

## Defining Small and Medium Enterprises: a critical review

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### Abstract

The OECD estimates that small and medium enterprises account for 90% of firms and employ 63% of the workforce in the world (Munro: 2013). Small and medium enterprises account for that amount of businesses that it is senseless the arbitrariness with which they are defined. Language mainly used for definition is numbers, but it is difficult to find two institutions, statistical agencies or countries who speak the same language in terms of small and medium enterprises. Academics, authors, policy makers apply SME definitions in terms of dichotomy between universality and standardization of a unique definition and relativity and sectorized specialization. Although qualitative criteria-characteristics of SMEs easily distinguish them from large businesses, quantitative criteria are mainly used for their dimensional classification. This paper deals with a critical approach to the definition of small and medium enterprises, inconsistencies in criteria and various proposed approaches to the definition towards universal acceptance.

**Keywords:** *SMEs, definition, quantitative criteria, quantitative indicators, standardization.*

### Introduction

The European Commission, the executive body of the European Union, with a recommendation of May 2003 has standardized the definition of micro, small and medium enterprises (European Commission: 2003). This definition is appropriated beyond the geographical scope that falls under the jurisdiction of the EU. European Commission at the request of the Council of Industry, has proposed in 1992 limiting addition of the definition of small and medium enterprises that Commission uses. The first recommendation that marked the beginnings of a unique definition of SMEs was that of April 1996 (European Commission: 1996). It was based on the idea that the existence of different definitions at Community level and at national level could create inconsistencies. If economists claim that small and medium enterprises are the backbone of the economy, how come they can't determine the number and the order of its discs?

But SME definition is far from being a solved, meaningful and acknowledged issue. One of the main challenges in developing a cross-country analysis of SME data is the lack of a universal definition of what constitutes an SME (Ardic et al.: 2011). Pobobsky (1992) cites a study of the International Labour Organization, which identifies over 50 definitions in 75 countries with considerable ambiguity in the terminology used.

Since then the heterogeneity of SME definitions has hardly softened.

An acute issue in the literature is the terminology used for the category of businesses that do not fall into the field of large enterprises. One part refers to them as small businesses, others use the concept of small and medium enterprises, while some refer to them as micro, small and medium enterprises. Although referring to the same class of business, the definitions differ in the degree of involvement of these businesses in the generic name. However, these concepts can be used interchangeably and can be understood if an author or an institution shows preference for any of them.

Differences in SME definition extend in three flanks: definitions by international institutions, definitions by national laws and by industry definitions. Finding a universal standard poses a sharp and acute critic to institutionalists, economists, academics and industrialists. Although a dilemma, more negligible is coining enterprise or business, although all authors use them interchangeably. Abbreviation SME which is usually faced in the European Union and international organizations as the World Bank, United Nations and World Trade Organization (Nwankwo and Gbadamosi: 2011), suggests that companies that fall into categories according to criteria that are different from large companies to be labeled as enterprise (Small and Medium Enterprise).

This article is an attempt to summarize SMEs definitions of various authorities, a review of relevant literature of the field, theoretical overview through comparison with practices of the different countries and critical overview of standard criteria and approaches of different authors in the definition of small and medium enterprises.

### **SME definition criteria: quantitative criteria**

It's sufficient the swiftest attempt to study SMEs to understand that there is no specific definition of them that may be taken as a reference by all economies, statistical agencies or researchers of economy. Despite the lack of universality of the definition and the lack of alignment in the criteria, the importance of SMEs definition is inalienable. The definition of small and medium enterprises is important and useful: in the preparation of statistics and the monitoring of the health of the sector over time; in benchmarking against other economies and between regions within an economy; in providing arbitrary thresholds for imposition of tax or other regulations; in determining eligibility for particular forms of public support (UNIDO OECD: 2004).

Small and medium enterprises are named by adjectives indicating size, thus economists tend to divide them into classes according to some quantitative measurable indicators. The most common criterion to distinguish between large and small businesses is the number of employees (Hatten: 2011). One of the first attempts to provide a definition of SMEs is that of the Bolton Report 1971 (Carter and Jones-Evans: 2006). This report suggests two approaches to the definition: quantitative approach and qualitative approach. Academics, policymakers, international institutions and statistical agencies mainly apply quantitative criteria in defining SMEs.

