

CONSTRAINTS AND OPPORTUNITIES FOR MICRO-ENTERPRISES IN MALTA

Keith Psaila*

Abstract. This paper discusses the key challenges and constraints facing micro-businesses in Malta. The analysis is based on the views of respondents to a questionnaire in connection with a survey carried out by the present author. The paper also discusses the role of micro-enterprises in Malta. Results show that small size poses various constraints on the firms' performance, although a number of advantages were also identified. On the basis of these responses the paper puts forward a number of policy measures aimed at improving business performance of small firms, and therefore on the economy as a whole, given the prevalence of small firms in the Maltese economy.

Introduction

Despite the widespread belief that the existence of small firms is a key factor in economic development, studies on the relationship between micro-enterprises and macro economic growth are relatively limited, especially for Malta. The strength of this relationship would determine the extent to which constraints and opportunities for the growth of micro-enterprises impinge upon the development of the entire economy.

Based on this premise, the paper gives a definition of micro-enterprises and an assessment of their economic relevance to the Maltese economy. It subsequently summarises the mainstream literature concerning the constraints and opportunities faced by micro-enterprises, and assesses the extent to which they are applicable in the Maltese economy by means of a survey approach.

* Keith Psaila is Head of the Parliamentary Secretariat for Small Business and the Self-Employed. He possesses an MA (Economics) degree from the University of Malta.

Micro-Enterprises: Definition

The definitions of medium, small and micro-enterprises adopted by the EU Commission are summarised in Table 1. Micro-enterprises are defined as having fewer than 10 employees, have an annual turnover of not more than EUR 2 million and with a balance sheet total amounting to not more than EUR 2 million. Micro-enterprises thus comprise diverse types of firms ranging from one-person businesses to cooperatives. Whilst some micro-enterprises offer very traditional services or craft products, many others are fast growing high-tech companies.

In 2004 around 91 percent of European businesses were micro-enterprises (see Figure 1) out of which nearly 66 percent were one-person-enterprises (OPEs), i.e. enterprises that employ no personnel, at least not on a regular basis. (European Commission, 2005). In the case of Malta, the population of private business enterprises in 2004 comprised around 31,006 units, 96 per cent of which were classified as micro-enterprises. According to statistics for 2004, the largest sectoral category of micro-enterprises in Malta was in retail trade, with nearly 7,700 units.

Economic Relevance of Micro-Enterprises

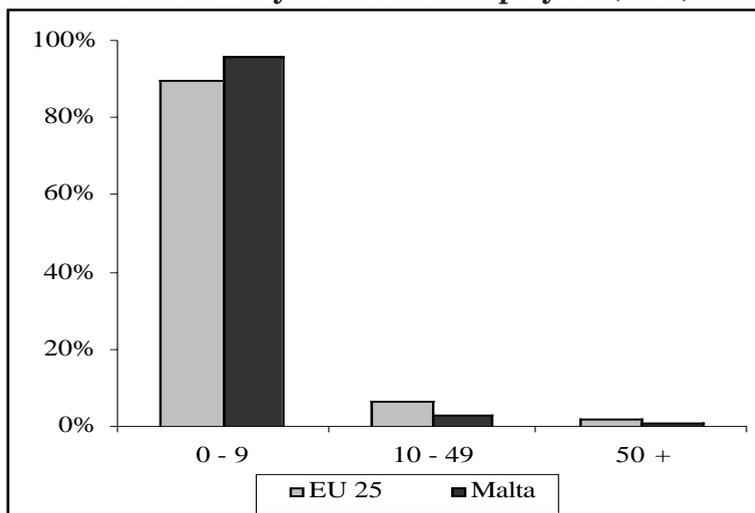
Table 2 presents the situation of Maltese private sectors employment for 2004 distributed into differently-sized categories of firms.

