

## REGIONAL PECULIARITIES OF DEVELOPMENT OF LITHUANIAN SME

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### Abstract

All over the world the growing evidence that small and medium enterprises play an important role in the national economic development of any country could be observed. Small and medium enterprises provide the majority of new jobs and produce much of the creativity and innovation which fuels economic growth and at the same time is the principal condition of regional development. As the level of small and medium business development is the determinant of economic development of a region, the analysis of small and medium enterprises development peculiarities in regions is a quite useful tool to demonstrate the economic situation in country's regions. The analysis show, that focusing sustainable development the main problem exists in towering regional disparities of small and medium business development in Lithuanian regions. Nevertheless regional differences should gradually tone down because of EU structural funds and national regional development programs that are targeted to minimize regional disparities.

*Keywords:* small and medium enterprises (SMEs); region; gross regional product; foreign trade; foreign direct investments.

### Introduction

Trying to maximize country's potential for economic and social development, the attention is greatly focused on country's small and medium enterprises (SMEs). Practical experience had shown that some of national targets can not be achieved without significant involvement of SMEs that face a number of conflicting forces inhabiting environmental change. A number of authors demonstrate how a range of business initiatives and projects have been developed to assist SME to improve their environmental performance. The importance of smaller firms, especially since the late 1980s, has been increasingly recognized as a key to the revived competitiveness of the United States. In other countries such as Germany and the Netherlands in Europe, or Japan and Taiwan, such recognition has been accorded for decades.

The economic growth in Lithuania was one of the most impressive ones in Europe in past decade. It was observed that SMEs are more actively establishing in urbanized areas that are attractive for investments by having a well-developed institutional business infrastructure and accumulated research, technical and intellectual potential in Lithuania.

The observed **problem** is the towering regional disparities of SMEs development in Lithuanian counties.

The **objective** of a paper is to analyze the regional peculiarities of development of Lithuanian small and medium enterprises.

Main **tasks** of the research are as follows: to analyze the GDP created in Lithuania and by counties in general and specifically by SMEs; to explore the dynamics of SMEs share in country's GDP; to traverse the GDP per capita created by SMEs in regions; to analyze the peculiarities of SMEs foreign trade and foreign direct investments as competitiveness of SMEs in regions.

The research **methodology** includes the analysis and generalization of scientific literature in the topical regional peculiarities' field and systematic analysis of Lithuanian SMEs statistical data.

### Benefits and challenges of SMEs growth

Encouraging the creation of a dynamic economy, with balanced public, private and social interests, the development of internal stability and growth is vital for country's evolvement. As the beginning on the 21<sup>st</sup> century is the age of knowledge based society and knowledge economy creation and of increasingly developing transformations in the whole world and all spheres of life (Melnikas, 2007). This development encompasses the identification of opportunities, the encouragement of enterprise and entrepreneurial skills, the tapping of resources and exploitation of human potential and knowledge.

On the above mentioned conditions following the ortodox view SMEs play the key role as intermediate wealth creators involving both goods and services, exploiting surplus and investable financial capital, and providing a ready and efficient way of meeting many personal and local needs. Many case analysis claim that SMEs are the catalyst provider for the national economy and its future development. Still

the theory has to acknowledge the high failure rate of SMEs and the reality that many never grow significantly. D. Radzeviciene (2008) states, that in the newly developing economy with a relatively narrow physical resource base, small population and domestic market open to high competitive forces the adoption of the SME model carries risk.

A problem emerges, when small firms become larger and older, i.e. medium-sized companies. This increase in size, and the passage of time, can generate problems which make financing, integration of resources and threats from competition more problematic. The factors promoting growth can change over time and “intervening variables” can slow down growth (see Figure 1).



Source: composed by authors

Figure 1. Challenges for SMEs

Thus evolutionary, historical, and stage theories of the firm are a necessary complement to systems and network theories of growth (Greiner, 1972; Kazanjian, 1988; Kimberly & Miles, 1980; Klofsten, 1997; Penrose, 1995; McKelvey, 1997). According to Holt, Stewart and Howard (2000), it is difficult to see how some of national targets can be achieved without significant involvement of small and medium-sized enterprises. SMEs face a number of conflicting forces inhibiting environmental change, and, as a number of authors demonstrate (Hooper et al. 1998; Hutchinson and Hutchinson 1997; Murphy and Bendell 1997), a range of business initiatives and projects have been developed to assist SMEs improve their environmental performance.