European Commission promotes "the criterion of the number of staff as the main criterion, however, introducing a financial criterion is nonetheless a necessary adjunct in order to grasp the real scale and performance of an enterprise and its position compared

to its competitors” (European Commission: 2003, item 4). European Commission through a guide determines the criteria for defining enterprises: number of employees, annual turnover and annual balance sheet (European Commission: 2005). It is determined that meeting the criteria of the number of employees is mandatory, while filling another from the two financial criteria is a choice of the enterprise. The definition of SMEs that came into effect from 1 January 2005 is shown in the following table.

Table 1: Definition of Small and Medium Enterprises with European Union standards.

Enterprise category	Headcount: Annual Work Unit (AWU)	Annual turnover	or	Annual balance sheet total
Medium-sized	< 250	≤ €50 million	or	≤ €50 million
Small	< 50	≤ €10 million	or	≤ €10 million
Micro	< 10	≤ €2 million	or	≤ €2 million

Source: European Commission(2005)

The World Bank uses three quantitative criteria for defining SMEs: number of employees, total assets in U.S. dollars and annual sales in U.S. dollars (IEG: 2008). A business must meet the quantitative criteria of number of employees and at least one financial criteria to be categorized as micro, small or medium business.

Table 2: Definition of Small and Medium Enterprises by World Bank standards.

Enterprise indicators (2/3)	Number of employees	Total assets	or	Total annual sales
Medium	> 50; ≤ 300	>\$3,000,000; ≤\$15,000,000	or	>\$3,000,000; ≤ \$15,000,000
Small	> 10; ≤ 50	>\$100,000; ≤ \$3,000,000	or	>\$100,000; ≤ \$3,000,000
Micro	< 10	≤ \$100,000	or	≤ \$100,000

Source: Independent Evaluation Group (2008)

If we compare the two criteria, “approximations” are observed in quantitative criteria of number of employees, with the exception that the World Bank raises the upper threshold for medium-sized businesses to 300 workers. Inconsistencies are most pronounced in financial criteria. Besides differences in denomination (EUR/USD) which is understandable, financial criteria used are quite different. While the EU uses the criteria of annual turnover and balance sheet total, WB use the criteria of total assets and total annual sales. Financial criteria of the two institutions have no basis of comparability; moreover there are substantial differences in definition. World Bank criteria seize more minimalist thresholds than the European Union. While for the EU has a micro business has a turnover of up to two million Euros, for WB it must not exceed annual sales of up to one hundred thousand dollars. EU sets maximum threshold of fifty million Euros to distinguish medium businesses from large ones, while WB sets it to only fifteen million

dollars for the two financial criteria.

Although being the most common criterion in the definition, the number of employees has many variances indifferent sources of SME statistical reporting. The largest number of sources defines SMEs to have a cut-off range of 0-250 employees (Ayyagari et al.: 2003). Among all SMEs definitions, the one most implemented in SME studies is that of the European Union. However, it remains far from being appropriated by the state governments and policymakers. Although recommended by the EU, that definition is only mandatory for institutions and businesses seeking funding from it (Carter and Jones-Evans: 2006). A World Bank study, materialized by a publication known as MSMB Country Indicators reveals that out of 132 countries covered in the study, 46 of them or a third define SMEs as businesses with fewer than 250 employees (Kushnir et al.: 2010). Each country exercises the freedom to define SMEs specifically, as aftermath of which today's SME theory counts with a great host of definitions. The following table (Table 3) presents some of them.

Table 3: Distribution of firms by number of employees in different countries

	Micro	Small	Medium	SME	Large
EU countries, Iceland, Norway, and Switzerland	1 - 9	10 - 49	50 - 249	1 - 249	250 +
Australia	0 - 9	10 - 49	50 - 199	0 - 199	200 +
Canada	0 - 9	10 - 49	50 - 499	0 - 499	500 +
Japan	4 - 9	10 - 49	50 - 249	1 - 249	250 +
Korea	5 - 9	10 - 49	50 - 199	5 - 199	200 +
Mexico	0 - 10	11 - 50	51 - 250	1 - 250	251 +
New Zealand	1 - 9	10 - 49	50 - 99	0 - 99	100 +
Turkey	1 - 19	20 - 49	50 - 249	1 - 249	250 +
United States	1 - 9	10 - 99	100 - 499	1 - 499	500 +

Source: OECD (2010)

Gibson and Van der Vaart (2008) note that “we are far from an international consensus on what constitutes SMEs” and that it is not a scientific division based on macroeconomic indicators, but it is a statistical arbitrariness.

