



## RESEARCH ARTICLE

## Development of Small and Medium Enterprises and their Characteristics

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**ABSTRACT**

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In the current era of global economic changes and reforms, it is crucial to study and appropriately identify the factors that ensure the sustainable development of countries. In this context, the role of small and medium enterprises (SMEs) in economic growth during the transition period is significant. Therefore, this research examines the theoretical and methodological development of SMEs in Mongolia, the factors influencing them, and the challenges they face, comparing them with the experiences of other countries. The study provides conclusions and recommendations on the characteristics of SME development in Mongolia and suggests ways to promote their growth.

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### INTRODUCTION

In the era of globalization, where countries' economic relations are becoming increasingly integrated, identifying the factors that ensure sustainable development is crucial. The development of SMEs plays a particularly important role in this regard. Therefore, SMEs are a fundamental factor in establishing a market economy structure.

"The development of SMEs is formed as a result of various forms of ownership, creating competition through privatization, bringing services closer to consumers to meet demand, and dismantling monopolies, thus acting as a key driver of innovation. Flexible and mobile forms of small ownership significantly contribute to maintaining competitive economic relations under market conditions, as they inherently lack monopolistic characteristics. They also serve as a guarantee of social stability (Dolgorsuren.Ts, 2008)."

SMEs have played a significant role in the economies of countries, especially developing ones, and will continue to be important for the socio-economic development of nations worldwide. Currently, SMEs account for about 90% of all businesses globally, creating a substantial number of jobs and contributing significantly to global economic development.

In Mongolia, the study of issues related to the establishment of SMEs began in recent years, as SMEs started developing in the country in 1990. Before that, there was no scientific research or practical studies on this topic, and the concept of SMEs was not clearly defined. Therefore, it became necessary to study the support provided by the government, the business environment, and the internal organizational management capabilities to develop SMEs in Mongolia.

## 2. LITERATURE REVIEW

The development of SME business has been studied from both theoretical and practical perspectives by scholars from various countries. For example, the terms "production" and "entrepreneur" were first used in the 17th and 18th centuries by economist Richard Cantillon, who defined an entrepreneur as "a person working under conditions of risk." He also identified land and labor as the main sources of wealth. French economist Jean-Baptiste Say expanded on these ideas in his 1803 work "A Treatise on Political Economy," defining industrial activity as the coordination of land, capital, and labor to produce goods for public consumption, with the entrepreneur's income being the reward for skillfully managing these factors (Entrepreneurship: Textbook for universities / Edited by Prof. V. Ya. Gorfinkel, Prof. G. B. Polyak, Prof. V. A. Shvandar. Moscow: Banks and Exchanges, UNITY, 1999, p. 11). There is a consensus in the literature that a decrease in a country's GDP level triggers firms' defaults, whereas SMEs are considered especially vulnerable to such changes (Simons & Rolwes, 2009).

Adam Smith, in his seminal work "An Inquiry into Nature and Causes of the Wealth of Nations," described the entrepreneur as a capital owner driven by the desire to implement a commercial project and make a profit, while also serving the interests of others in the process (A. Smit, 1962). David Ricardo viewed industrial activity as an integral part of capitalism. In the 20th century, French economist Alfred Marshall added "organization" as a fourth factor to the classical three factors of production. American economist John Clark defined production as an activity that generates income for the entrepreneur (Hayek, F, 1989). Joseph Schumpeter, in his work "Economic Theory," described the entrepreneur as an innovator (V.D. Kamaev, 1998). Nobel laureate Friedrich von Hayek defined production as the activity of exploring and seeking production opportunities (J. Schumpeter, 1958). Russian economist V.D. Kamaev described entrepreneurship as producing, selling, and exchanging goods and services under mutually beneficial conditions. Bocconcelli, Roberta shows that SME' marketing has received great attention in both management and marketing literature in recent years. His reveals, on the one hand, the emerging role of social networks and information and communication technologies in marketing behavior by SMEs (Hassan Dauda Yahaya & Gunalan Nadarajah, 2023). In addition, while there are generic studies on strategic orientations, there is a need to empirically investigate the specific factors that influence SMEs' performance in the current knowledge economy, where intangible assets have become critical for competitive advantage. (Hoogendoorn,B & Guerra,D & van der Zwan, P. 2015) .

