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**ANALYSIS OF SMALL AND MEDIUM-SIZED
BUSINESS IN LITHUANIA**

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Conventional wisdom says increased globalization to present a more hostile environment to small businesses. It may seem that the importance of small and medium-sized enterprises (SMEs) is inevitably deteriorating in the world dominated by *global markets, global products, economies of scale*, etc. Despite that, governments of many countries are increasingly emphasising the necessity to support SMEs: entrepreneurship and small and medium-sized enterprises are universally accepted as the vehicle of socioeconomic development, contributors to a better employment and improvement of international competitiveness. Enterprises are at the heart of the strategy launched by the European Council in Lisbon in March 2000. Reaching the objective of *becoming the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, creating more and better jobs, and developing greater social cohesion* will ultimately depend on the success of enterprises, especially small- and medium-sized ones.

While support of SMEs for political and social motives is crystal-clear, the economic efficiency in terms of support and development of SMEs is not that obvious.

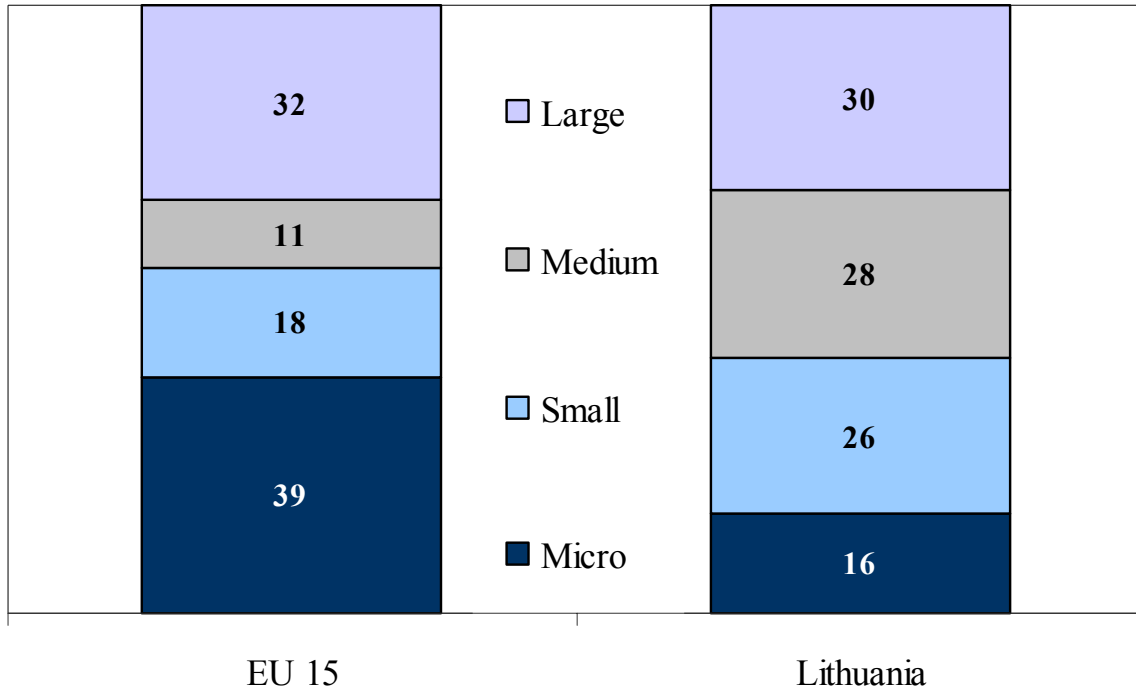
SMEs in Lithuania and the EU

In 2004, Statistics Lithuania reported that the share of small and medium-sized enterprises operating in Lithuania remained stable in 2003 and comprised 99.3% of all active businesses. Such distribution of companies is almost equivalent to the EU business structure where SMEs make up 99.8% of all companies. However, in-depth analysis throws in some *surprises*: small enterprises in Lithuania are almost twice as large (by the number of employees) as those in the old EU neighbours. An average enterprise in the EU employs 7 people, and even such giants as *Royal Shell, Siemens, Nokia or PSA Peugeot Citroen* do not outweigh the share of small entrepreneurs in the labour market. In Lithuania, the same indicator is over 13 people. This difference is because very small businesses (micro-enterprises) play a much less important role in Lithuania.