### Relativising SME definitions

Even though the number of employees constitutes an objective and easily applicable criterion, it has important limitations, primarily because the number of people employed is dependent on the sector of the business and this makes generalized comparisons across sectors difficult (Stokes and Wilson: 2010). Bolton Committee Report, which provides a definition of SMEs based in the UK, recognizes the size of the firm in terms of relativity (Lee-Ross and Lashley 2009). A business in a big market in a certain sector can be considered small, while another in a small market in any particular sector of the business can be medium or large. In North America, the Small Business Act states that a small business is independently owned and operated and not dominant in its field of operation but recognizes that the definition will vary from industry to industry to reflect

industry differences (Lee-Ross and Lashley 2009). Small business size standards vary by the industry within which the business operates: construction, manufacturing, mining, transportation, wholesale trade, retail trade, and services (Hatten: 2011).

SBA definition of in the United States of America accepts the industry variables as one of the determinants amidst SME definition criteria. For some individual branches in various industries defined as a criterion standard size in millions of dollars and other standard number of employees.

The main criterion in agriculture subsector of grain production is turnover of 750,000 dollars. In mining industry the criterion is the number of employees from 500. The most common criterion in the food manufacturing industry is the employment of 500 or fewer employees to be tagged as small business. The only criterion in wholesale trade is the number of employees from 100 (USSBA: 2013)

A definition of SMEs considering the specifics of the industry comprises an important determination that not all businesses are to be "wiped with one broom." The universality of the definition adopted does not suit some specific industries in which the volume of sales and labor intensity are determined by other market forces and make it incomparable to other branches.

Curran and Blackburn (2001) note that the definition of SMEs by number of employees has become difficult due to part-time work, casual work or temporary work becoming more widely used by employers. Full-time employment as a relative percentage is ever decreasing, as workers find innovative forms of engagement at work, not only in content, but also in terms of schedules.

Financial criteria suffer some drawbacks that can not be left unaddressed. Some of the shortcomings of using annual turnover as a determinant in defining SMEs are: financial reporting practices of accountants can vary up to incomparability and inconsistency, managers/owners see cash flow rather than turnover as a relevant indicator for monitoring the progress of the company (Curran and Blackburn: 2001), inflation and exchange rates make comparisons over time and between countries more difficult (Stokes and Wilson: 2010). For Gibson and van der Vaart (2008), the criterion of turnover is the most consistent of the three quantitative criteria. In the world of developing country SMEs, where employment figures and profits are often seriously blurred by tax considerations, one might say that sales are the measure of all things. (Gibson and van der Vaart: 2008). These authors, striking deficiencies in SME definition criteria, propose a new model that adheres to the following formula:

An SME is a formal enterprise with annual turnover, in U.S. dollar terms, of between 10 and 1000 times the mean per capita gross national income, at purchasing power parity, of the country in which it operates (ibid: 2008).

There is no based evidence that literature and policy makers have adopted this alternative formula for SME definition, however, attempt for a different approach is an important message, at a time when the criteria vary depending on the institution, country or industry.

## The SME definition unnumbering: qualitative indicators

Small firms may be difficult to define precisely on paper, but most are easy to recognize once they are seen in operation (Stokes and Wilson: 2010). Not only because of the greater likelihood of facing small and medium enterprises, due to greater share compared to large businesses, but also because of the simpler practices and structures, SMEs are relatively easily distinguishable from a superficial survey.

Theile (1996) finds two basis to distinguish small and medium enterprises from large ones, “personal principle” and “unity of leadership and capital” (as quoted in Loecher: 2000).