Large enterprises clearly have the advantage of mass production in capital-intensive processes and high volume products, but smaller enterprises have an advantage in niche markets and geographically restricted markets. SMEs have in particular an advantage when it comes to provide a lower volume of products or specialized products. They are also more flexible and can easier adapt to changes in demand, technology and unevenness than large enterprises. Factors impacting the role of SMEs are summarized in table 1.

Table 1. SMEs’ role impacting factors

Impacting factor	Description
<b>Advent of the knowledge society</b>	<ul style="list-style-type: none"> <li>▪ Knowledge as a valuable resource, exploitable by individuals;</li> <li>▪ SMEs thus become major vehicle for the creation and distribution of knowledge;</li> <li>▪ Knowledge spillovers are important also for LSEs.</li> </ul>
<b>Changes of the competitive environment</b>	<ul style="list-style-type: none"> <li>▪ Emerging SMEs alter the competitive environment by increasing competition;</li> <li>▪ Increasing innovation.</li> </ul>
<b>Effect on diversity</b>	<ul style="list-style-type: none"> <li>▪ New and diverse approaches to business;</li> <li>▪ Increasing degree of diversity in the marketplace.</li> </ul>

Source: composed by authors

Most often it is claimed that the extra growth throughout the industrialized countries during the past decade was due in large to the growth of SMEs. Globally SMEs account for 99 percent of business numbers and from 40 to 50 percent of GDP. According to the latest available reveals that in 2005 the EU-27 non-financial business economy there was almost 20 million SMEs, they accounted for 99.8 percent of enterprises in Europe. With less than 250 employees, these enterprises provided 67.1 percent of the employment and generated 57.6 percent of the non-financial business economy’s value added.

Still, the comparative analysis show that European SMEs grow slower and are less productive than their US counterparts (Pekari, 2008) despite existing various policies and programs at the EU as well as at the national level to assist SMEs and improve their performance. In the US, surviving firms on average increase their employment by 60 percent by their seventh year, while employment gains among surviving firms in Europe are in the order of 10 to 20 percent. SMEs still face market failures undermining the conditions in which they operate and compete with other players in areas like finance, especially venture

capital, research, innovation and the environment. For example, about 21 percent of SMEs indicate that accessing finance is a problem (Observatory of EU SMEs, 2007). In many Member States the percentage is much higher for micro-enterprises. Also, fewer European SMEs innovate successfully when compared to large businesses. The situation is worsened by structural difficulties such as the lack of management and technical skills, and remaining rigidities in labor markets at national level.

Purposing to establish a coherent framework for SMEs, the European Commission launched the “Small Business Act” (SBA) in 2008, which is based on a partnership between the EU and member state to implement measures improving SMEs’ business environments. The core principles of the SBA focus three main areas: a) recognition of the importance of entrepreneurship by improving society’s perception of entrepreneurship and making business start-up an attractive option for individuals; b) thinking small first principle implementation: rules must respect the majority of those who will use them – SMEs and making specific assessments of SMEs’ requirements in policy development; c) promotion of SMEs’ growth by defining policy areas where problems exist and developing measures to tackle these problems. Implementation of these SBA ideas should create the best possible environment for micro and small enterprises, and give a concrete answer to the different challenges SMEs are facing along their life-cycle. It should be geared by respect for the entrepreneurs and for their invaluable contribution to society.

### Operating SMEs in Lithuania as a whole and in separate regions

The concept of SMEs currently used in Lithuania was defined in the Law on Small and Medium-Sized Business, admitted on October 22, 2002. The new edit of the Law came into force on January 1, 2008. The Law provides the definition of small and medium-sized entities and defines the forms of possible state support to these entities as well as other related provisions. It is established in the Law that small and medium-sized businesses entities comprise micro, small or medium-sized enterprise. The concept of Lithuanian’s SMEs goes almost in line with EU concept of SMEs as seen in Table 2.