Table 1
Definition of Medium, Small and Micro-Enterprises

Enterprise Category	Annual Labour Units	Annual Turnover	Annual Balance Sheet Total
Medium	< 250	50 million euros	43 million euros
Small	< 50	10 million euros	10 million euros
Micro	< 10	2 million euros	2 million euros

Source: Commission Recommendation 2003/361/EC

Figure 1
Business Units in Malta and in Europe
Classified by Number of Employees (2004)



Source: Eurobarometer 2005 and National Statistics Office, Malta

Micro-enterprises employed over 44,600 workers in that year, accounting for 43.5 percent of total employment.

Small- and medium-sized firms each accounted for slightly over 20 percent of private sector employment, while 13.1 percent out of the gainfully occupied in the private sector were employed in large firms.

Table 2
Private Sector Employment (2004)

Type	Persons	%	Employees per Firm
Micro	44,624	43.5	2
Small	22,685	22.1	20
Medium	21,851	21.3	119
Large	13,418	13.1	419

Source: National Statistics Office, Malta

In terms of the generation of value added in the economy, however, the distribution between enterprises of different sizes is somewhat different, as shown in Table 3.

Table 3
Value Added Generated in Malta (Average 2002-2004)

Type	Value Added (Lm)	%	Value Added (Lm) per Enterprise
Micro	290.1	22.3	9,800
Small	213.8	16.4	190,900
Medium	207.4	16.0	1,127,100
Large	590.5	45.3	18,453,100

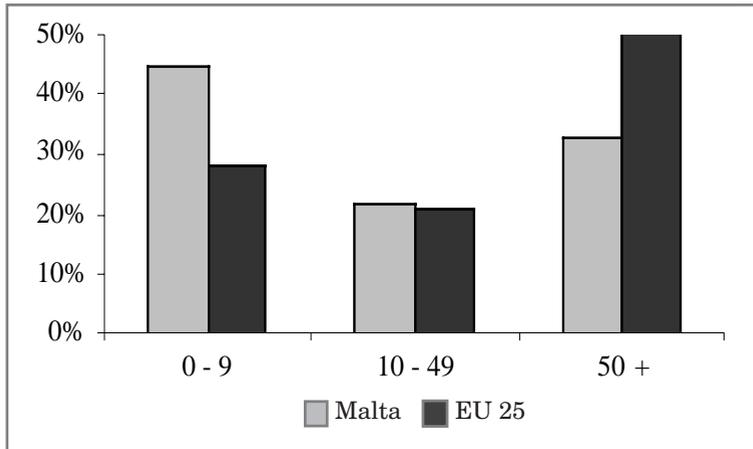
Source: National Statistics Office, Malta

Between the years 2002 and 2004, micro-enterprises generated an average annual value added of Lm290.1 million, or 22.3 percent of the total for the enterprise sector. This represented an average value added per firm of Lm9,800 or Lm6,500 per employee. During the same period, large firms generated more than double the value added of the micro firm sector, accounting for 45.3 percent of the enterprise sector. This implied that each firm produced an average annual value added of about Lm18.5 million. Available statistics suggest that the impact on the overall Gross Fixed Capital Formation generated in Malta is relatively low for micro-enterprises when compared to large firms.

Irrespective of the high number of business units classified as micro-enterprises (nearly 96 percent of total business units) within the Maltese economy, the average investment generated over the 2002-2004 period was Lm28.8 million, representing 8.7 percent of the average total Gross Fixed Capital Formation (source NSO, Malta).

The patterns of contribution of micro-enterprises to overall economic activity described above appear to be, in general terms, similar to those prevalent in the EU.

