



TRANSFORMATION IN SMEs: BIG SUCCESS OF SMALL FIRMS

EXECUTIVE SUMMARY

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In all countries in the world, major part of employment is created by small and medium size enterprises (SMEs) and these enterprises again account for a significant part of total output and new Technologies developed. Although they have their significant contribution to employment, production and new Technologies, it is common knowledge that SMEs face many problems including Access to financial resources in the first place. Thus, SMEs have their special place in the economic policies of all countries.

Compared to developed countries, SMEs in developing countries like Turkey both have their larger share in economy and they also face more problems and obstacles. In Turkey, there are many studies on the problems of SMEs.

These studies mostly focus on the failures of SMEs, list the range of problems they face and discuss various solutions.

In these discussions SMEs are portrayed as a homogenous block in which enterprises struggle with problems they will never overcome, use primitive production technologies, employ unqualified workers and conduct informal activities. Yet, such accounts are not true. There are SMEs that perform very successfully in spite of all problems and can grow fast in rather harsh competitive environments. Understanding how such SMEs reached success may present extremely important experiences and lessons to both other SMEs and policy makers.

The objective of this study is to investigate factors that make successful entrepreneurs so and to determine other factors that impede their further success. Under the present study, 24 “successful entrepreneurs” were identified as a result of a two-round assessment and in-depth interviews were conducted with these entrepreneurs. At the outset, 5 criteria were set for “success” and those entrepreneurs who had high performance in at least one of these criteria were considered as “successful”. The criteria for success were as follows: i) growth performance, ii) performance in exporting, iii) performance in innovation and technology, iv) brand performance, and v) performance in value added and profit.

According to manufacturing industry data, there were 6,000 new enterprises most of which were defined as SME were established in the period 1981-1991. In these new establishments there were 330,000 persons employed at the beginning. Only a half of these new enterprises could survive in their first 10 years while the other half was closed down in this period. In spite of enterprises closed down, the number of persons employed by surviving ones after 10 years was about 300,000. In other words, enterprises that could grow in their first 10 years largely offset the loss in employment caused by closed down enterprises. The fastest growing 10% of about 3,000 surviving enterprises and their (295 enterprises) contribution to employment was assessed. These fast growing 295 enterprises provided employment to approximately 120,000 persons in 10 years. Given that the average annual number of persons employed in manufacturing industry in the period 1980-2001 was about 1 million and the annual rate of growth in employment was 1%, it can be inferred that fast growing 295 enterprises accounted for about a half of total increase in employment.

The average annual employment growth in fast growing enterprises in manufacturing industry is around 14%. In fact, employment growth in the period 2004-2008 in 24 enterprises selected as “successful SMEs” is approximately at this level. This shows that selected enterprises are quite successful relative to country average.

Analyses conducted suggest that it would be incorrect to consider SMES as constituting a homogeneous block. There are significant differences. Many SMEs newly established soon withdraw from the market unable to cope up with competitive pressures. Even many of others who have managed to survive cannot mark a significant growth and continue with the same size as they were first established.

A small part of SMEs displays a rather fast growth performance beyond merely surviving. These very few fast growing SMEs contribute significantly to employment growth in manufacturing industry. This fact shows that rapid growth is as important for SMEs as their establishment and survival.

According to outcomes of in-depth interviews conducted in order to identify factors behind the success of well-performing SMEs, neither do these successful enterprises constitute a homogeneous group. Their educational and occupational background is rather diverse. For example there are some successful entrepreneurs who started business life by establishing their enterprises without any earlier business experience. A significant part of successful entrepreneurs are those who started their own business after having worked in other enterprises (in similar or different trades). A large majority of successful entrepreneurs are those who have gained experience and been trained in their family enterprises. In general, the first experience is gained in a family enterprise and then comes a productive activity (mostly related to the original enterprise). In the selection of businesses and sectors by those starting with family enterprises and then turning into individual entrepreneurs the particular activity carried out by the first family enterprise plays an important role.

COMMON CHARACTERISTICS OF SUCCESSFUL ENTREPRENEURS

Given all these differences, there are still some **common characteristics of successful entrepreneurs**.

