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BOOKLET OF STANDARDIZED SMALL AND MEDIUM ENTERPRISES DEFINITION

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BOOKLET OF STANDARDIZED SMALL AND MEDIUM ENTERPRISES DEFINITION-2007

SUSTAINABLE ACHIEVEMENT OF BUSINESS EXPANSION AND
QUALITY (SABEQ)

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ACTIVITY 1.5 (INCREASED ACCESS BY SMES AND MFIS TO
COMMERCIAL BANK LENDING FACILITIES AND OTHER
SOURCES OF FUNDS)

SUBACTIVITY 1.5.1 (STANDARDIZED DEFINITION FOR SME)

DELIVERABLE 1.5.1.1 (BOOKLET OF STANDARDIZED DEFINITION
AND SUPPORTING ANALYSIS)

DISCLAIMER:

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LIST OF ABBREVIATIONS

| | |
|------------------|--|
| OECD | Organization for Economic Cooperation and Development |
| EC | European Commission |
| MIGA | Multilateral Investment Guarantee Agency |
| IFC | International Finance Corporation |
| APEC | Asia Pacific Economic Cooperation |
| UNIDO | United Nations Industrial Development Organization |
| UNIDO/IPU | United Nations Industrial Development Organization / Investment Promotion Unit |
| MIT | Ministry of Industry and Trade |
| DOS | Department of Statistics |
| CBJ | Central Bank of Jordan |
| VTC | Vocational Training Center |
| ZCI | Zarqa Chamber of Industry |
| ICI | Irbid Chamber of Industry |
| ACI | Amman Chamber of Industry |
| JUMP | Jordan Upgrading and Modernization Programme |
| NAFES | National Fund for Enterprise Support |
| HCST | Higher Council for Science and Technology |
| JEDCO | Jordan Enterprise Development Corporation |
| WTO | World Trade Organization |
| UNCDF | United Nations Capital Development Fund |
| MET | Ministry of Economic Trade, Lebanon |
| ICBS | Israel Central Bureau of Statistics |
| MONE | Ministry of National Economy, Oman |
| YEA | Young Entrepreneurs Association |
| BDC | Business Development Center |
| EJADA | Euro-Jordanian Action for the Development of Enterprise |
| JLGC | Jordan Loan Guarantee Corporation |
| MoPIC | Ministry of Planning and International Cooperation |

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EXECUTIVE SUMMARY

This booklet recommends a unified definition for Small and Medium Enterprises (SMEs for short) that is appropriate to Jordan's economic structure and business environment. Eventually, following a unified SME definition would contribute to the consistency and efficiency of data compilation on SMEs in Jordan, which in turn would provide researchers and policy makers with valuable statistics on credit extended by banks and other credit institutions to SMEs.

The importance of collecting adequate statistics on SMEs in Jordan – and the amount of credit extended to SMEs by credit institutions – should not be underestimated. As time goes on, SMEs will come to be recognized more and more as the engines of employment growth in the economy, and credit institutions will have to be prepared to demonstrate that they are meeting the financing needs of SMEs in their communities. Indeed, banks are probably already lending more to SMEs than is generally believed; but verification is impossible when there is not a standardized definition of SME that is actually used in gathering these figures.

Moreover, SMEs attract funds not only from credit institutions in the form of loans, but also from individuals, families, and institutions in the form of equity capital. Tracking these flows of funds to SMEs is also essential in order to determine if SMEs are gaining access to the capital they need for expansion. At some point, an annual or biannual “Survey of Small Business Finances” should be instituted in Jordan to ascertain, via sampling, the utilization of various financing mechanisms by these enterprises. Through surveys such as this, underutilization of certain types of financing for which formal data are seldom collected (such as supplier credit) can be revealed, and remedies proposed. This type of survey will also require a standardized definition of SME.

In order to reach the objective of the booklet, an extensive research on the used definitions and SMEs eligibility thresholds was undertaken covering the local, regional and international scenes.

The research examined the rules and defining criteria for SMEs that were used and implemented by a number of international organizations (e.g. United Nations Organization for Industrial Development, European Commission, Multilateral Investment Guarantee Agency, and Asia Pacific Economic Cooperation.) Additionally, a number of country-specific SMEs definitions within the region were researched. Locally, the understanding of commercial banks for SMEs was examined and relevant initiatives were studied. Examples include: the SMEs definition created by the Central Bank of Jordan to support BASEL II requirements, and the industrial SMEs definition created by the Ministry of Industry and Trade to determine enterprises' eligibility to financial and technical assistance, among others.