Figure 2
Employment: Malta Compared to EU 25



Source: Eurobarometer 2005 and National Statistics Office, Malta

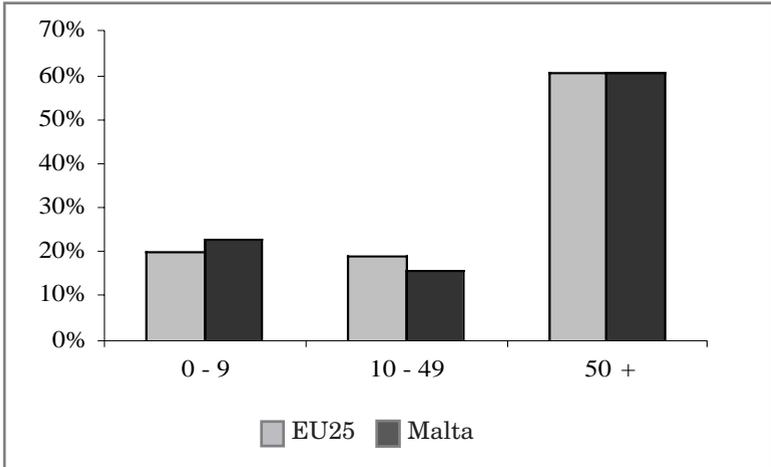
However, Malta appears to be relatively more dependent on micro-enterprises for the generation of employment, as shown in Figure 2.

As the share of value added generated by micro-enterprises in Malta is comparable to that in the European Union, as shown in Figure 3, it follows that, the value added per employee in Malta is lower than the average of EU countries.

These observations highlight the need for attention towards the micro-enterprise sector in Malta, on which the labour market is heavily dependent but which appears to be characterised by a relatively low level of productivity. In the recent past, medium and large firms have gone through a restructuring processes to remain competitive, and also through significant investment. It appears that micro-enterprises still need to catch up in this respect.

It is therefore important to assess the constraints towards the further growth and development of the micro enterprise sector in Malta with a view to reaping the opportunities ensuing from enhanced levels of productivity.

Figure 3
Value Added: Malta Compared to EU 25



Source: Eurobarometer 2005 and National Statistics Office, Malta

Constraints and Opportunities

From a review of the literature (see Psaila, 2006) it transpires that the constraints and opportunities of micro-enterprises stem from their very inherent characteristics. There are so many different kinds of micro-enterprises that generalising risks oversimplifying reality. Patterns do however exist and important indeed, and inherent characteristics, running through all the literature on small and micro-enterprises can be drawn up.

A characteristic associated in micro-enterprises is that they tend to be independent minded, workaholic and have a strong family orientation. (Boissevain, 1991). This explains their ability to take flexible decisions, affording them less bureaucracy and taking timely action to respond to day-to-day arising situations. Their main focus is family well-being and thus they tend to dislike government interference, and tend to be particularly averse to taxation on their hard-earned profits. The flexibility and lack of formality of micro-enterprises is at the same time their weakness in that these characteristics often lead firms not to seek professional guidance.

Accessing finance is difficult for micro-enterprises and often seen as a major stumbling block for their success. This is due to the high risk element which such enterprises carry with them.

This difficulty in accessing finance often puts them at a disadvantage, constraining their options for the carrying out the necessary restructuring, which in this era of globalisation, is much needed to withstand external competition.

Many such enterprises in Malta are also not finding refuge in the EU funding opportunities since most funding schemes contain an element of co-financing, which tends to be relatively large for micro-firms.

Gleaning through the literature on micro-enterprises (see for example, Carree and Thurik, 1998; Davis *et al.*, 1996; Storey, 1994), one may succinctly summarise the strengths and weaknesses of micro-enterprises as follows:

Strengths:

- Flexibility in decision making
- Motivation to succeed due to ownership
- Speed in taking decisions
- Lack of bureaucracy
- Continuity through the possibility of building the business for future members of the family.

Weaknesses:

- Limited possibilities to reap the benefits of economies of scale
- Difficulties in accessing finance
- Difficulties to withstand competition from larger firms

The strengths of micro-enterprises, if properly exploited, will yield competitive advantages and opportunities to enhance the profitability and sustainability within a market environment.

On the other hand, the weaknesses, if carefully understood and addressed, will help micro-enterprises mitigate the constraints for their growth and help overcome the negative impact of external shocks on their internal operations.