According to Loecher (2000), personal principle means that the company manager performs a central role in the business decision-making processes, heor she understands the company as a lifelong duty and maintains direct contact with employees, customers and suppliers. The principle of unity of leadership and capital means that the company manager proprietor are one and the same person, the manager-owner in addition to leadership duties takes up all or at least some of the liability risk (ibid: 2000). The idea of unification of property and management, namely to address the responsibility and accountability is imbued in the criteria of the European Commission (2003), who add to quantitative criteria another criteria expressed the maximum with the ownership percentage of less than 25% fromother enterprises and/or outsiders to determine business autonomy.

Bolton Report, the primary reference for qualitative definition of SMEs for all subsequent literature in the field, defines three essential characteristics of small firms: management of firm by its owner(s) in a personalized manner; relatively small share of the market in economic terms; independence in the sense that it does not form part of a larger enterprise is relatively free from outside control in its principal decisions (Bolton: 1971 as quoted in Stokes and Wilson: 2010). The following table (Table 4) presents some qualitative indicators defining SMEs, summarized by UNIDO, Industrial Development Organization of the United Nations.

Table 4: Qualitative indicators in discerning SMEs from large companies

Category	SMEs	Large Companies
Management	<ul style="list-style-type: none"> <li>• Proprietor-Entrepreneurship</li> <li>• Functions linked to personalities</li> </ul>	<ul style="list-style-type: none"> <li>• Manager-entrepreneurship</li> <li>• Division of labor by subject matters</li> </ul>
Personnel	<ul style="list-style-type: none"> <li>• Lack of university graduates</li> <li>• All-round Knowledge</li> </ul>	<ul style="list-style-type: none"> <li>• Dominance of university graduates</li> <li>• Specialization</li> </ul>
Organization	<ul style="list-style-type: none"> <li>• Highly personalized contacts</li> </ul>	<ul style="list-style-type: none"> <li>• Highly formalized ecommunication</li> </ul>
Sales	<ul style="list-style-type: none"> <li>• Comparative pozition not defined and uncertain</li> </ul>	<ul style="list-style-type: none"> <li>• Strong competitive position</li> </ul>
Buyer's Relationships	<ul style="list-style-type: none"> <li>• Unstable</li> </ul>	<ul style="list-style-type: none"> <li>• Based on long-term contracts</li> </ul>
Production	<ul style="list-style-type: none"> <li>• Labor intensive</li> </ul>	<ul style="list-style-type: none"> <li>• Capital intensive, economies of scale</li> </ul>
Research Development	<ul style="list-style-type: none"> <li>• Following the market, intuitive approach</li> </ul>	<ul style="list-style-type: none"> <li>• Institutionalized</li> </ul>
Finance	<ul style="list-style-type: none"> <li>• Role of family funds, self financing</li> </ul>	<ul style="list-style-type: none"> <li>• Diversitied ownership structure, access to anonymous capital market</li> </ul>

Source: UNIDO (as quoted in Yon and Evans: 2011)

Marwede delineates SME definitions based on qualitative aspects, such as the legal form, the role of the firm owner, the firm's position in the market, organizational structure or economic and legal autonomy (as quoted in: Decker et al. 2006). Bolton's Committee was quick to acknowledge that the weakness of qualitative definition was that it was not easy to

operationalize (Curran and Blackburn: 2001). This deficiency is carried by any attempt to use utterly qualitative characteristics of businesses to categorize them into several classes that have size references.

### **How much/many or just how?**

The main advantage of qualitative versus quantitative indicators in the definition of SMEs is the universality, the same array of features all small and medium enterprises across the sector or the country in which they operate can be discerned. Ferreira and Leite (2011) note that several studies have shown that, despite inconsistencies in quantitative criteria, SMEs across different countries tend to display similar organizational, cultural and strategic characteristics that are unique. These aspects are more qualitative, but nevertheless provide ground to create a wider homogeneous perspective in the analysis of firms around the world (Ferreira and Leite: 2011).

The simultaneous use of quantitative and qualitative indicators for definition constitutes a compromise to "ease feuds" between opponents of these indicators. Lumping together all businesses with under 50 employees as 'small businesses' implies that besides having below this number of employees, they also share enough other characteristics to be treated as members of the same category for research or policy purposes (Curran and Blackburn: 2001). This is a sharp issue, easily criticizable. Two businesses that hire between 10 and 50 employees do not necessarily carry the same activity in the same sector, with the same ownership structure, etc., but there are substantial differences in non-quantitative characteristics of businesses that can not be overlooked taking only numeric considerations.