The research revealed that despite the impressive strides that a few organizations have made toward defining the SMEs sector in Jordan, none of the definitions presents a panoptic view on the SME sector in Jordan; most definitions were developed for a certain purpose and/or sector. There is nothing inherently wrong with different definitions being used for different purposes, but extreme caution must be exercised. For example, it is often said that “Basel II defines an SME.” This is not strictly accurate. Countries that have adopted Basel II as a means of calculating regulatory capital requirements use categories of exposure such as “other retail exposure” and “small loans to business” based

on the bank’s consolidated business credit exposure to the company. But that is a definition of the type of credit exposure for the purposes of monitoring risk, not the type of business to which the credit exposure is incurred.

Following on the research findings, several indicators that were commonly used as definition criteria were assessed in terms of their relevancy to the size of an enterprise and ease of measurability. The following table summarizes the assessment results.

| Relevance and Measurability of Different Indicators | | |
|---|-----------|-----------------------------------|
| Indicator | Relevance | Measurability on a national level |
| Number of employees | H | H |
| Annual sales | M/H | L |
| Total assets | M/H | L |
| Registered capital | L | H |
| Total credit facilities | L | M |
| Qualitative indicators | M | L |
| H: High M: Medium L: Low | | |

Based on this assessment and according to common practices, three indicators were considered important to for an SME definition: **The number of employees, annual sales and total assets.**

Due to lack of up-to-date relevant statistics on the three main identified indicators, it was difficult to determine the SMEs defining thresholds by examining any obvious natural “breaks” between micro, SMEs, and large enterprises. Instead, definitions of regional countries that are similar to Jordan’s in terms of economic development and market advancement were reviewed. According to this review, SMEs in most regional countries were found to be fitting comfortably within the 10 to 99 employee range (with small defined as those employing between 10 and 49, and medium as those employing between 50 and 99). No relevant regional definitions took into consideration the annual sales and total assets as defining indicators. Therefore, other local definitions and “best-judgment” estimates were used to set out the threshold for total sales and total assets.

Based on the results of the research and several assessments and measures, the following is our recommendation on the indicators that should be used to define an enterprise as an SME:

- **The employment threshold is a mandatory indicator that any enterprise must fall within in order to be defined as an SME. SMEs are those enterprises that employ between 10 and 99 employees. Small enterprises are those employing between 10 and 49 employees whereas medium enterprises would be those employing between 50 and 99 employees.**

- **The annual sales threshold is JD 1 million (\$ 1.4 million)**
- **The assets threshold is JD 1 million (\$ 1.4 million)**
- **If any enterprise falls within either of the above two thresholds, it qualifies as an SME; if *both* annual sales *and* total assets exceed JD 1 million, it does not qualify as an SME.**

We also recommend revisiting this definition once there is more precise and comprehensive data that covers all establishments in Jordan in order to test thresholds and see if they match the natural breaks in the enterprise sizes.

INTRODUCTION

There is a consensus among policy makers, economists, and business experts that Small and Medium Enterprises (SMEs for short) are drivers of economic growth. A healthy SME sector contributes prominently to the economy through creating more employment opportunities, generating higher production volumes, increasing exports and introducing innovation and entrepreneurship skills. Nevertheless, SMEs in Jordan, as in other countries, are still facing a number of difficulties and obstacles that are impeding and complicating their operations and growth.

The most visible difficulty is the enterprises' limited ability in obtaining credit particularly in its early stages. According to the "Med Best Process in Jordan"¹ report this is mainly due to the perceived high risk of lending to SME projects as opposed to larger more established organizations, information asymmetry in terms of a lack of clear and detailed financial history on the part of SMEs, and loan application requirement shortcomings such as the lack of a long term business plan. As banks view SMEs as a sector with high credit risk, there are often high collaterals and interest on loans imposed by banks and financial institutions on them. SMEs are treated on a "one-to-one" basis which is greatly influenced by the notion of "name lending".

Moreover, the different SME definitions among various entities, including banks and other financial institutions, make it difficult to obtain relevant and consistent statistics and performance indicators on the SMEs sector, such as total credit outstanding to SMEs in general or SMEs in specific sectors.

As such, the objective of this booklet will be to suggest a unified definition of SMEs that is appropriate to Jordan's market structure and economy. The booklet will present the analysis followed in arriving at this definition as well as providing the supporting material and background research that was utilized in this assignment. A unified definition of SMEs will also provide a common ground for research and statistics of credit extended by banks and other credit institutions to SMEs.

The following objectives have been set forth to meet the overall objective of preparing the booklet;

- Researching the market of available SME definitions and comparing them to internationally and regionally used definitions
- Analyzing the local SME industry to better understand the conditions under which it operates in order to provide reasonable criteria for definition

INTERNATIONAL DEFINITIONS

According to the Organization for Economic Cooperation and Development (OECD)², the characteristic of SMEs not only reflects the economic patterns of a country but also the social and cultural dimensions. These differing patterns are noticeably reflected within different definitions and criteria of SMEs adopted by different countries: whereas some refer to the number of employees as their distinctive criteria for SMEs, others use invested capital, and some other use a combination of the number of employees, invested capital, sales and industry type.