The Survey

To investigate which aspects of micro-enterprise are relevant for the Government to help promote economic growth, the present author carried out a survey by means of a questionnaire targeting 150 firms employing less than 10 persons or less, chosen at random from firms operating from within industrial zones (such as Handaq, Mriehel, Haz-Zebbug and Mosta) and in main commercial centres (such as in Sliema, Hamrun and Valletta). The targeted enterprises were selected through a sampling frame derived from the National Statistics Office (NSO) Business Register. Ninety eligible micro-enterprises replied to the survey (60 percent response rate). Of these 53 firms were located within industrial zones whilst the remaining 37 were located within commercial centres. Firms located within the industrial zones had an average of six employees each with 54 percent of them operating warehouses and back-office services for other retail outlets located in village core centres and commercial centres. The retail outlets employed on average two employees each. Only three of the responding micro-enterprises located within the industrial zones did some export business.

On the other hand nearly all the respondent firms located in commercial centres were mainly one person enterprises mostly involved in the retail business of wearing apparel, IT, DVD rentals, and daily utilities. The rest were service providers and comprised professional firms of lawyers, accountants and doctors, a tailor and a shoe mender.

Responses to the Survey

Given the breadth and quality of the respondents to the survey, survey results provide a useful snapshot of the Maltese micro business situation. However, as with any other survey, the results need to be interpreted with caution.

Opportunities for Micro-Enterprises

One of the questions posed in the survey sought to elicit information on the strengths of micro-enterprises, as perceived by the respondents themselves.

Figure 4
Survey Responses: Strengths of Micro-Enterprises

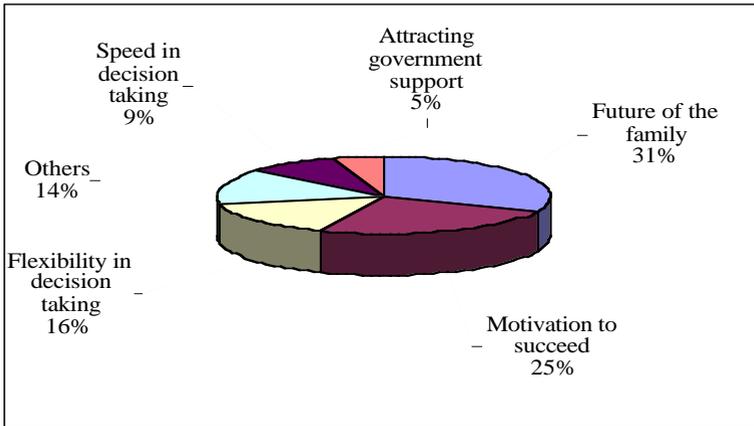
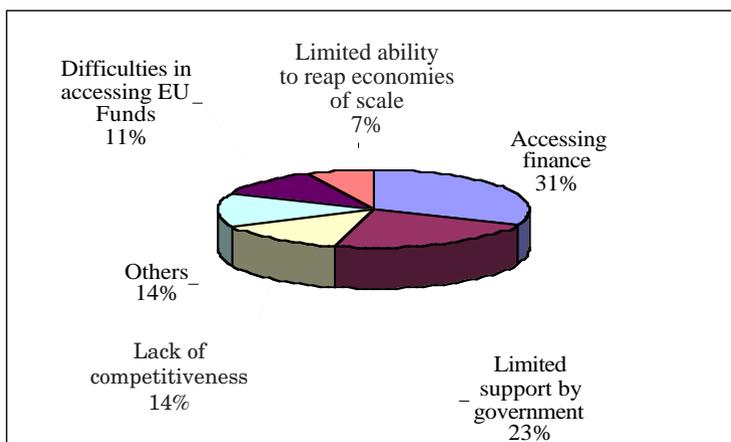


Figure 4 summarises the responses. In this diagram only the first preferences are included. Survey results show that 31 percent of the respondents consider their business as first and foremost a form of providing for the future well being of all the members within the family. Opportunities for growth in family businesses are often financed from within the same businesses—that is internally through reinvestment of past business profits and by accessing family financial resources.

Within such a Maltese context one must thus first understand family dynamics before trying to understand business dynamics. Indeed, herein lies the main motivation to succeed. As a matter of fact a quarter of the respondents associate micro-enterprise with a stronger motivation towards success as a result of self-ownership. Decisions in micro-enterprises are usually a single person's prerogative with at most, consultation being made with the husband or wife for the decisions which are considered particularly important.