Curran and Blackburn (2001), mention the circumstances in which simple SME definitions are useful, despite their imperfection. It can be drawn in two aspects, statistical usefulness: estimates for SME size distribution using qualitative criteria are useful for researchers and policymakers; political and administrative utility: it would be difficult politically and administratively expensive setting separate VAT thresholds for every different kind of economic activity (ibid: 2001).

European Commission (2005) defines the importance of a European Union definition for SMBs like this:

In a single market with no internal frontiers, it is essential that measures in favor 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... For Member States, use of the definition is voluntary, but the Commission is inviting them, together with the European Investment Bank (EIB) and the European Investment Fund (EIF) to apply it as widely as possible.

Despite the volume of SME definitions, there is a tendency to accept quantitative criteria, first and foremost the headcount or employee number criterion as the main determinant in categorizing SMEs. Also within this compromise, there is a tendency for definitions that outspread beyond border of a single country at a time when economic interaction

between countries is intense. Precisely, product of these definitions is the definition of SMEs legitimized by the European Union and which is used by most of the researchers.

### SME definition in Kosovo

Definition of SMBs in Kosovo is regulated by Law no. 02/L-5 for small and medium enterprise support. Article 4, paragraphs 2 and 3, determine that: a small enterprise is an enterprise that employs up to nine (9) employees during the previous 12 months and had total turnover of EUR 500,000 or less, while a medium enterprise is enterprise which employs between (ten) to 10 (forty-nine) and 49 employees during the previous 12 months had total turnover of 2.4 million Euros or less (Assembly: 2005). Paradoxically, the OECD publications, referring to the same law, show that Kosovo classifies SMEs by the following scaling: Micro: up to 9 employees, small: up to 49 employees, medium up to 249 employees (OECD et al.: 2012).

Laws in interpretation should have a unique and universal understanding. In the case of 02/L-5 law approved by the Assembly, the fact that an international organization quotes otherwise, raises the suspicion that the translated version of law is consulted and that it has suffered "loss" in translation while undergone translation from English version. Whatever the background, the most important is to stress the need for standardization in the definition of SMEs and the need for oneness and universality of this definition.

Strategy for SME development in Kosovo: 2012-2016, of the government of the Republic of Kosovo reports statistics of the Agency for Registration of Businesses in Kosovo (ABR) with EU standard criteria (Table 5.)

Table 5.: Enterprises registered in Kosovo by number of employees (2010)

Classification by size	Number of employees	Number of enterprises	Percentage in total
Micro	1 - 9	102,070	98.37
Small	10 - 49	1,406	1.35
Medium	50 - 249	221	0.22
Large	250 or more	58	0.06
Total		103,755	100.00

Source: Government of Kosovo (2011)

Periodic publications of the Statistical Office of Kosovo categorize companies according to size by taking as reference the number of employees in the same shape as the Strategy for SME development and the SME law in Kosovo. However, statistical repertory, a quarterly on economic enterprises in Kosovo, implements two different criteria, along using the standardized one; it uses another taxonomy, quite separate from any other categorization encountered in publications or literature (Table 6.). At the very least this is criticizable being that it abstracts the uniformity of statistical reporting, when it should be subject of sanction by law.

Kosovo is a member of the Western Balkans in geopolitical terms, CEFTA member in economic terms and aspirant to join the European Union in geostrategic terms.



Consequently, Kosovo's economic relations and trade exchanges with various countries, which require full comprehension in every respect. Concerning the SME definition, Kosovo "speaks the same language" with most countries, in fact all the European Union countries and the Western Balkans with which Kosovo performs most of its economic exchangeactivity, use the EU criteriafor the definition of SMEs (OECD et al., 2012).