This section will examine the different definitions of SMEs among various institutions.

¹ "Med Best Process in Jordan" Country Report August 2004- Competitiveness Unit, Ministry of Planning and International Cooperation.

² OECD (2004), SME Statistics: Towards a More Systematic Statistical Measurement of SME Behaviour. Background report for the 2nd OECD Conference of Ministers Responsible for Small and Medium Enterprises (SMEs), p.10.

Definitions include those of the European Commission (EC), Multilateral Investment Guarantee Agency (MIGA)/International Finance Corporation (IFC), Asia Pacific Economic Cooperation (APEC), and United Nations Industrial Development Organization (UNIDO).

(1) The European Commission (EC) Definition

The definition of the EC takes into consideration three different indicators; **staff headcounts, annual sales and assets**. Though it is mandatory to abide by the staff headcounts’ threshold, however, an SME qualifies by falling under either the sales or the assets ceilings. This definition was introduced to ensure that eligible enterprises engaging in different types of economic activities do not lose their status as SMEs. This definition allows enterprises to be treated fairly, as enterprises in the manufacturing industry for example, have lower sales figures than those operating in the trade and distribution industries.

According to the EC, SMEs are those enterprises that employ fewer than 250 people and have annual sales not exceeding \$67 million and/or total assets not exceeding \$56 million.

Small enterprises are defined as those enterprises employing less than 50 persons and with annual sales or total assets that do not exceed \$13 million. Meanwhile, micro enterprises are defined as those which employ fewer than 10 persons and with annual sales or total assets that do not exceed \$3 million.

It is worth mentioning that this definition replaced a previous one that was introduced back in 1996; the previous definition had the same staff headcount but a significantly lower financial threshold. The increase in financial thresholds was attributed to the positive economic developments in prices and productivity in the EU member states over the last decade.

| Enterprise Category | Headcount (Annual Work Unit) | Annual Sales | Total Assets |
|----------------------------|-------------------------------------|---------------------|---------------------|
| Micro | < 10 | ≤ \$ 3 million | ≤ \$ 3 million |
| Small | < 50 | ≤ \$ 13 million | ≤ \$ 13 million |
| Medium Sized | <250 | ≤ \$67 million | ≤ \$56 million |

Note: All monetary values have been converted using the following exchange rate: 1 EUR is equal to 1.34017 USD

(2) Multilateral Investment Guarantee Agency (MIGA) and International Finance Corporation (IFC) Definition of SMEs

The MIGA and the IFC define small enterprises as those that meet two of the following three conditions:

1. Less than 50 employees
2. Less than \$3 million total assets
3. Less than \$3 million total annual sales

Meanwhile, medium enterprises are those that meet two of the following three conditions:

1. Less than 300 employees
2. Less than \$15 million total assets
3. Less than \$15 million total annual sales

Unlike the EC definition, the MIGA and IFC definition does not consider the staff headcount threshold mandatory for an enterprise to qualify as an SME.

(3) Asia Pacific Economic Cooperation (APEC) Definition

The most common criterion used within the economies of APEC is the **number of employed personnel** within the business itself, therefore, APEC defines SMEs as enterprises with less than 100 people, whereby, a medium sized enterprise employs between 20 and 99 people, a small firm employs between 5 and 19, and a micro firm employs less than 5 employees which includes self employed managers.

According to this definition, 75% of enterprises in APEC were micro, 21% were small, and 4% were medium during the period between 1990 and 2000.

(4) United Nations Industrial Development Organization (UNIDO) Definition

According to UNIDO the definition of SMEs is a significant issue for policy development and implementation and depends primarily on the purpose of classification. Hence, SME definitions vary among various countries as well as within the country over a period of time.

For the purposes of policy development, UNIDO generally advises countries to take into account the quantitative and qualitative indicators for SME definition. The following table summarizes the main qualitative indicators that may be used in order to differentiate between SMEs and large companies.

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

Source: UNIDO

In light of the above, UNIDO Investment Promotion Unit (UNIDO/IPU) offices in Amman refer to the local definition that has been set by the Ministry of Industry and Trade (MIT), which defines SMEs as follows;

- Micro-sized enterprises are those employing between 1 and 9 employees and/or have a registered capital of less than \$42,300
- Small enterprises employ between 10 to 49 employees and have a registered capital of more than \$42,300
- Medium enterprises employ between 50 to 249 employees and have a registered capital of more than \$42,300

Large enterprises, on the other hand, are those employing more than 250 employees and have a registered capital of more than \$42,300

REGIONAL DEFINITIONS

The World Bank Group "Micro, Small, and Medium Enterprises: A Collection of Published Data" database compiles the publicly available country-level data on micro-small and medium enterprises (MSMEs for short) from 118 countries. The definitions are collected from various local and international organizations.