**Table 2.** The comparison of micro, small and medium-sized enterprises’ concept in EU and Lithuania

Category	Number of employees		Maximum turnover, million EUR		Maximum balance sheet, million EUR		Independence	
	EU	LT	EU	LT	EU	LT	EU	LT
Medium-sized enterprise	< 250		50	40	43	27	independent*	
Small enterprise	< 50		10	7	10	5	independent*	
Micro-enterprise	< 10		2	2	2	1	independent*	

*\*independent enterprises are all enterprises, except those whose 1/4 or more of the authorised capital or voting rights belong to one or several enterprises, which are not SMEs. This limit may be exceeded if the enterprise belongs to investment companies, funds or other legal persons investing risk capital in SMB*

The Lisbon Strategy, that encourage implementation of innovation, development of partnership, competitiveness and growth of jobs, SMEs had played a pivotal role in Lithuanian economy as registered enterprises accounted 63,6 thousand in total of 18.7 per 1000 inhabitants in 2008. The indicator represented as including the number of self-employed natural persons was much larger and accounted 59. D. Jones (2008) stated that Lithuanian economy had been growing very fast and the country holds very good positions in communication and SME-friendly environment. Comparing with other Baltic States, Lithuanian companies grew much faster and go beyond the average productivity growth of Central European countries focusing more on entering new markets. As Lithuanian companies are very specialized they hold strong positions within their activity areas and make profit (Radzeviciene, 2008).

Throughout the world one finds the SMEs to be the employee, the customer and the supplier who provide goods and services in local market ( Kozak, 2007). The Republic of Lithuania is divided into ten administrative items called counties. As Lithuanian county is similar to the regional item in other European countries, in this paper we use term “regions”. The GDP calculations based on figures received from different Lithuanian regions are very important for SMEs analysis, evaluating its regional development peculiarities.

**Table 3.** Distribution of operating SMEs by county in 2001 compared to 2007

Regions	Year	Micro enterprises		Small enterprises		Medium-sized enterprises	
		Number of entities	%	Number of entities	%	Number of entities	%
Alytus	2001	2379	4,5	410	3,7	169	4,7
	2007	2361	3,9	594	3,9	207	4,5
Kaunas	2001	11325	21,3	2388	21,4	735	20,4
	2007	12127	19,9	3093	20,4	957	20,7
Klaipeda	2001	7018	13,2	1278	11,5	397	11,0
	2007	7648	12,5	1803	11,9	482	10,4
Marijampole	2001	2344	4,4	435	3,9	151	4,2
	2007	2181	3,6	577	3,8	208	4,5
Panevezys	2001	4175	7,8	838	7,5	267	7,4
	2007	4699	7,7	1033	6,8	340	7,3
Siauliai	2001	4931	9,3	1001	9,0	365	10,1
	2007	4832	7,9	1304	8,6	454	9,8
Taurage	2001	1607	3,0	305	2,7	98	2,7
	2007	1468	2,4	374	2,5	144	3,1
Telsiai	2001	2440	4,6	447	4,0	155	4,3
	2007	2364	3,9	619	4,1	204	4,4
Utena	2001	2188	4,1	437	3,9	188	5,2
	2007	2098	3,4	526	3,5	206	4,4
Vilnius	2001	14821	27,8	3600	32,3	1074	29,8
	2007	21218	34,8	5268	34,7	1431	30,9
Lithuania on the whole	2001	53228	100,0	11139	100,0	3599	100,0
	2007	60996	100,0	15191	100,0	4633	100,0

Source: Author's calculations, Department of Statistics to the Government of the Republic of Lithuania (2001-2008).

The analysis of SMEs structure in regions is made up to the end of 2007 because of the available statistical data in comparing the peculiarities of foreign trade and foreign direct investments in 2001 and 2007. One of the major drawbacks hindering sustainable SMEs development in Lithuania is big differences of economic development in different regions. The comparative analysis of operating SMEs by regions at the beginning in 2001 compared to 2007 is explored in Table 3. In terms of comparative statistical data analysis, the available data overloads the period of between 2001 and 2007, thus the following analysis is executed by comparing figures in the mentioned period of time.

