

ANALYSIS AND CLASSIFICATION OF EUROPEAN SMES USING THE FINANCIAL CRITERIA ESTABLISHED BY THE “NEW SME DEFINITION”

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In order to enhance the general economic development and to improve the competitiveness of the SME's was established a common definition of the SME's. The new definition of SME's is an important tool for implementing efficient measures and European and national financing programmes to support the development and success of SMEs. The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro. To check if an entity is an SME the first step is to verify if it is an enterprise and if it fits to the following three criteria (ceilings): staff headcount, annual turnover and annual balance sheet. Other classification of SMEs is based on their relationships with other enterprises. Based on this they can be autonomous, partner or linked enterprises.

1. Introduction

As Gunther Verheugen, Member of the European Commission, Responsible for Enterprise and Industry, declared at the establishment of the new SME definition: “Micro, small and medium-sized enterprises (SMEs) are the engine of the European economy. They are an essential source of jobs, create entrepreneurial spirit and innovation in the EU and are thus crucial for fostering competitiveness and employment”¹²³. The European Union board of statistics counts around 25 millions SMEs in all the 25 member states, which is representing around 99% of all EU companies, providing 75 million jobs. In order to enhance the general economic development and to improve the competitiveness of the SME's was established a common definition of the SME's and were created special financing programs both at the level of the European Union and at the level of the national governments.

The definition of SME was established by the “Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises” and was published in the in the *Official Journal of the European Union* L 124, p. 36 of 20 May 2003 and is the sole authentic basis for determining the conditions regarding qualification as an SME. As presented in the Recommendation 2003/361/EC, the category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.

Micro, small and medium-sized enterprises (SMEs) play a central role in the European economy. They are a major source of entrepreneurial skills, innovation and employment. However, they are often confronted with market imperfections. SMEs frequently have difficulties in obtaining capital or credit, particularly in the early start-up phase. Their restricted resources may also reduce access to new technologies or innovation. Therefore, support for SMEs is one of the European Commission's priorities for economic growth, job creation and economic and social cohesion.

123 Extract from the declaration of Gunther Verheugen, Member of the European Commission Responsible for Enterprise and Industry, at the establishment of the New SME Definition.

2. The new SME definition

In a single market with no internal frontiers, it is essential that measures in favour of SMEs are based on a common definition to improve their consistency and effectiveness, and to limit distortions of competition. This is all the more necessary given the extensive interaction between national and EU measures to help SMEs in areas such as regional development and research funding. In 1996, a recommendation establishing a first common SME definition was adopted by the Commission¹²⁴.

This definition has been widely applied throughout the European Union. On 6 May 2003, the Commission adopted a new recommendation¹²⁵ in order to take account of economic developments since 1996. It entered into force on 1 January 2005 and will apply to all the policies, programmes and measures that the Commission operates for SMEs. As mentioned in the *“The New SME Definition – User Guide and Model Declaration”*, for Member States use of the definition is voluntary, but the Commission is inviting them, together with the European Investment Bank and the European Investment Fund to apply it as widely as possible.

According to the European Office of Statistics the average European enterprise employs no more than six people, so most of the enterprises can be considered as SMEs. However, the new definition takes into account possible relationships with other enterprises. In certain cases, those relationships, particularly if they create significant financial links with other enterprises, may imply that an enterprise is not an SME. This is the only way to ensure that only enterprises which genuinely require support are targeted by public schemes.

For this reason, it introduces methods to calculate the staff and financial thresholds to gain a more realistic picture of the economic situation of an enterprise. A distinction has been introduced between different types of enterprises: autonomous, partner and linked.

As mentioned above the Article 2 of the Annex of Recommendation 2003/361/EC considers that “The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.” The first step to qualify as an SME is to be considered as an enterprise. According to the new definition, an enterprise is “any entity engaged in an economic activity, irrespective of its legal form”. By being formally included in the recommendation, the scope of the new SME definition is now clearly marked out. Thus, the self-employed, family firms, partnerships and associations regularly engaged in an economic activity may be considered as enterprises.¹²⁶

3. SMEs categories based on their headcount and annual financial data

In order to check if an entity is an SME the first step is to verify if it is an enterprise. Further it must be established the data of the analyzed enterprise according to the following three criteria: staff headcount, annual turnover and annual balance sheet.

Comparing the data of the analyzed company with the thresholds for the three criteria will allow determining whether the company is a micro, small or medium-sized enterprise. It is necessary to note that while it is compulsory to respect the staff headcount thresholds, an SME may choose to meet either the turnover or balance sheet ceiling. The new definition offers this choice since, by their nature, enterprises in the trade and distribution sectors, have higher turnover figures than those in manufacturing. Providing an option between this criterion and the balance sheet total, which reflects the overall wealth of an enterprise, ensures that SMEs engaged in different types

124 Commission Recommendation 96/280/EC of 3 April 1996 concerning the definition of small and medium-sized enterprises (Text with EEA relevance), Official Journal L 107, p. 4-9, of 30 April 1996

125 Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (Text with EEA relevance), Official Journal L 124, p. 36-41, of 20 May 2003.