Moreover, certain economic indicators are included within this database such as the Gross National Income (GNI), Income Group, and contribution of MSMEs sector to the total

employment. These economic indicators are useful in investigating the linkage between economic growth, poverty reduction and the small and medium enterprise sector.

As shown in Table 3, all of the following countries categorize the size of their SMEs using the number of employees' indicator.

| Definition according to number of employees | | | | | | | | | Economic Indicators | | |
|--|---------------|--------------|--------------|---------------|----------------------------|---------------------|-----------------------------------|---|----------------------------|--|--|
| Country | Source | Micro | Small | Medium | GNI per Capita (\$) | Income Group | MSMEs per 1,000 population | MSMEs employment as a % of Total | | | |
| Egypt | UNCDF | 1-4 | 5-14 | 15-49 | 1,240 | Lower Middle | 26.8 | 73.5 | | | |
| Lebanon | MET | *0-9 | 10-49 | 50-99 | 3,760 | Upper Middle | 47.2 | n/a | | | |
| Israel | ICBS | *0-9 | 10-49 | 50-100 | 18,620 | High | 67.8 | n/a | | | |
| Oman | MONE | 0-5 | 6-20 | 21-100 | 9,070 | Upper Middle | 2.9 | n/a | | | |
| Jordan | DOS | 1-4 | 5-19 | 20-99 | 2,190 | Lower Middle | 26.8 | 50.0 | | | |
| United Arab Emirates | HSBC | *0-9 | 10-49 | 50-499 | 19,420 | High | 34.2 | 86 | | | |
| Tunisia | UNIDO | <10 | 10-49 | 50-99 | 2,080 | Lower middle | 0.9 | n/a | | | |

Source: MSMEs Database – World Bank – January, 2007

Note: Although it is not possible to have a micro enterprise with 0 employees, the range has been displayed within the table as provided by the source itself.

By examining the figures in Table 3, the following observations can be inferred:

- United Arab Emirates has the highest threshold for staff headcount within the medium enterprises category; this can be attributed to the high number of large-scale foreign companies that are operating in the UAE's dynamic and strong economy. UAE's GNI income is the highest among all the listed countries standing at \$19,420 and in the same income group as Israel. Therefore, and given Jordan's incomparability with the structure of economy in UAE, as in Israel, a representative SMEs definition in Jordan cannot borrow from SMEs definition of either country (UAE and Israel).
- Israel, Oman, Tunisia and Lebanon share almost the same definition for MSMEs. The high technological advancement of Israel may have contributed to the prevalence of capital-intensive industries, making it slightly different from the rest. In contrast, Oman, Tunisia and Lebanon are relatively comparable to each other in terms of economic structure, development stage, and demographics.

- Notwithstanding the fact that Egypt has the one of the largest local markets within the Arab region, the threshold for Egypt’s MSMEs is the lowest among the listed countries. However, the thresholds listed above vary with those that were introduced by the Ministry of Industry and Trade in Egypt as illustrated in Table 4.

| Table 4: Definition of SMEs According to the Egypt’s Ministry of Industry and Trade | | | |
|--|-----------------------------|-----------------------------|------------------------------|
| Definition according to number of employees | | | |
| Indicator | Micro Establishments | Small Establishments | Medium Establishments |
| Number of Employees | 1-9 | 10-50 | 50-100 |
| Registered Capital | Up to \$ 87,864 | \$87,864-\$878,659 | \$878,659-\$1,757,318 |

Note: All monetary values have been converted using the following exchange rate: 1 EGP is equal to 0.17573 USD.

OVERVIEW OF THE LOCAL SMES MARKET

LOCAL INITIATIVES

Several entities have realized the importance of arriving at a common definition for SMEs in order to establish the ground rules on which SMEs can be fairly treated by relevant stakeholders in terms of their eligibility to technical and financial assistance. Although those initiatives were largely fragmented, they have nevertheless contributed to a better understanding of SMEs in Jordan.

The following are the main initiatives that were studied during the course of this assignment:

(1) Industrial Establishments Definition

In 2003, a national steering committee headed by the MIT was assigned to come up with a standardized SMEs definition only for industrial establishments in Jordan. Apart from MIT, the committee included representatives from; Department of Statistics (DOS), Central Bank of Jordan (CBJ), Vocational Training Corporation (VTC), Zarqa Chamber of Industry (ZCI), Irbid Chamber of Industry (ICI), Amman Chamber of Industry (ACI), Jordan Upgrading and Modernization Programme (JUMP), National Fund for Enterprise Support (NAFES), Higher Council for Science and Technology (HCST) and Jordan Enterprise Development Corporation (JEDCO).