Currently, SMEs provide jobs to almost 70% of the national labour force. Comparison with other European countries (where the relevant indicator is also close to 70%, see Chart 1) reveals the difference only after analysing the relative weighting of the very SMEs in the structure of available jobs. In the EU, micro-enterprises provide jobs to almost 40% of the workforce but only to about 16% in Lithuania. In recent years, Lithuania has slightly caught up with the EU in terms of the role of micro (family) business in job creation. Moreover, considering that working in micro-enterprises is a more popular form of business in almost all the European countries, it is likely that the share of these businesses in the employment structure will continue to grow in Lithuania.

Chart 1

Breakdown of labour force in company groups by the number of employees in 2003, %



However, some caution is needed when making conclusions about the prospects of micro-enterprises in Lithuania based on the experience of the EU-15 countries as business structures and their development in various EU states vary greatly. While large companies in the United Kingdom, Germany, Netherlands or Finland employ about 45% of the labour force, micro-enterprises dominate in France, Italy, Spain, Greece, Sweden and Norway. In the latter group of countries, the share of micro-enterprises alone may reach 60% in job creation. The average size of enterprises in Europe ranges from 2 employees in Greece to 12 in the Netherlands.

Differences in SMEs weighting in various countries can be related to the level of economic development of countries, branch structure of economies, historic conditions, legal environment, etc. A general trend is that in the countries with larger GDP per capita such as Germany, Luxembourg or Netherlands usually an average enterprise size exceeds that of the less-developed countries such as Greece, Spain or Portugal. However, general level of economic development does not explain the difference in the role of SMEs over the countries completely.

The branch structure of the economy is another factor that impacts the weight of SMEs in the national economy. It is obvious that large businesses are better suited to large scale production and investment-intensive processes. Therefore, large businesses predominate in many mining and manufacturing industries and energy sector as well as in transport and communication sectors. However, in the latter sector, difference must be

made between water, air transport and telecommunication industries that tend to concentration and land transport and supporting transport activities that are dominated by small entrepreneurs. Construction, commerce, hotel and restaurant industries are also attractive to small businesses. This is well-reflected in the structure of both the EU and Lithuanian economy. Large businesses employ the majority of the labour force in the manufacturing industry as they create almost 40% of jobs. Chemical (59% of all jobs are created by large players), textile (51%), food (45%) and furniture (38%) industries are distinguished by intense concentration. In the energy sector, the relevant indicator is as high as 85%. A classic example of oligopoly in Lithuania is the telecommunication services market where the main players employ almost the entire labour force. By contrast, SMEs employ most of the labour force (75%) in the construction industry, in the wholesale sector (about 85%) and hotel and restaurant sector are dominated by micro and small enterprises. The same applies to the retail trade industry, although market concentration processes are gaining momentum there in this sector.