126 “The New SME Definition – User Guide and Model Declaration”, p12

of economic activity are treated fairly. The distribution of the companies in the micro, small or medium-sized enterprises categories is presented in the figure no. 1 below:

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover	or	Annual balance sheet total
Medium-sized	< 250	≤ €50 million (in 1996 € 40 million)	or	≤ €43 million (in 1996 € 27 million)
Small	< 50	≤ €10 million (in 1996 € 7 million)	or	≤ €10 million (in 1996 € 5 million)
Micro	< 10	≤ €2 million (previously not defined)	or	≤ €2 million (previously not defined)

Figure 1. Categories of SMEs according to the new thresholds

(Extract from “*The New SME Definition – User Guide and Model Declaration*”, p. 14)

The **staff headcount** is a crucial initial criterion for determining in which category an SME falls. It covers full-time, part-time and seasonal staff and includes the following:

- Employees, persons working for the enterprise being subordinated to it and considered to be employees under national law,
- Owner-managers, partners engaged in a regular activity in the enterprise and benefiting from financial advantages from the enterprise.

The staff headcount is expressed in annual work units (AWU). Anyone who worked full-time within an enterprise, or on its behalf, during the entire reference year counts as one unit. The part-time staff, seasonal workers and those who did not work the full year are treated as fractions of one unit. As mentioned in the User Guide **the annual turnover** is determined by calculating the income that the enterprise received during the year in question from its sales and services after any rebates have been paid out. Turnover should not include value added tax (VAT) or other indirect taxes¹²⁷. The **annual balance sheet** total refers to the value of the company’s main assets¹²⁸.

4. Categories of SME’s based on their relations with other enterprises

The main categories of SMEs, based on their relations with other enterprises are **autonomous** – by far the most common category – a **partner** or **linked enterprises**. Depending on the category in which the analyzed enterprise fits in, it might be needed to add some, or all, of the data from those enterprises to the analyzed enterprise. The calculations for each of the three types of enterprise are different and will ultimately determine whether the enterprise meets the various ceilings established in the SME definition. Enterprises which draw up consolidated accounts or

127 Article 28 of Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, Official Journal L 222, p. 11-31, of 14 August 1978.

128 Article 12.3 of Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, Official Journal L 222, p. 11-31, of 14 August 1978.

which are included in the accounts of an enterprise which does so are usually considered as linked.

4.1 Autonomous enterprises

An autonomous enterprise is that enterprise that is not partner or linked with other enterprises. The main conditions for an enterprise to be autonomous are:

The enterprise is totally independent, doesn't have any participation in other enterprises and no enterprise has a participation in it.

The enterprise holds less than 25% of the capital or voting rights (whichever is the higher) in one or more other enterprises and/or outsiders do not have a stake of 25% or more of the capital or voting rights (whichever is the higher) in the above mentioned enterprise.

For an autonomous enterprise, are used only the number of employees and the financial data contained in its annual accounts to check if it respects the above mentioned thresholds and to determine whether is a an micro, small or medium enterprise.

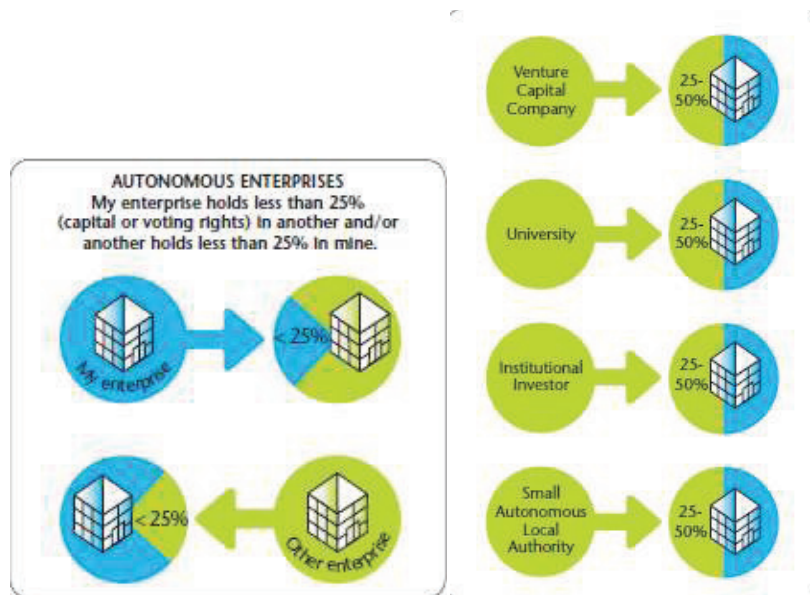


Figure 2. Autonomous enterprises

(Extract from "The New SME Definition – User Guide and Model Declaration", p. 17, 19)

As exceptions to this rule, an enterprise may still be ranked as autonomous, and thus as not having any partner enterprises, even if this 25% threshold is reached or exceeded by any of the following investors:

- Public investment corporations, venture capital companies and business angels.
- Universities and non-profit research centers.
- Institutional investors, including regional development funds.
- Autonomous local authorities with an annual budget of less than 10 million euro and fewer than 5,000 inhabitants.