Mongolian scholar Ts. Dolgorsuren defined the development of SMEs as a key driver of innovation, competition, and meeting demand by bringing production and services closer to consumers.

Based on the research of various scholars, it is evident that some have focused on the main issues of SME development, while others have studied specific economic issues. Ts. Dolgorsuren emphasized that limiting the study of SME development to a single aspect results in incomplete research. Therefore, it is necessary to consider multiple aspects of SME development in Mongolia, including government support, the business environment, internal regulation, and management capabilities.

## 3. RESEARCH METHODOLOGY

The scientific research and analysis related to the development of SMEs in Mongolia were conducted using methods such as synthesis and analysis, statistical mathematics, modeling and correlation analysis, sociology, psychology, and other combined methods.

After studying the activities of SMEs from various perspectives, Ts. Dolgorsuren defined SMEs as "an organized activity that generates income by adapting production activities to market needs, regardless of risks." Therefore, it is essential to research government support, the socio-economic role of SMEs, the business environment, challenges, and management capabilities, comparing them with the experiences of other countries.

The main objectives of this research are to systematically study the management issues of SMEs in Mongolia, provide a definition and criteria, and propose a model for their role in the socio-economic development of the country. The research aims to enhance competitiveness, strengthen supply chains, and improve government regulation.

The importance of this research lies in scientifically studying the challenges of SME development, improving their structure and organization, stabilizing their growth, and increasing production efficiency.

## **4. FINDINGS/RESULTS**

### **1.1. Definition of SMEs in International and Mongolian Contexts**

Globally, there is no uniform classification for SMEs, and their definitions vary based on the characteristics of the business and the level of economic development in each country. For example, in the UK, SMEs are defined as businesses with up to 200 employees, without the right to issue securities. In developed countries, SMEs are classified based on the number of employees, as shown in Table 1.

In Singapore, SMEs are defined as businesses with fewer than 100 employees. According to the Malaysian National Bank, SMEs are enterprises with registered net assets of up to 500,000 Malaysian Ringgit. In European countries, the annual turnover is often used as a criterion, with different thresholds in various countries.

In Mongolia, the National Statistical Office classifies businesses as follows:

Large enterprises: more than 100 employees

Medium enterprises: 21-100 employees

Small enterprises: 1-20 employees

There is a need to classify Small and Medium Enterprises by sector in Mongolia to implement targeted government policies (budget, tax, finance, loans, investment) for the development of micro and household production, and small and medium enterprises.

In conclusion, while the theoretical and methodological concepts of Small and Medium Enterprises are similar, there are slight differences in definitions and classifications among international organizations and scholars from different countries. These differences are influenced by the economic and social development, industrialization level, production capacity, market size, workforce development, income, and production volume of each country.

### **1.2. Characteristics of SME Development in Mongolia**

Currently, 69,500 Small and Medium Enterprises businesses are operating in Mongolia. Over the past five years, the number of Small and Medium Enterprises has steadily increased. The majority (75.4%) of Small and Medium Enterprises have 1-9 employees and annual sales of up to 300 million MNT, showing a 19.4% increase from the previous year. Small and Medium Enterprises with 10-49 employees and annual sales of 300 million to 1 billion MNT account for 12.0%, and those with 1-2.5 billion MNT in sales account for 12.6%.

In urban areas, 49.9% of SMEs operate in the trade sector, 21.8% in various services, and 28.3% in manufacturing (National Statistics Office of Mongolia, Statistical Yearbook 2022). Despite progress, SMEs in rural areas face challenges such as underdeveloped infrastructure, insufficient energy and water supply, inadequate production facilities, and weak financial and economic stability. Additionally, the lack of management skills and experience hinders the rapid development of SMEs.

Supporting and expanding SME businesses are crucial for ensuring balanced regional development, creating new jobs, increasing product supply, and fostering fair competition in production and services. The Mongolian government has focused on SME development, enacting the SME Law in 2007, which created favorable conditions for considering SMEs within industrial policy.

## **RESULTS**

Considering the characteristics of SME development in Mongolia, government policies should focus on the following:

Utilizing raw materials from livestock.

Emphasizing the use of local resources.

Developing SMEs as a basis for industrial structure.

Addressing the dispersed workforce.

Focusing on the production of final products.