Sixteen percent of the survey respondents see their strength in being flexible, a characteristic which they can find very useful in pursuing their growth prospects.

Figure 5
Survey Responses: Weaknesses of Micro-Enterprises



Constraints for Micro-Enterprises

Figure 5 presents the views of the respondents regarding the most important constraints facing micro-enterprises in Malta.

In economic literature the limited ability of micro-enterprises to reap economies of scale is often identified as one of the major constraints. In the case of the Maltese respondents, access to finance was identified as the most important constraint. While the objective of a family business may be expressed in terms of profit, one of the preoccupations of the management team in every family business should be with cashflow.

Limited government support was also indicated as one of the main constraints. This should come as no surprise given the strong reliance of the local micro firm sector on government agencies and departments which are often seen as the one only solution to much of their inherent problems. This in part also reflects the protectionist stance which micro firms have for long been accustomed to prior to EU membership which is still in many instances called for to shun away from their external competitive forces.

More can be done however by the government to render its support more known to micro-enterprises and more synergy amongst the various ministries, departments and public authorities is thus solicited in order to ensure a more effective Government wide action. The present government has put in place a dedicated Parliamentary Secretariat to take care of the problems of small enterprises, and this institution is carrying out major initiatives in this regard. Since becoming a member of the European Union, Malta has been adhering to the harmonised set of policies included in the European Charter for Small Enterprises (European Commission, 2000), whereby each member country acknowledges the Charter action areas as being of utmost importance towards reaching the Lisbon Agenda targets.

To this end the Maltese Government launches a yearly work programme (Parliamentary Secretariat for Small Business and the Self Employed, 2006), highlighting how the action areas defined in the European Charter will be implemented by the different Ministries, Government departments and public authorities through a series of policies and initiatives in favour of small business and self employed. 14 percent of the respondents see difficulties in withstanding competition from abroad as the primary constraint facing micro-enterprises. In Malta micro-enterprises are still in the process of finding their own market niche within the EU market. Unfortunately micro-businesses, especially in the retail sector, are still characterised by lack of innovation in service and presentation.

This problem is associated with the limited possibilities to reap the benefits of scale, which is a major difficulty facing micro-enterprises. 7 percent of the respondents identified this problem as being very important for them. Of course, increasing the size of the business will reduce this problem. In practice however, growing larger in size and space is very often not possible even if the demand permits. Given the substantial numbers of micro-sized operations which are located in residential areas, space is very limited and relocation of such business entities is often not possible either. To make matters worse for competing micro-enterprises, Malta's market is very small and limited and therefore becomes quickly saturated. It is for this reason that, at times, growing larger is very difficult and not economically feasible. It is perhaps for this reason that many micro-enterprises still favour protectionist practices.

In addition, when looking at business expansion opportunities, micro-enterprises must not only look at market demand but must also properly weigh the cost burdens they would be faced with should they choose to expand their operations. Wages and non-wage labour costs, as well as administrative costs of employment, might be so high that increase in output might not be worthwhile even if there might be a strong demand for the product or service offered.

Apart from the recurrent costs such as wages, the recruitment of an employee might also require certain investment expenses, (e.g. for additional equipment, larger work rooms, and a second car) that would put further burdens on business overheads. In practice before employing more people, the business has to reach a certain critical mass. According to the observatory for SMEs set up by the European Commission, recruiting a first employee often requires that the turnover doubles. For some businesses this might simply not be possible because the market is not big enough and/or because there is too much competition from other firms. Even if a business owner decides that he can afford to hire staff he/she might not be able to find suitable employees. Some jobs are directly linked to the person doing them so that the business owner cannot delegate such work to any employee. The reason for this link could be the special knowledge and abilities required for a specific task, that the owner possesses. Another typical example would be personal services that require a special relationship of trust between the owner and the client. The problem of high cost per unit in small-sized businesses in Malta is exacerbated by a lack of interest in innovation and in technological advancement by many small enterprises.¹

Implications for Policy

The constraints identified by the respondents to the questionnaire may lead to a situation where many micro-enterprises are not to be sustainable in the long run. The restructuring process started needs to be