1. Success takes a long proves. It is understood that the success of entrepreneurs **is no coincidence and it requires prolonged efforts to take place**.
2. A large majority of successful entrepreneurs states that they did not/could not use bank loans when they first started their business and financed their original investments **with their own (and family) assets**. The reasons why they did not use bank loans include macroeconomic uncertainties, fluctuations in input costs, high interest rates and short terms. So they preferred to start with small scale in order to reduce risks. But starting with small scale often brings along higher production costs for SMEs.
3. Successful entrepreneurs have **good information about the market in which they are active** and also closely follow preferences and demands of consumers/clients as well as the products and activities of their rival firms.
4. A large majority of successful entrepreneurs also possess **technical information** gained either from their higher education or their past experience in the trade concerned. They can decide on ways to produce their goods with higher quality while introducing necessary changes to their production processes accordingly.
5. An important part of successful entrepreneurs **see the difference and make a distinction between technical information and marketing skills**; consequently as one partner takes care of technical issues the other concentrates on marketing activities.
6. The most important common characteristic of successful entrepreneurs is that they are all **innovative**. In some of the successful SMEs it is **technological innovation** that comes to the fore. Innovative entrepreneurs develop new products or processes on the basis of their technological base. Some others enjoy advantage over other firms in their sector by developing **different organizational and marketing methods**. The fact that technologically innovative firms in particular benefit from TÜBİTAK support points to the importance of such support. These entrepreneurs may also engage in close cooperation with universities.

STRATEGIES OF SUCCESSFUL ENTREPRENEURS

Differences in overall qualifications of entrepreneurs show that there is no single way leading to success and that **different strategies may be pursued depending on specific resources and skills of respective entrepreneurs as well as developments and opportunities in the market**. On the basis of interviews conducted, four distinct strategies can be discerned:

- **Obtaining competitive advantage in existing local markets**
- **Holding the status as reliable supplier to large firms**
- **Import substitution in “niche” markets**
- **Creating new niche markets**

While successful entrepreneurs can be found in different sectors and regions, it can also be said that regional and sectoral factors also influence the success conditions of entrepreneurs and thus their strategies as well. Demand factors may be influential in the selection of sites of enterprises by successful entrepreneurs. In cases where consumers concentrate in a specific region, it may be important for entrepreneurs to be active in the same region in order to reduce marketing, stock and communication costs. However, as observed with the majority of successful entrepreneurs interviewed under this study, this situation is not a determinative factor for entrepreneurs who are active at national level or producing for markets abroad. What is more important for innovative entrepreneurs is keeping close to specialized suppliers and sources of information. Especially those entrepreneurs who use special purpose machinery and equipment and who have ties with universities at some level prefer to be located in big cities to be close to such resources. In other words, urbanization and economies of scale leads technologically successful entrepreneurs to gather in specific urban centres. Without this concentration, it is quite difficult for urban centres and regions to attract innovative entrepreneurs.

Sectoral differences can be said to be partly influential in selecting a strategy. Such strategies as import substitution in niche markets and creation of new niche markets in which technological innovation comes to the fore can be observed in technology-information intensive sectors including machinery, electronics and chemical products. On the other hand, entrepreneurs active in what may be called as “traditional” such as food, textiles, garments and metal parts can reach success mostly on the basis of cost advantage and different marketing strategies. Nevertheless, even in textiles and garments where R&D expenditures and technological innovation are low, design and production of different and/or higher quality products may be an important factor in bringing success. Thus, there is need to go beyond existing industry classifications while developing industrial and SME policies.

OBSTACLES

Although entrepreneurs interviewed under this study are characterized as “successful”, they still face some **problems and obstacles that prevent their further success**:

1. One of the most important obstacles before new entrepreneurs and SMEs is the problem of **finance** particularly at the stage of start-up. Some successful entrepreneurs state that they preferred not to use credit at this stage due to uncertainties and high rates of interest. So they would have opted for a larger scale in case they had the chance of using loans in favourable terms.
2. One of the most serious problems caused financial constraints at the start-up stage is related to **scale**. Many successful entrepreneurs say they would have been able to cut down their costs much more if they could invest and produce at larger scale at the beginning.
3. Another problem that successful entrepreneurs faced at initial stages is the **unavailability of qualified personnel**. This problem was expressed by almost all entrepreneurs. Entrepreneurs unable

to find qualified personnel prefer to recruit those who have taken vocational training despite their criticizing stance towards the quality of such training and launch comprehensive training programmes to close the gap in qualified personnel. An ensuing problem is the transfer of trained and qualified personnel to other enterprises.