### **1.3 Comparative Study of SME Business Development Based on Examples from Asian Countries**

#### **Characteristics of SME Development in Japan**

Although the growth and profitability of large factories and companies significantly impact Japan's economic development, most of these factories and companies are small and medium-sized enterprises (SMEs). Since the enactment of the "Small and Medium Enterprise Law" in 1963, there have been no changes to the main legal framework, which has effectively supported the operations of SMEs in Japan with a stable legal policy.

In 1973, amendments were made to change the capital limits, setting the maximum capital at 50 million yen for the mining and manufacturing sectors and 10 million yen for the service and trade sectors. In Japan, a factory with an investment of one million yen and more than 300 employees is considered a large factory. About 75% of the total workforce in Japanese factories works in SMEs (Japan Small and Medium Business Agency. Statistical Information, 2021 No.03). The transformation of large factories and the increasing role of SMEs form the basis of the international competitiveness of Japanese factories. Japan's SME support policy focuses on improving and strengthening the management base, providing financial support, tax policies, structural support, management assistance, and facilitating supply contracts and agreements.

The policy also aims to create a favorable environment for starting new businesses, support innovation, optimize labor resource management and distribution channels, ensure ecological safety, support international activities, and promote regional development. Through the tax system, support for SMEs includes tax incentives for family businesses, tax reductions for technological upgrades, and providing advice on the tax system.

#### **Characteristics of SME Development in South Korea**

In South Korea, 99.9% of all enterprises are SMEs, employing 90% of the economically active population. SMEs account for over 50% of GDP and more than 35% of total exports. South Korea's economy has developed rapidly since the 1960s, with researchers identifying four stages of development:

**First stage (1960-1970):** Large companies expanded, and exports grew rapidly, while SMEs remained relatively stagnant.

**Second stage (1970-1980):** SMEs began to revive as the government supported heavy and chemical industries and implemented policies to protect them from foreign competitors, leading to the rapid growth of large factories, which laid the foundation for SME development.

**Third and Fourth stages:** The industrial structure changed, and technological innovations were made.

In South Korea, enterprises with fewer than 300 employees in the manufacturing, mining, transportation, construction, and information technology sectors are classified as SMEs. The development of SMEs in South Korea has accumulated unique experiences. During the initial phase of export-oriented industrial policy, the government focused on capital savings, with large factories playing a crucial role in the economy until the mid-1970s. In the late 1970s, the government introduced specific programs to support SME development. With government support, the business environment for SMEs began to improve significantly by 1980.

Over the past 30 years, South Korea's SME sector has experienced stable growth. By 2024, the share of SMEs in the service sector increased to 43.7%, and total exports reached 76.8 billion USD (MTI & KFSB Annual Export Statistics on Small and Medium Industries). The government's SME support policy focuses on using advanced technological solutions and stabilizing the economic environment to facilitate the import of technology into the SME sector. A well-organized and centralized policy has

enabled the SME sector to attract new knowledge and technology from developed countries, fostering innovation and contributing significantly to South Korea's economic growth.

### **Characteristics of SME Development in China**

SMEs and household enterprises are essential for increasing employment, driving technological innovation, and supporting economic and social development. The government supports SMEs through policies that include:

Increasing financial support.

Providing tax incentives and reducing fees.

Supporting technological changes and regulatory policies.

From 2022 to June 2023, the People's Bank of China provided financing to SMEs at an interest rate of 1% and supported increasing loan amounts. China places significant importance on developing SME clusters, which are high-performance computing systems that connect multiple computers through internal networks or the Internet to share resources and distribute tasks.

There are 216 textile and garment industry clusters operating nationwide, with clusters exceeding the set number of enterprises, main business income, and profits accounting for about 45% of enterprises. Major clusters in Jiangsu's Wujiang, Jiangyin, Changshu, Zhejiang's Xiaoshan, Keqiao, Tongxiang, Fujian's Jinjiang, Changle, and Guangdong's Puning have annual main incomes exceeding 100 billion yuan (Ministry of Industry and Information Technology, Department of Consumer Goods Industry. (2019, November 26).

### **Characteristics of SME Development in Russia**

Support for the SME sector in Russia varies widely. In some regions, SME support is well-developed and effective, while in others, it is less accessible or ineffective. During the challenging conditions of the COVID-19 pandemic and sanctions, the Russian government implemented special anti-crisis measures to support businesses, leading to an increase in the number of SMEs.