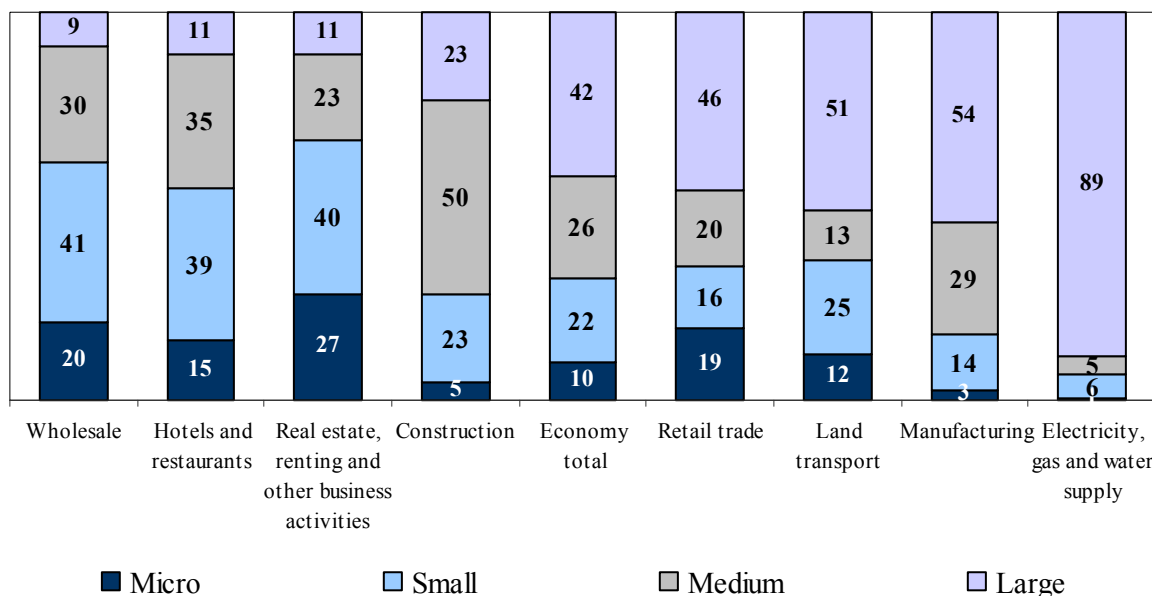
The entire services sector is underdeveloped in Lithuania compared with other EU member states, while the contribution of the energy sector and other industries to the common national *pool* is rather significant. So the structure of the economy in a way explains why enterprises in Lithuania are twice as large compared with other EU countries. However, it is necessary to acknowledge, that comparison of Lithuanian and EU businesses engaged in similar activities would still show that Lithuanian businesses are larger than those in EU15 countries.

Possible reasons for such difference are, among other things, relatively low level of entrepreneurship and inefficient business structures in some industries inherited from the era of planned economy. Entrepreneurship level, measured by the number of enterprises (including SMEs) per one thousand people in Lithuania (16) is almost three times lower than the average in the EU-15 countries, not to mention some of its new members. In some of them, for instance, Czech Republic, Slovakia or Hungary the same indicator ranges between 60 and 80. It is worth noting that all the three Baltic States have an extremely low relative number of SMEs compared with the other new EU members.

The contribution of SMEs into the national GDP nearly corresponds to the share of the persons employed in this segment. In 2003, businesses employing less than 250 people contributed to about 60% of the national GDP. The same indicator in the EU is nearly 65% and only 45% in the USA. And again, the situation is different in various industries (see Chart 2). The allocation of roles between businesses of different size correlates with the weights on labour market but higher labour efficiency in larger companies ensures that their contribution to the value added created in the country exceeds their weighting in the labour market.

Chart 2

Breakdown of Lithuanian companies by created value added in 2003, % .



Because of better organized production processes and the fact that SMEs are more often engaged in labour-intensive activities, one employee of a large company on average creates almost 80% more of value added than an employee of a SME. Labour efficiency in micro-enterprises is three times lower than that in large competitors. However, the lag of SMEs should not be dramatised considering the structural differences (as mentioned before, SMEs dominate in the services sector where labour efficiency is averagely lower because of labour-intensiveness of activity). A similar situation in terms of productivity of employees in various size businesses exists in the European Union as well. Therefore, it can be expected that progress towards the average EU labour productivity (currently, labour productivity in Lithuania measured in PPS is twice as low as in the EU on average) will improve this indicator in both small and large enterprises.

It is also worth noting that larger businesses are able to generate better profit margins than their small competitors. Two years ago, profitability of companies with more than 250 employees was at 4.9%, while the indicator of SMEs was only 3.2%. It seems that the financial success of the company correlates closely with its size. However, it is obvious that transparency of operations, which is sometimes lower in the SMEs segment, can contribute significantly to the *declared* performance of SMEs.

Better performance of large businesses also relies on broader opportunities to compete abroad. Small businesses find it more difficult to penetrate foreign markets. Various subjective and objective reasons prevent small Lithuanian enterprises which try to gain ground in foreign markets from effectively using the developed infrastructure of these markets including their information systems, financial, insurance, communications, transport services, fairs, exhibitions and exchanges, support from international business organisations and national government. Possibilities of financially weaker small businesses to participate in international trade are limited by harsh business environment and

differences in payment systems, language and culture. However, despite all these setbacks, Lithuanian small enterprises, and especially medium-sized ones are able to increase their export capacities. In 2001, their share in total exports was at 24% but grew to 43% in 2004. (According to the Lithuanian Development Agency for SMEs). Micro-enterprises are having more difficulties competing abroad, so their primary focus is the domestic market.

