME category with the condition that its capital value be less than 100 millions Japanese yens.

From the definitions above, it is observed that there are significant differences of classification of SMEs by sector and number of employees between the three countries.

That is why the IASB in developing IFRS for SMEs proposed a reliance on qualitative criteria in the definition of SMEs in the hope that these qualitative criteria would create premises for harmonization and comparability of financial reporting for SMEs, even though nationwide could be used quantitative criteria for classification of SMEs at least in statistical terms.

Qualitative criteria in defining the SMEs

Best known qualitative criterion in defining a SME is the independent ownership. Other qualitative criteria such as the relative size of the enterprise compared to other enterprises or non-dominant market share are considered ineligible criteria because it is not considered the fact that many SMEs are specialized in certain market niches and often dominate their market segment or their specific unique industry (Recklies, 2001).

Osteryoung and Newman (1993) suggested that small and medium-sized enterprises should be defined as entities which are not publicly traded and entities in which the owners must personally guarantee any existing funding.

Another example of qualitative definition is the definition used by United States Congress, which suggested the following definition for a SME: "small entity whose capital is independent and does not occupy a dominant market position" (Recklies, 2001).

Latest qualitative categorizing of SME is supported by the special standard IFRS for SME, issued by IASBB. Under this standard, the IASB defines an SME as "an entity that does not have public accountability and publish general purpose financial statements for external users", therefore, by a qualitative definition. Thus, in terms of IASB there is a classification of enterprises by nature, not the size criteria, as SMEs are classified in accordance with Recommendation No. 2003/361/CE.

A classification of enterprise as SME based on qualitative criteria may represent an alternative that would facilitate the harmonization of SMEs but the EU preference for financial reporting of SMEs is still in favour of the accounting directives, and implicitly for quantitative criteria.

Comparability of the classification criteria for SMEs and financial reporting criteria at European level

Even if in EU there is already the definition formulated by the European Commission and recommended to be used for classifying SMEs, it is not used for accounting purposes framing in all the states. Therefore there are discrepancies between the definitions of an SME according to criteria provided in Recommendation No. 2003/361/EC and the screening criteria of accounting terms in the Member States regarding the value limits of quantitative criteria used.

At EU level, there are official definitions adopted in accounting for financial reporting purposes only in some countries (European Commission, Cna Interpreta, 2011)[7]. Official definitions of entities classified in the category of medium-sized

enterprise for accounting purposes only exists in Austria (c), Denmark (c), Germany (c), the Netherlands (b), Slovenia (a), United Kingdom (a) and the category of the small businesses in Austria (c), Belgium (a), Denmark (c), Germany (c), the Netherlands (b), Slovenia (a), United Kingdom (a), Spain and Sweden. In the other EU countries is not a specified classification of small and medium enterprises in accounting law, as is the case in Romania, but the entities takes into account the European accounting directives for financial reporting.

Table 4. *Quantitative criteria for classification of SME in the European Union*
for accounting purposes

	Quantitative criteria for classification of SME in the European Union for accounting purposes	
	Medium-sized enterprises	**Small enterprises**
a.	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 29,200,000 Euros; total balance sheet < 14,600,000 Euros; number of employees < 250	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 7,300,000 Euro; total balance sheet < 3,650,000 Euro; number of employees < 50
b.	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 35,000,000 Euros; total balance sheet < 17,500,000 Euros; number of employees < 250	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 8,800,000 Euros; Total balance sheet < 4,400,000 Euros; number of employees < 50
c.	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 38,500,000 Euros; total balance sheet < 19,250,000 Euros; number of employees < 250	Enterprises which at the end of the year do not exceed two of the three criteria: net turnover < 9,680,000 Euros; total balance sheet < 4,840,000 Euros; number of employees < 50

Source: European Commission, Final Report submitted by Cna Interpreta, (2011).

Absence of a definition of classification in terms of SME accounting of national law of certain countries do not necessarily have a significant negative impact (European Commission, 2011) because anyway the implementation of the European Accounting Directives accounting legislation took into account the size criteria from European directives for preparing the set of simplified financial statements or completed, as applicable, or the obligation to draw up financial audit.

Although using the same classification criteria for SMEs (number of employees, turnover and/or total value of assets) in the European Union, threshold values used for accounting classification are lower than those specified in Recommendation No. 2003/361/EC (exemplified in Table 2, First line).

For example, in Romania, entities reports financial statements in accordance with OMPF No. 3055/2009 for approving the Accounting Regulations in accordance

with European directives where are prescribed aspects of the format, content and general provisions of the annual financial statements, users, qualitative characteristics of financial statements, general accounting principles, valuation rules, etc.

According to OMPF No. 3055/2009, legal entities which at balance sheet date do not exceed two of the following three criteria: total assets: 3,650,000 Euros, net turnover: EUR 7,300,000, the average number of employees: 50, prepare are simplified annual financial statements which comprise: abridged balance sheets, profit and loss account, simplified notes to the annual financial statements. Other companies prepare complete set of financial statements and are required to carry out statutory audits.

So, consider a company with a total of 50 employees and a turnover of 8,8 million Euros. Even if the company is categorized as small according to Recommendation No. 2003/361/EC, from an accounting perspective it is not classified in any category. According to the Romanian national rules, in terms of annual accounts do not benefit from any facility, having to prepare the complete set of financial statements and to carry out statutory audit and although the costs of preparing financial statements and the audit are not significant for small and medium businesses, these costs may have different impact on enterprises.

It is considered however that the quantitative limits of existing micro enterprises according to Recommendation No. 2003/361/EC are too high, not consistent with accounting reporting requirements. Thus, by proposing a new directive, the European Commission (2009) suggested that for the framing of the micro accounting terms it is preferable to shrink the quantitative limits (average number of employees <10, turnover < 1,000,000 Euros, the total balance sheets < 500,000 Euros) in order to minimize the burden of financial reporting because most of the times the micro financial reporting requirements are not proportionate to their specific accounting needs.

However, even if in the EU it is not a general definition that would satisfy both economic and accounting SME classification, it is clear that there is a consensus about the use of the same criteria of classification: number of employees, turnover the total value of assets, and a barrier limits represented by different thresholds promoted by Recommendation No. 2003/361/EC and Directive IV of the European Union.

Conclusions

Given that SMEs are considered true economic engine (European Commission) which contribute to the cultural enrichment and industrial development of all countries, there are understandable the efforts undertaken by international and

European bodies aimed to harmonizing the definition of SMEs. Based on a unique definition or definitions that include at least the same criteria of classification of SMEs we can speak of comparability between SMEs in different economies and so SMEs, can benefit from certain international opportunities and advantages (easier access to international markets, to finance, labour force, etc.)

Quantitative limits and values are often influenced by characteristic factors (economic, social, cultural, and political) of each economy separately. Although there are several quantitative definitions of classification of SMEs provided in order to be tailored to several economies, the thresholds must be adjusted according to the sector and the specific economy, which are impediments in existence of a universal definition of SMEs. Hence, the existence of a universal definition of SMEs in global accounting and financial reporting for SMEs could involve only a qualitative definition because as stated Paul Pacter, director IASB IFRS for SMEs "is virtually impossible to have a global quantitative definition ".

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