Table 6.: Number of new enterprises by number of employees in Q4 2014

Categories of number of employees	Total	Foreign	Domestic
	2175	6	2169
1 - 4	2118	6	2112
5 - 9	38	-	35
10 - 19	17	-	17
20 - 49	4	-	4
50 - 99	-	-	-
100 - 499	1	-	1
> = 500	-	-	-

Source: Statistical Repertoire of Economic Enterprises in Kosovo (Q4-2014)

The exception is Albania, which uses different criteria. Albanian law (No. 8957) for Small and Medium Enterprisesfrom 2002 defines these definition criteria: micro businesses are the ones that have up to 5 employees, small as those with 6 to 20 employees, medium-sized businesses are the ones with 21 to 80 workers, while large enterprises are the ones with over 81 workers (SMEA: 2004). Albanian Institute of Statistics, INSTAT, publishes statistical reports in compliance with the definition of the European Union bypassing the legal definition. All this surfaces a defect, which while has not been witnessedin other nations may be called an Albanian flaw. Kosovo and Albania have failed to adopt thoroughly the EU standards in defining SMEs, moreover their partial utilization and the implementation of other criteria occasionally harms the professionalism due to lack of uniformity in the definition of SMEs.

Small and medium enterprises in Kosovo constitute not less than 99.94 percent of businesses (Government of Kosovo: 2011). This denotes that Kosovo's economy consists mainly of small and medium enterprises, as the likelihood of picking a big business "out of the bag" is extremely small. Thus, the importance of defining SMEs relativizes, at a time when most businesses are such like and what's left is extracting of shades between them. Moreover, Kosovo has no differentiated programs for the support of businesses by category; SME Strategy provides no specific considerations for micro, small or medium enterprises. Even fiscal treatment of small and medium is not fragmented; all are treated as a category of businesses in relation to large businesses.

Notwithstanding this drift that discourages discussions onSMEdefinition, the issue

constitutes a profound discussion. The large number of definitions itself, trends towards sameness and revisions of definitions of agencies and institutions demonstrate how vividly elaborates the discussion of definition of SMEs in pursuit of a wider compliance and finding an optimal set of criteria. This discussion in Kosovo is silent, if not completely unheard of. This article is an attempt to provide a boost to the issue of the definition of small and medium enterprises, which at least for academics and policymakers in the world remains a topic of interest and far from sealed.

## **Conclusions and recommendations**

Economic literature contains major differences in the definition of small and medium enterprises. Statistical agencies, international organizations, governments of independent countries emerge with different definitions and categorizations for businesses which do not reflect the differences between them. Different SME definitions are more arbitrary than a resemblance of the level and the nature of economic development.

There is no unique, universally accepted definition for small and medium enterprises. Current criteria have undergone revision and are always in the process of evaluation. There is neither agreement nor a propensity for approximation in respect of definitions, even among international organizations, which assemble as members the very same states. The definition of small and medium enterprises is relevant for the statistical purposes of assessing economic performance within a country, across sectors and between states. The importance of SME definition for policymakers lies in estimating the categories of businesses and their contribution to employment, Gross Domestic Product and in other macroeconomic indicators, to guide efforts, policies, to development strategies and support programs for small and medium enterprises.

For SME definition mostly the quantitative indicators are used, the size criterion of number of employees and economic criterion of annual turnover and the summation of economic results in the financial statements. Quantitative criteria provide ease of dimensional categorization of businesses, but contain the deficiency of lack of confidence and lack of access to reported data. It is indispensable the need of involving qualitative characteristics of businesses in their sorting into classes. SMEs are named according to dimensional criteria, but the characteristics of management, ownership structure and other unquantifiable aspects distinguish them from large businesses more easily than quantitative indicators.

Kosovo does not use a specific SME definition and like most of the Western Balkan countries has adopted the standard definition of the European Union. The increased volume of trade exchanges, strategic orientation for EU membership, commitment to accomplish the standards and the implementation of practices that this institution determines, guarantee the logical basis for going for the quantitative criteria of the European Commission. With the exception of Albania and Turkey, Kosovo has a complementary SME categorization with an absolute majority of trading partners, with which it develops economic affairs in the form of trade exchange and trade agreements.

In circumstances when standard definition becomes legitimate it should be formalized in all institutions, public or private. Statistical Agencies should report economic statistics

in compliance with the criteria set out and do it in a standardized way, because official statistical reports constitute a source of development of cross-sector and interstate analyzes and comparisons.

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