SMEs development in Lithuania depends on industry and region

In terms of the share of value added created by SMEs and its dynamics, it is obvious that the situation differs depending on the economic activity. In the food products and beverages industry, large companies created almost 70% of the value added in 2003 and there was a significant increase in their contribution compared with previous years. After Lithuania's accession to the EU in 2004 and abolition of customs duties and quotas, this sector, especially milk and meat processors, grew thanks to the increasing export volumes. Large businesses are more successful at meeting the needs of foreign customers. They also have to compete for raw materials since there is a shortage of supplies of them in Lithuania. These factors contribute to continuing concentration processes in the milk and meat production markets. It especially applies to meat producers since their small size is the main obstacle for export development.

Last year, the growth of confectionary businesses which focuses more on the domestic market was slow. Successful small manufacturers included manufacturers of niche products such as *Romnesa* (production and export of traditional apex cakes) or enterprises focusing on regional customers.

By contrast, small businesses in the clothing and textiles sector were growing more successfully than their large competitors. Stronger competition from Asian countries forced small businesses in the textile sector to increase their value added created in 2003 by 45%, compared with a 16% decline in value added created by large businesses. In 2004 and the first half of 2005, the value added created by the sector was gradually decreasing but some small businesses managed to boost their turnover several times. Such companies included *Verpstas* from Šiauliai, *Rožė* from Vilnius, *Vilkma* from Ukmergė, etc.

Wood and wood products industry is another sector where small businesses are able to compete with their large contestants. The sector is dominated by micro-enterprises and almost half of them are personal enterprises. In 2003, there were only five large businesses which contributed to as much as 25% of the value added created by the sector due to their higher labour productivity. Prospects of less efficient SMEs in this sector will depend on the reserves of raw materials and regulation of forest felling quotas. Currently, most of small factories successfully export the majority of their production to the EU countries where foreign customers ensure a stable demand of wood products and encouraging short-term prospects for SMEs in this sector. However, long-term prospects are not clear because of depleting wood resources.

A slightly different situation is in the furniture production sector where large businesses created over 50% of the value added in 2003, or 4 percentage points more than in 2002. However, it is likely that Lithuanian furniture manufacturers will face difficulties competing with Asian businesses in a few years. Niche production is one of the possibilities to survive this competitive battle and it gives an edge to specialised small businesses compared with mass-producing companies. A good example is *Sintuva* which received the *Gazelle* award in 2004. The company specialises in production of leather

furniture and upholstery. In 2002–2003, the turnover of the company grew 10 times and over 80% of its production was exported to the EU.

Quite often two giants – *NBG* and *Putokšnis* – make the rubber and plastic products sector seem to be inaccessible to small businesses. However, this does not reflect the reality as these two *whales* dominate a single segment of the plastic products market, i.e. production of PET preforms. The production process which requires huge investment capacity ensures high concentration level of the segment worldwide. However, activities of the plastics sector are notable for the great variety of production processes, products and market segments which are often dominated by small businesses.

Extremely flexible injection moulding processes (to produce of a new product you simply have to change a pressform) and the variety of plastic products ensure excellent development opportunities for small companies which use this technique. A good example is a rapidly growing *Maksima* from Kaunas which produces plastic containers. *Umaras* from Utena uses the extrusion technology for production and is successfully increasing its manufacture and exporting most of its products to EU countries. The company employing seventy people is the largest producer of plastic film in the country.

Considering that production of plastic products per capita is twice as low in Lithuania as that in EU-15 countries at the moment, it can be concluded that SMEs have relatively good prospects in this sector.