According to MIT, this initiative was mainly driven by the proliferation of various local and foreign technical programmes that aimed at enhancing and sustaining the competitiveness of Jordan's SMEs. These assistance programs required a standardized definition in order to ensure that eligibility criteria are fairly implemented among applicants. Furthermore, the introduction of preferential treatment for SMEs within international trade agreements that Jordan has signed, necessitated the establishment of a unified SMEs definition. One such example is the World Trade Organization (WTO) "Government Procurement" agreement which duly took into account the need of developing countries to *"promote the establishment or development of domestic industries including the development of small-scale and cottage industries in rural or backward areas; and economic development of other sectors of the economy"*³

The national steering committee took into account different measures in order to come up with an SME definition. This included reviewing the "Chamber of Industry Law" no. (25) for the year 2005 which has been referred to as a baseline for identifying micro-enterprises and industrial establishments in Jordan.

- a. **Micro industrial establishment:** micro industrial establishments are either companies or individual establishments with a registered capital of less than \$42,300 and with less than ten registered employees within the social security program

³ World Trade Organization – Agreement on Government Procurement Article V 1 (b).

- b. **Small and medium Industrial establishment:** any company or individual establishment that operates within a certain industrial sector and have a registered capital exceeding \$42,300 and more than ten registered employees within the social security program

In conjunction, the committee reviewed other countries' official definitions of SMEs of which the majority of them were dependent on the staff headcount indicator. Moreover, the committee examined the official statistics on industrial establishments in Jordan to study the distribution of those establishments according to several indicators (i.e. number of employees, registered capital, sales, etc.).

Accordingly, in September 2005, the industrial SMEs definition was endorsed by the Prime Ministry as a national standardized definition to be used among all relevant governmental institutions. The definition is as follows;

- Micro-sized enterprises are those employing between 1 and 9 employees and/or have a registered capital of less than \$42,300
- Small enterprises employ between 10 to 49 employees and have a registered capital of more than \$42,300
- Medium enterprises employ between 50 to 249 employees and have a registered capital of more than \$42,300

(2) SMEs under BASEL II Agreement

BASEL II guidelines aim at having a safer international financial system through reflecting the riskiness of banks' loan portfolio in the capital charges they need to set aside against unexpected losses. The risk-weight attached for SMEs by CBJ has been set at the same level as the claims included in the retail portfolio which stands at 75%, as opposed to a risk-weight of 100% for claims on the corporates portfolio. Thus, given the preferential edge that SMEs have gained within the guidelines of this agreement, and to strictly identify this segment of enterprises, the CBJ has recently issued the following definition for **small enterprises** in Jordan;

“Firms with maximum total credit facilities that do not exceed \$352,500 from all commercial banks, and do not exceed more than \$211,500 from each commercial bank and with maximum total assets and annual sales of \$705,000 and \$1,410,000 respectively. This definition applies on all firms except public shareholding firms.”

Whilst banks are not obliged to change the way in which they manage businesses and risks, however, in order to derive the minimum capital requirement, banks must categorize their banking-book exposures into the broad classes of assets (a) corporate (b) sovereign (c) bank (d) retail and (e) equity, and reflect the different underlying risk characteristics of each assets within their Internal Rating Based (IRB) approach. Consequently, under this approach, commercial banks will be permitted to separately distinguish exposures to SMEs borrowers from those to large firms.

It is worth noting that CBJ's role is a supervisory role which strives to ensure the soundness and safety of the banking sector in Jordan. Thus, CBJ's definition which has been developed within the framework of the Basel II agreement **is not mandatory** for commercial banks to apply in all circumstances, but rather to segment the portfolio for reporting purposes to derive the favorable treatment in calculating the regulatory capital requirements.

Furthermore, this definition has its own shortcomings, since it consolidates both the size of firm and the exposure into the same definition. This is due to the fact that instead of defining the type of credit exposure that is entitled to favorable treatment in calculating the regulatory capital requirement, the CBJ defined the type of business to which the credit exposure is incurred. Thus, banks and other relevant entities might not feel bound to adopt it, because it was not intended as an SME definition and might not be the most appropriate one to use.

(3) Accredited Entrepreneur Initiative (AE)

The Young Entrepreneurs Association (YEA) is currently undertaking the "Accredited Entrepreneur" (AE) initiative in collaboration with the IFC. The initiative aims at creating a reputable accreditation program for YEA members, entrepreneurs and SMEs owners in general towards helping them find access to financing their projects through banks, financial institutions and investors.

The program, which is mainly based on the IFC's business edge program, covers 36 management subjects in five different topics related to marketing, human resources, quality management, finance, accounting, and productivity skills. The entrepreneur, after completing a number of training hours, shall be assessed through an examination. The scores of the examination will be taken into consideration within banks' credit scoring criteria.