4. One of the factors impeding the further success of entrepreneurs producing quality goods is the **low level of awareness on the part of end users/consumers in regard to quality**, yet undeveloped **quality standardization and certification** by which they can distinguish quality goods from others and negative effects of **informal production**.
5. The absence of **suppliers specialized particularly in technical aspects** hinders the establishment and growth of SMEs that could be successful. The problem is to such extent that successful entrepreneurs have to resolve all technical problems on their own. Entrepreneurs often have to modify machinery supplied from without according to their own production processes.
6. Another problem similar to that of the absence of specialized suppliers is yet **undeveloped networking and clustering** among firms. Although an important part of SMEs interviewed are active in organized industrial zones, their statements indicate that there is almost no entrepreneur benefitting from networks and clusters.
7. Particularly those entrepreneurs who want to grow further and invest state that macroeconomic environments may well lead to significant problems. Problems expressed by various entrepreneurs in this context include **macroeconomic uncertainties, extreme fluctuations in prices of raw materials, cheap imports** from Asian countries including China in the first place and **bank loans with too short periods and high interest rates**.
8. Finally, **excessively bureaucratic formalities and procedures in state assistance** prevents any meaningful use of such assistance if not driving SMEs further away from these.

Analyses clearly show that SMEs are not homogeneous units. They are highly differentiated units operating in different circumstances and having their different orientations, resources and advantages. The only yardstick that makes it meaningful to gather them in the same group is that their scale is small. Hence, policies targeting SMEs have to take into account this huge diversity.

There are some SMEs that started in the wrong place and wrong time and, even more important, at wrong scale. Consequently, unable to cope up with competitive pressures they had to close down after some time. Hence, any long term support to enterprises that is doomed to failure means keeping successful SMEs in a disadvantaged position and channelling already scarce resources not to successful but unsuccessful workplaces.

An important part of SMEs are those enterprises that can grow to a certain extent during first few years after their establishment and then maintain the same scale afterwards. No expansion in scale after a specific point is related to the character and size of markets that these enterprises operate in. Taken as a whole, such enterprises play an important role in creating employment and contributing to economic development. Thus, SME policies must support those SMEs that face problems in accessing funding sources and new technologies just because their small size.

A small part of SMEs, on the other hand, attain a very high performance for their organizational and technological innovations and contribute significantly to employment and growth in the economy as a whole. Consequently, creating favourable environments for innovative entrepreneurs and removing obstacles to the establishment and growth of this kind of SMEs should constitute the focus of SME policies.

Another issue that must be taken into account while developing SME related policies is that these enterprises need diversified policies since different problems are encountered at various stages of their

emergence and growth (i.e. establishment, holding a place in the market, growth at domestic level and growth at global level).

POLICY SUGGESTIONS

On the basis of interviews with successful entrepreneurs, some policies that may guarantee their **further success** are outlined below:

1. Firstly, measures for new entrepreneurs starting their business on small scale to help them **lower their costs of establishment** and ensure **proximity to potential clients** (locations closer to city centres and/or incubations centres in campuses, etc).
2. **Promotion and diversification of financial instruments supporting the establishment and growth of promising SMEs** (development of risk or seed capital practices, according tax conveniences to enterprises established on such capital).
3. **Diversification of R&D support programmes** (conditional support, etc) and **backing up these programmes with other policy instruments** (bringing enterprises together with researchers in universities and in industry, extension of long-term credit to investments to be made following TÜBİTAK supported projects, establishing a special guarantee fund for such credits, etc).
4. **Encouraging vocational training** and mobilizing public funds to extend **“training support” to those SMEs that provide vocational training**.
5. Assessment of the status of such support programmes as KOSGEB, **enhancing the capacity of KOSGEB especially in the field of technical support** and eliminating its present shortcomings.
6. **Implementation of sectoral programmes geared to developing and spreading specialized suppliers and services that SMEs would build upon**.
7. Wider use of **quality standards and certification**.
8. Though not placed in the context of SME policies, also important are **macroeconomic measures** intended to ensure economic stability and reduce uncertainties which are so important for SMEs.

It is widely recognized that SMEs have their important place and weight in Turkish economy. Yet, it is equally clear that their present contribution to employment, growth and technological advance is much below their actual potential. Correct, coherent and systematic policies in this field will contribute the realization of this potential of SMEs.

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