Almost 90% of the value added in the metal industry is created by small and medium-sized enterprises. Most of them successfully export their production to the EU. Last year, the producer of garage gates *Ryterna* tripled its exports and further increased its turnover by a third this year. *Cosmica* from Kaunas, producer of industrial pressure vessels, works with quite large orders from its partners in Germany and Switzerland and exports about one half of its production. In 2004, *Saprega*, producer of containers and metal constructions, received the *Gazelle* award and was the leading and fastest-growing business among SMEs in Telšiai county.

There are several success stories in the national electric and optical equipment industry, which is undergoing difficult times. One of the success stories is the subsidiary of the Norwegian company *Kitron* in Kaunas which produces electronic products and received the *Gazelle* award in 2004. The combination of Norwegian experience and Lithuanian diligence led to unbelievable growth of production volumes as the company boosted its turnover 36 times from 2000 to 2003. This year, there has been a slight reduction in sales but the company expects more rapid development in Lithuania.

Traditionally, small and large businesses are walking hand in hand in the construction industry. The statistics of recent years show that both SMEs and large companies were successful in increasing the value added. The size of the construction object is crucial for the size of the constructor. Moreover, larger businesses have more opportunities to act as general contractors. Small businesses usually provide subcontracting, other specialised and finishing services. The spurt of the Lithuanian real estate market ensures great opportunities for construction companies of all sizes. The only problem that remains to be tackled is the increasing shortage of the workforce.

Concentration in the retail trade market continues. As the turnover of businesses with 50 and more employees is growing rapidly, smaller companies see their turnover shrinking. This is mainly due to concentration of the segment of trade in non-specialised stores which includes retail chains. Currently, largest stores have about 56% of this market in Lithuania. However, there is still room for growth there as the same indicator in EU-15 countries is

81% (according to *ACNielsen*). Joining forces is the only option for the small entities to compete with the retail trade *giants*. This is what the small traders belonging to the *CBA aibė* and *AVS prekyba* chains are doing. However, retail trade in non-specialised stores accounts for about two-thirds of the turnover and the remaining third is comprised of sales of stores (mainly small ones) engaged in specialised trade. Although it is possible to expect minor growth in this segment, it is unlikely that large chains will be able to oust small stores which sell niche products.

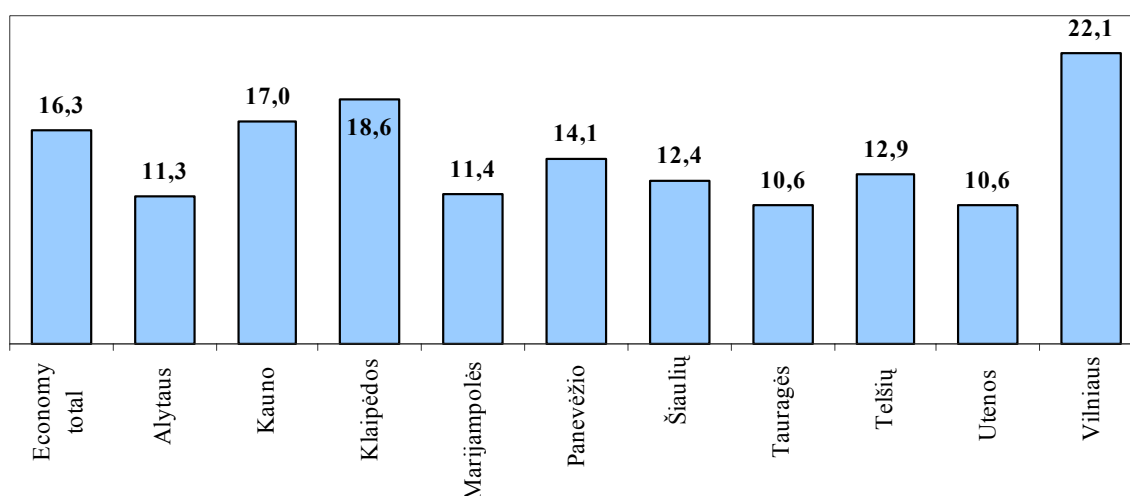
Small businesses should have largest expectations in relation to development of hotel and restaurant sector as well as the business services sector. Considering that the share of these industries in the Lithuania's GDP is twice as little as that in EU-15 countries, their rapid development followed by the growth of small and micro-enterprises dominating these sectors is to be expected.