It is possible to remain autonomous while having one or more of the investors listed above. Each of these may have a stake of no more than 50% in your enterprise, provided they are not linked to one another. Of course, each investor has its rights as shareholder, but may not go beyond these and influence the management of the enterprise.

4.2 Partner enterprises

According to the “*The New SME Definition – User Guide and Model Declaration*” This type of relationship represents the situation of enterprises which establish major financial partnerships with other enterprises, without one exercising effective direct or indirect control over the other. Partners are enterprises which are neither autonomous nor linked to one another. A company is a partner enterprise if:

It has a holding equal to or greater than 25%, of the capital or voting rights in another enterprise and/or another enterprise has a holding equal to or greater than 25% in the analyzed company.

It is not linked to another enterprise. This means, among other things, that the companies’ voting rights in the other enterprise (or vice versa) do not exceed 50%.

If a company is a partner enterprise, must add a proportion of the other enterprise’s staff headcount and financial details to its own data when determining its eligibility for SME status. This proportion will reflect the percentage of shares or voting rights – whichever is the higher – that are held. Thus, if a company has 30% stake in another enterprise, must add 30% of its headcount, turnover and balance sheet to its own figures. If there are several partner enterprises, the same type of calculation must be done for each partner enterprise situated immediately upstream or downstream from the analyzed enterprise.

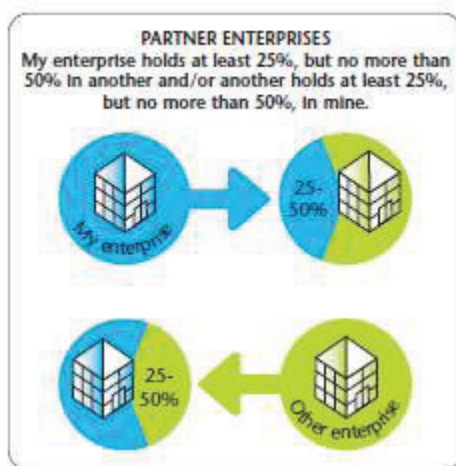


Figure 3. Partner enterprises

(Extract from “*The New SME Definition – User Guide and Model Declaration*”, p. 20)

4.3 Linked enterprises

This type of relationship corresponds to the economic situation of enterprises which form a group through the direct or indirect control of the majority of voting rights of an enterprise by another or through the ability to exercise a dominant influence on an enterprise. Such cases are, thus, less frequent than the two preceding types. Two or more enterprises are linked when they have any of the following relationships:

One enterprise holds a majority of the shareholders’ or members’ voting rights in another.

One enterprise is entitled to appoint or remove a majority of the administrative, management or supervisory body of another.

A contract between the enterprises, or a provision in the memorandum or articles of association of one of the enterprises, enables one to exercise a dominant influence over the other.

One enterprise is able, by agreement, to exercise sole control over a majority of shareholders’ or members’ voting rights in another.

A typical example of a linked enterprise is the wholly-owned subsidiary. All 100% of the linked enterprise's data must be added to those of your enterprise to determine if it complies with the staff headcount and financial thresholds of the definition. An enterprise generally knows immediately that it is linked, since in most Member States it is required by law to draw up consolidated accounts or is included by consolidation in the accounts of another enterprise.

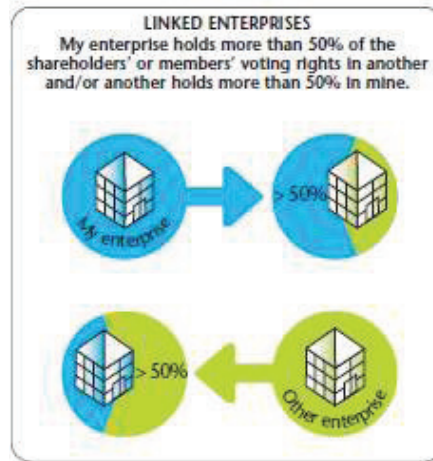


Figure 4. Linked enterprises

(Extract from “*The New SME Definition – User Guide and Model Declaration*”, p. 24)

5. Conclusions

In order to enhance the general economic development and to improve the competitiveness of the SME's was established a common definition of the SME's. The new definition of SME's is an important tool for implementing efficient measures and European and national financing programmes to support the development and success of SMEs As presented in the Recommendation 2003/361/EC, the category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro. To check if an entity is an SME the first step is to verify if it is an enterprise and if it fits to the following three criteria: staff headcount, annual turnover and annual balance sheet. The main categories of SMEs, based on their relations with other enterprises are autonomous – by far the most common category – a partner or linked enterprises. The calculations for each of the three types of enterprise are different and will ultimately determine whether the enterprise meets the various ceilings established in the SME definition and later if ot benefits of special financing programs, created both by the European Union and by national governments.

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