Since 2018, the national project "Support for SMEs and Individual Entrepreneurs" has provided comprehensive support at all levels, with implementation progressing according to plan and being updated to reflect new realities.

## **5. DISCUSSIONS AND CONCLUSIONS**

The role of SMEs in Mongolia's development has increased, achieving tangible progress and establishing a unique presence in the industrial sector. However, since the transition to a market economy in the early 1990s, SMEs have faced challenges such as an unfavorable macroeconomic environment, financial shortages, technological issues, management skills, and information shortages. These challenges have slowed SME development due to the lack of an optimal market distribution system and insufficient loan guarantee systems for SMEs.

The law supporting SMEs in Mongolia classifies "micro-enterprises and service providers" but lacks a definition for household businesses or family handicraft production, creating a legal gap. Although the law defines SMEs from a subject perspective, the revised Civil Law and related tax laws do not include the concept of SMEs or small businesses.

SME technology should be highly productive, competitive in the market, and suitable for local conditions. Financial support should be provided through long-term, low-interest loans for installing machinery that meets global market standards and acquiring new technology. Franchising should be developed through trademark transfer agreements, and leasing agreements should be used for acquiring equipment. The foreign investment law should include a system of incentives for investors who work under these conditions.

Leading SMEs should be granted temporary tax incentives. This includes rewarding enterprises that exceed pre-set export volumes, contribute to employment without reducing productivity, and provide accurate financial reports. Investments in training and human resources development should be tax-exempt to support SME growth.

## 6. Limitations and direction for future research

### Limitations

**Legal Environment:** The legal environment for developing SMEs in Mongolia is unclear and complex. Starting a business, obtaining operational permits, paying taxes, and engaging in cross-border trade face many obstacles.

**Access to Finance:** SMEs have limited access to financing. High interest rates, short-term loans, and service fees reduce the financial accessibility for SMEs.

**Technological Advancement:** SMEs have limited opportunities for technological innovation and upgrades. There is a lack of financial and knowledge support for adopting advanced technological solutions.

**Market Limitations:** The domestic market capacity is small, and export opportunities are limited. Cross-border trade operations are complex and time-consuming.

### Directions for Future Research

**Improving the Legal Environment:** Research on improving the legal environment to support SME operations, simplifying the startup process of a business, and obtaining operational permits.

**Increasing Financial Accessibility:** Research on increasing the financial accessibility for SMEs, reducing interest rates, and providing long-term loans.

**Technological Advancement and Innovation:** Research on increasing opportunities for technological innovation and upgrades for SMEs and providing technological support.

**Increasing Export Opportunities:** Research on increasing export opportunities for SMEs and simplifying cross-border trade operations.

**Human Resource Development:** Research on improving the skills of SME managers and employees, providing training and consultancy services.

## 7. Appendices

**Table 1 Source: Resource Center for Support of Small Entrepreneurship, Federal Fund for Support of Small Entrepreneurship, Mishin A. G. "Small Business: Essence and Practice," 2004, No.4, pp. 36-37**

Country	Factory size / number of employees			
	Micro Enterprise	Small	Medium	Large
European Union	1-9	50	51-250	251+
OECD	Up to 19	Up to 99	100-499	500+
United Kingdom	1-24	25-99	Up to 200	201+
France	1-9	10-50	51-200	201+
Germany	1-9	10-49	50-499	500+
Sweden	Up to 200			201+
Japan Enterprise Wholesale trade Retail trade	1-10	11-50 Up to 300 Up to 100 Up to 50	51-500	501+
Russian	1-25	26-100	101-250	251+

United States Enterprise Wholesale trade Retail trade	1-24	25-99 Up to 250 Up to 100 Up to 50	100- 499	500- 999
World Bank	1-19	20-99	100- 499	500+

## 9. Authors' Contributions

**Chuluuntsetseg Tsend** conceived the idea, designed the study, and drafted the manuscript. **Dorj Tudev** contributed to the theoretical framework, provided critical revisions, and supervised the research process. **Avirmed Badarch** performed the data collection, statistical analysis, and contributed to manuscript writing. **Dolgorsuren Tsenddorj** conducted the literature review, assisted in data analysis, and participated in manuscript revision. All authors read and approved the final manuscript.

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