To ensure banks' support to this initiative early on, and to ensure that the AE will be a benchmark that suits their scoring criteria, the YEA and IFC have conducted several workshops with the commercial banks. Within these workshops, the issue of unifying the SMEs definition was brought up; however, banks showed a huge rejection and resistance towards setting one definition among them all, since their definition may vary greatly according to each bank's strategy, portfolios, risk management, etc.

(4) Business Development Center (BDC)

The BDC does not have a standard definition for SMEs; in fact, the center's definition for SMEs differs according to each of its projects and initiatives. Accordingly, the Center has two "informal" definitions for SMEs under each of the following programs;

(1) Business & Export Development Project for Jordanian Enterprises-Tatweer:

A USAID funded project that aims at enhancing the competitiveness of Jordanian SMEs through providing specific technical assistance services and programs. The program defines SMEs as those firms employing between 5 and 250 employees. The definition, however, is somewhat restricted to industrial establishments since the program is mainly concerned about this segment of enterprises specifically.

(2) Financial Operations Results – FOR - Jordan Project: In partnership with the US-based Financial Markets International (FMI) BDC is currently executing the For-Jordan project that aims at bridging the gap between MSMEs and Financial

Institutions, through improving the financial management and operations of MSMEs and stimulating significantly higher levels of credit provision to MSMEs.

The project definition is the same as the definition of MIT except that it takes into account the annual sales indicator to consider particular sectoral features.

(5) Jordan Enterprise Development Corporation (JEDCO)

JEDCO applies the same definition that was issued by the MIT in 2005 which covers industrial SMEs only.

(6) Jordan Loan Guarantee Corporation (JLGC)

JLGC depends on the staff headcount in identifying SME enterprises; the threshold of the headcount differs according to the type of service offered by the Corporation, for instance the “Loan Guarantee Scheme for Small and Medium Enterprises” programme which guarantees 75% of outstanding balance for all types of loans up to \$56,400 and 50% guarantee on all loans in range of \$56,400-141,000, targets SMEs with labor force **ranging between 5 and 50 employees**.

The remaining types of services target **SMEs with labor force ranging between 5 and 250 employees**. One example of those services is the “Industrial Modernization Loan Guarantee Programme”- which guarantees up to 70% of all SMEs loans up to \$606,300.

It is worth mentioning that the latter definition was set in 2001 in a joint effort between the Ministry of Planning and International Cooperation (MoPIC), Euro-Jordanian Action for the Development of Enterprise (EJADA) and JLGC and was greatly influenced by the EC’s definition back then.

Commercial Banks’ Definitions

According to a survey which was conducted by the CBJ back in 2006, only two banks among all operating banks in Jordan defined SMEs precisely.

There is an increasing interest among commercial banks in extending credit to the SMEs sector. Although an SME might be looked at as a risky borrower, having a diversified portfolio of SMEs is less risky: lending to a large number of SMEs is less risky to the bank than lending to a few large companies. However, this depends on the bank’s strategy and risk appetite.

Notwithstanding the above positive alteration in banks’ attitude towards SMEs, the need for further clarification and understanding of SMEs is still felt within this sector. Indeed, whilst a few banks have established SMEs department with specialized teams that cater specifically for their SMEs clients’ needs and requests, others still lag behind and have a vague notion of what really identifies and characterizes SMEs.

Throughout the field visits that were conducted to a number of banks within June, 2007, the following general observations were made;

- **Establishment of SME departments** within a couple of banks was carried out to serve a larger number of small and medium scaled businesses in Jordan through either expanding their existing projects, financing their working capital or increasing their production capacities. Despite the fact that most departments were

relatively newly-established, they had a remarkable positive impact on the banks' credit portfolio, which according to one bank has increased by 200% within their 9 months of initial operation.

- **Banks' lending to SMEs is mainly influenced** by their strategic direction, credit portfolios, capital adequacy, risk management and risk appetite, among other indicators, instead of being influenced by the regulations of the CBJ.
- A few banks indicated that that the **staff headcount is a crucial factor** in qualifying an enterprise as an SME since it can be easily verified by the bank through several entities such as the Social Security Corporation and Income Tax Department, whereas other quantitative indicators can be misleading and cannot be easily verified through official sources.
- **Scientific approaches were minimally utilized** within the process of deriving the definition, except for a couple of banks which benefited from the technical assistance of the EJADA program.