Regional analysis of SMEs in Lithuania shows a relatively higher concentration of SMEs around the capital. Nearly 35% of active SMEs operate in Vilnius county where 25% of Lithuanian population lives. The share of SMEs operating in Kaunas and Klaipėda counties is almost equal to their number in total population, while the level of entrepreneurship in the remaining counties is clearly lower than that in the big cities.

Moreover, SMEs in Vilnius county demonstrated an impressive growth in 2002-2003 as the annual growth of the value added created by them was 18% on average, which is twice as high as the indicator of large businesses. A slightly different situation was in Kaunas and Klaipėda counties as SMEs did not have such a distinct advantage there.

Chart 3

Number of SMEs per 1,000 people at the end of 2004



Support to SMEs is one of the priorities of the EU and Lithuanian policy

Both in Lithuania and in the European Union, SMEs dominate as the type of business employing the majority of the workforce and, at the same time, having much lower efficiency and profitability. Despite their rather complex role in the economy, development of SMEs is one of the priorities in the EU and Lithuanian policy. There are

several underlying reasons. Firstly, SMEs is the backbone of steady employment. At times of economic stagnation, employment in SMEs decreases relatively less and increases relatively more during the upturn compared with large companies. SMEs is a cure for structural unemployment: often a personal company is a good option for people with occupation for which there is low demand.

Secondly, more businesses is an impetus for economic growth as a result of stronger competition. In their battle for the market share, businesses are forced to look for new solutions and segments which is a great premise for emerging innovative products and services. Focus on changing needs of customers, specialisation and diversification of production as well as niche production give a competitive edge over Asian competitors. It is obvious that Lithuanian producers of mass production are losing their ground because of increasing labour costs. Small and medium-sized enterprises are more sensitive to changes in demand and supply patterns, are more flexible and occupy specific market segments. They create new jobs in the areas where products and services have highest demand at the particular time. As mentioned before, even though small business have to overcome more barriers than large businesses in order to penetrate and strengthen their positions in foreign markets, many Lithuanian SMEs develop their exports successfully and are able to compete abroad.

Small and medium-sized business has an important role in the long-term economic development strategy of Lithuania until 2015. Every year SMEs receive increasing financial support from the government as well as from generous EU Structural Funds. However, some initiatives fall short of their goals because of bureaucratic barriers and underdeveloped business information infrastructure.

SPD's Measure 3.1 Direct Support to Business provides for 167.3 million Litas to be appropriated for support of SMEs in 2004–2006. Unfortunately, decisions on appropriation of funds are often delayed. As of now, support was given only to nine SMEs out of almost 250 candidates (more than 75% of support under the above-mentioned measure has not been appropriated yet). In a dynamic and competitive environment, few projects are able to wait for a year and longer before they can be implemented. Significant financial flows from the EU funds are expected in 2007–2013. Hopefully, institutions responsible for support implementation will work more efficiently and businesses applying for support will not have to wait excessively for reply.

Following the economic and social situation in the country, proposals put forward by public and local authorities and business organisations, the results of implementation of the strategy for development of small and medium businesses until 2004, the long-term economic development strategy of Lithuania until 2015, and the objectives of the European Charter for Small Enterprises, the Government adopted a resolution on 12 October 2005 on the development of SMEs in 2005–2008. The resolution provides for four spheres of activity:

- improvement of legal and economic environment for SMEs;
- improvement of financial support to SMEs;
- promotion of entrepreneurship in regions;
- improvement of competitiveness of SMEs.

Let us hope that the Government will be able to fulfil its objectives for SMEs support and the good intentions will yield tangible results. The Government could be more proactive in promoting the export of goods by SMEs. Considering the above-mentioned difficulties faced by SMEs in expanding to foreign markets, such kind of support would be very important and would have a positive economic effect. As mentioned before, small businesses often find it difficult to penetrate foreign markets so support in this area would be extremely welcome.

In summary, we can conclude that in favourable political framework the prospects for development small and medium-sized business in Lithuania are positive. Development of SMEs will be further supported by assistance from the EU Structural Funds, provided that certain bureaucratic barriers are removed.