¹ Indicators show that Malta scores well below that of the EU 25 average in terms of innovation (European Innovation Scoreboard, 2006). In this regard it may be pertinent to add that available statistics indicate that about 75 percent of all self-employed persons have primary and secondary education only, and that only about 11 percent have a University degree (source: National Office of Statistics).

sustained and unless this is done, one would expect either their outright exit from the market, and/or a gradual drift into the underground economy. For this reason, a well-thought-out government assistance and guidance programme to both existing operations and start-ups should be drawn up and intensified where it already exists. Such a programme needs to be integrated as part of a nation-wide strategy. Government policy should aim at minimising the constraints and maximising the advantages associated with small business. These policies can be broadly classified into two, namely (1) those that target the efficiency and sustainability of micro-enterprises and (2) those that aim to promote entrepreneurship as a key instrument for stimulating economic growth. There exists a strong interrelationship between both contemporaneously.

Policies that aim to Improve efficiencies of micro-enterprises. This set of Government policies should primarily be targeted towards removing regulatory barriers and minimizing state induced costs, to be successful. Such policies should also be aimed at providing common services for micro-enterprises and encouraging clusters to reap the benefits of external economies. In addition, measures should be explored as to how finance for micro-enterprises could be facilitated to enable them to invest in more efficient forms of production.

Policies that encourage entrepreneurship. Such policies should be congruent with those intended to promote efficiency of micro-enterprises. Entrepreneurs—business-minded people who can take a good idea or innovation and turn it into a thriving business—are the lifeblood of a prosperous economy. They are also the key to creating jobs and boosting the growth and competitiveness of the European economy in the years to come. Policies should be targeted to minimise rules that could stifle innovation, creativity, and entrepreneurial success. Government policies in this regard should also aim to continue to facilitate start-ups and to promote knowledge-based entrepreneurial activity.

Conclusion

Micro-enterprises create jobs and contribute a considerable proportion of GDP to any economy with Malta not being an exception. Positive results

at micro-firm level furthermore often spill over positively on the overall economy. This paper has gone the pros and cons of micro-enterprises operating in Malta which are currently undergoing a restructuring process to meet the challenges of a fully open market. Given the importance of Micro-enterprises and their economic relevance, these pros and cons if carefully dealt with, will contribute to Malta's bid to enhance its competitive edge.

Commercial activity does not exist in a vacuum and thus for a thorough understanding and interpretation of the survey results, Malta's business environment and special circumstances must be considered. Operating within Malta's commercial context, micro-enterprises are currently faced with two important socio-economic realities, namely (a) Malta's high degree of economic openness; and (b) the EU membership obligations. These considerations rule out any protectionist policies, and calls for the promotion of efficiency, entrepreneurship and innovation. To this end this paper suggests that Government policy should revolve towards promoting efficiency and entrepreneurship within the Maltese micro-enterprise sector. Implementing the European Charter for Small Enterprises successfully will help tackle the inherent weaknesses of micro-enterprises and build up on their inherent strengths, reach their growth aspirations. This will be beneficial for micro-enterprises and for the Maltese economy as a whole.

References

- BOISSEVAIN, J. (1991) "Small Entrepreneurs and their Cultural Context," *Bank of Valletta Review*, Spring, (3): 1-16.
- CARREE, M.A. and THURIK, R. (1998) "Small Firms and Economic Growth in Europe," *Atlantic Economic Journal* 26, 137-146.
- DAVIS, S.J., HALTIWANGER, J. and SCHUH, S. (1996) "Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts," *Small Business Economics*, August, 8(4): 297-315.
- EUROPEAN COMMISSION (2005) *Putting SMEs First—Europe is Good for SMEs, SMEs are Good for Europe*. Luxembourg: Publications Office EC.
- PARLIAMENTARY SECRETARIAT FOR SMALL BUSINESS AND THE SELF EMPLOYED (2006) *Open for Business*. Malta: Print It Ltd.
- STOREY, D.J. (1994) *Understanding the Small Business Sector*. London: Routledge.