| Table 5: SMEs Definitions in selected commercial banks according to the indicators | |
|--|--|
| Category /Indicator | Occurrence of Indicator |
| Quantitative | |
| Staff Headcount | <ul style="list-style-type: none"> ▪ A maximum of 50 employees ▪ Between 1 to 99 employees |
| Total credit facilities | <ul style="list-style-type: none"> ▪ Between \$28,200 and \$705,000, if the total exceeds the upper limit then it is considered to be a corporate size enterprise ▪ Less than \$352,500, if the total exceeds that then the firm will be classified as a corporate size firm ▪ Total facilities up to \$352,500 ▪ Facilities not exceeding \$705,000 |
| Annual Sales | <ul style="list-style-type: none"> ▪ A maximum annual sales of \$705,000 ▪ Annual sales up to \$1.41 million ▪ SMEs which have commercial, industrial or vocational activities with an annual income (without specifying the amount) |
| Total Assets | <ul style="list-style-type: none"> ▪ Total assets up to \$1.41 million |
| Qualitative | |
| Legal Status | <ul style="list-style-type: none"> ▪ Limited liability, joint or individual Jordanian companies/enterprises |
| Managerial Experience | <ul style="list-style-type: none"> ▪ A minimum of one-year experience in the field of business is required from managers and owners |
| Supporting Documents | <ul style="list-style-type: none"> ▪ Valid company registration record and a trade license |

As noticed from the table above, most of the banks use the total credit facilities as an indicator for classifying SMEs, whereas few of them include other quantitative and/or qualitative indicators to classify the establishment as an SME, others depend solely on this indicator. The latter can be a misleading approach since any corporate business with vast amount of financial resources and high number of employees might be granted a loan within the above mentioned amounts, yet, it realistically can not be classified as an SME. Accordingly, this classification falls short from capturing the real number of SME clients in any bank.

Moreover, all of the banks interviewed apply a generic definition for all SMEs regardless of their lines of businesses. This also can be an ambiguous approach especially since some enterprises may be operating in highly rewarding lines of businesses irrespective of their profiles (i.e. number of employees, registered capital etc.). In order to overcome this, some banks refer to the sales indicator to make sure that such enterprises will not be qualified as SMEs.

On another note, only one bank referred to few qualitative indicators within its definition. The most important indicator in this regard is the managerial experience indicator which clearly requires one-year managerial experience from managers and business owners of SMEs within their field of business.

PROPOSED DEFINITION

Final Review of All Possible Definitions and Classification Criteria

By examining the international, regional, and local definitions of SMEs, a number of commonalities and shortcomings were observed. Table 6 below summarizes the main observations.

| | Description |
|----------------------|---|
| Commonalities | <ul style="list-style-type: none"> ▪ Staff headcount is a major indicator that is used in most definitions. |
| | <ul style="list-style-type: none"> ▪ Most SMEs classification criteria were based on a maximum of two indicators |
| | <ul style="list-style-type: none"> ▪ Most regional countries define SMEs as those enterprises that employ between 10 and 99 employees |
| Shortcomings | <ul style="list-style-type: none"> ▪ Little emphasis was given to sectoral based definitions. Instead a generic definition was used. |
| | <ul style="list-style-type: none"> ▪ Few local definitions were established for specific sector(s) which made it difficult to generalize the definition's criteria across the entire market. One such example is the MIT definition of Industrial SMEs. |
| | <ul style="list-style-type: none"> ▪ Few definitions were developed for certain purposes that do not follow the common logic of establishing an SME definition. As an example, the definition of the CBJ (in accordance with BASEL II) was developed for capital adequacy and risk calculation purposes. |
| | <ul style="list-style-type: none"> ▪ Despite the fact that UNIDO highlighted the importance of including qualitative indicators in SME's classification criteria, qualitative measures were often neglected. |

Additionally, definitions varied in terms of classification indicators. For the purpose of identifying the most meaningful indicators, a final review of the definitions and classification indicators that were examined throughout the report is necessary. Table 7 illustrates the prevalence of indicators among the various definitions examined.

| Indicator | International | Regional | Local |
|--------------------------------|---------------|----------|-------|
| Number of employees | ✓✓✓ | ✓✓✓✓✓✓ | ✓✓✓✓✓ |
| Annual sales | ✓✓ | | ✓✓✓✓ |
| Registered capital | | ✓ | ✓ |
| Total assets | ✓✓ | | ✓✓ |
| Total credit facilities | | | ✓✓✓✓✓ |
| Qualitative indicators | ✓ | | ✓ |

As shown in Table 7, the number of employees is by far the most commonly used threshold, followed by annual sales and, to a lesser extent, total assets. It is worth noting that credit

facilities as an indicator was only used among the local banks and the CBJ. Below is a brief assessment on the relevance and measurability of the above mentioned indicators.

- **Number of Employees:** The high relevance of the number of employees as an indicator was highlighted throughout the report. Furthermore, number of employees is probably the easiest figure to obtain. However, the local data on the number of enterprises is displayed within wide-range categories that do not indicate the true picture of the enterprises in Jordan. To illustrate, the establishment census categorizes enterprises as follows: number of enterprises with less than 5, 5-19, 20 and more. Further details on the data deficiencies are listed in Table 9.

For better measurability, we suggest that national statistics on enterprises should be categorized within smaller indicative ranges as follows: enterprises of employees between 1 to 5, 5 to 9, 10 to 99, 100 to 249, 250 to 499, and more than 499.

- **Annual sales:** Including this indicator in the SMEs classification criteria is particularly relevant if the enterprise is in the trade and distribution sector. Enterprises in trade and distribution have higher sales figures than those in manufacturing. For example, the EC definition included the option between the total annual sales and total assets depending on the sector in which the enterprise is operating.

However, obtaining annual sales figures on a national level is difficult, which might limit the ability of policy makers and researchers to study the SMEs sector.

- **Total assets:** As indicated in the description of the annual sales above, this indicator is particularly relevant to asset-based industries such as manufacturing. Similar to annual sales, figures on total assets are not easily obtainable on a national level.
- **Registered capital:** There is a tendency among local and international sources to use the registered capital as an indicator to the size of the enterprise in question. Although the registered capital is easily measurable on a national level, the relevance of the registered capital is highly questionable. Registered capital does not necessarily reflect the actual paid-in capital in any enterprise. In fact, registered companies could be non-operational. Also, the scale and scope of a firm's operations, as indicated by total assets, total sales, or other measures of activity, are not necessarily related to its registered capital. Two firms could have identical assets and identical sales, and yet one may have borrowed most of its funds (resulting in a small registered capital) and the other may not have borrowed at all (resulting in a large registered capital).
- **Total credit facilities:** As shown in Table 7, there is an emphasis among local banks on using the "Total Credit Facilities" as an indicator to the size of the enterprise. Nevertheless, total credit facilities are not relevant to the size of the enterprise; a small amount of credit does not necessarily imply that the enterprise is small or medium. Conversely, a medium-sized enterprise could borrow a large amount of funds, if it has decided to pursue a high-leverage strategy.

- **Qualitative Indicators:** Examples may include managerial experience and specialization level, among others. Although these indicators might be of relevance particularly to banks, the spread of use of such indicators in the various definitions examined is low. Additionally, these indicators are difficult to measure.

The following table summarizes the relevance and measurability as discussed above.

| Indicator | Relevance | Measurability on a national level |
|--------------------------------|------------------|--|
| Number of employees | H | H |
| Annual sales | M/H | L |
| Total assets | M/H | L |
| Registered capital | L | H |
| Total credit facilities | L | M |
| Qualitative indicators | M | L |
| H: High M: Medium L: Low | | |

It is also important to note that some definitions were based on an examination of relevant national statistics. Ideally speaking, relevant national statistics should be examined to show any obvious natural “breaks” between micro, SMEs, and large enterprises. Unfortunately, several statistical deficiencies limited the consultants’ ability to conduct this exercise. The following is a listing of the main statistical deficiencies.

| Source of Data | Deficiency |
|---|---|
| Establishments Census 1999/ "Frame of Establishments" which was conducted during the preparatory phase of the "Population and Housing Census" in 2003- DOS | The data categorizes the establishments using three indicators; staff headcount, registered capital and annual revenues. The three indicators are categorized into fixed wide ranges which impede the process of studying the distribution of establishments more precisely. For instance, the employment is distributed within the following categories; 0-4 employees, 5-19 employees and more than 20 employees. |
| Number and capital of registered companies and individual establishments according to economic sectors/ MIT | The data categorizes both the number of companies and individual establishments according to the registered capital only. This can be quite misleading especially since the figures do not reflect the actual invested amount. |
| Chambers of Industry | They provide the figures of staff headcount, registered capital and line of business for industrial establishments only. |
| Chambers of Commerce | They provide figures for commercial establishments only; their data covers the registered capital and the line of business only. |

Our Recommendations

In line with the regional definitions examined and the relevance and measurability assessed in Table 8, the following is our recommendation on the indicators that should be used to define an enterprise as an SME:

- The employment threshold is a mandatory indicator that any enterprise must fall within in order to be defined as an SME. SMEs are those enterprises that employ between 10 and 99 employees. Small enterprises are those employing between 10 and 49 employees whereas medium enterprises would be those employing between 50 and 99 employees.
- The annual sales threshold is JD 1 million (\$ 1.4 million)⁴
- The assets threshold is JD 1 million (\$ 1.4 million)⁵
- Enterprises may fall within either the annual sales and/or the total assets threshold – in other words, an SME could have annual sales of JD 2 million and assets of JD 900,000; or an SME could have annual sales of JD 800,000 and assets of JD 3 million. However, if both indicators are above JD 1 million, the enterprise cannot be considered an SME

⁴ As noticed, the thresholds are not in line with the MIGA/IFC definitions which were set at a maximum amount of \$15 million for SMEs generally. This is believed to be enormously high, in local terms, considering the structure of the Jordanian enterprises.

⁵ Ibid

However, this definition must be revisited once there is more precise and comprehensive data that covers all establishments in Jordan in order to test thresholds and see if they match the natural breaks in the enterprise sizes.

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