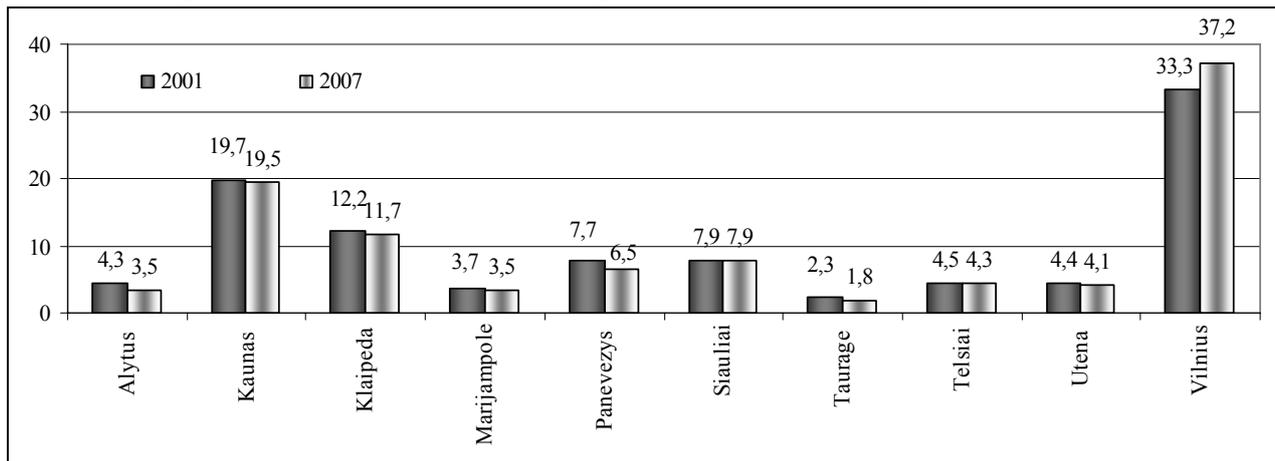
The analyzed period in separate regions of Lithuanian economic development potential is very different. Most SMEs focus the biggest regions' with the major cities centres (Department of Statistics to the Government of the Republic of Lithuania (Statistics Lithuania), 2001-2008). Available statistical data shows that the bigger share of all operating SMEs are condensed in the three biggest Lithuanian regions and these conditions are almost similar beginning with 2001. In 2007 the largest share of operating SMEs, e.g. 9.6 percent, was represented by enterprises operating in Vilnius, Kaunas and Klaipeda regions and less than one-third of SMEs operated in the remaining seven counties. The largest group of all operating enterprises was represented by micro enterprises with up to 10 employees: in 2001 micro enterprises accounted 78.3 percent and 2007 almost similarly 75.5 percent of all operating SMEs. These conditions of operating SMEs are important in the following analysis of SMEs regional peculiarities in terms of GDP created in regions, foreign trade and foreign direct investment.

### **Dynamics of SMEs created GDP in Lithuanian regions**

Over the recent years, bank credits granted on favourable terms, the European Union financial support, tax reduction and rise in wages were the main impetus for the growth of the Lithuanian economy. A decisive influence to the fact that the rates of economic growth in Lithuania during 2004-2006 were higher than the rates of economic growth in EU have had and it was mainly caused by positive rearrangements of the tax system (Kindstaferienė, Lukaševičius, 2008).

As the role of SMEs in the national economy and foreign trade is supported by different indicators, we use some of the most important ones. The gross domestic product (GDP) is one of the most important indicators enabling to assess the achievements of the national economy or its separate sectors. It is common that the GDP is the gross added value of all the goods and services produced in the country during the reporting period and estimated at current market prices. The GDP produced by SME shows the role of the SME sector in the national economy and foreign trade.

The share of GDP produced in small and medium enterprises in separate regions grew in 2001–2007 as shown in Figure 2. Comparing with the year 2001, the role of SME, assessed in terms of their share in created GDP, has increased and this reveals to the increasing productivity of SMEs activities. It is important to state that the biggest share of GDP (over 60 percent) SMEs produced in the same three regions were operates the largest share of SMEs (see table 3), e.g. Vilnius, Kaunas and Klaipeda.



**Figure 2.** The percentage share of SMEs in country's GDP in 2001 and 2007

Source: Author's calculations, Department of Statistics to the Government of the Republic of Lithuania (2001-2008)

Despite the regional differences in inhabitant density, parallel conditions could be observed calculating the GDP per capita in regions created by SMEs. The indicator "GDP per capita" is often used to make international comparisons. It enables to evaluate the achieved level of economic development and, respectively, the living standards in different countries. Economic growth in total in Lithuania was the strongest during the year 1995-2006, when the GDP per capita more than doubled. It should be stated, that the privatisation process in Lithuania has been strong as about 9,000 public companies were sold to private owners from 1991 to 2002 with the result that the share of public sector in Lithuania's GDP decreased to 12 percent of total GDP in 2002 (Amdam, Lunnan, Ramanauskas, 2007).

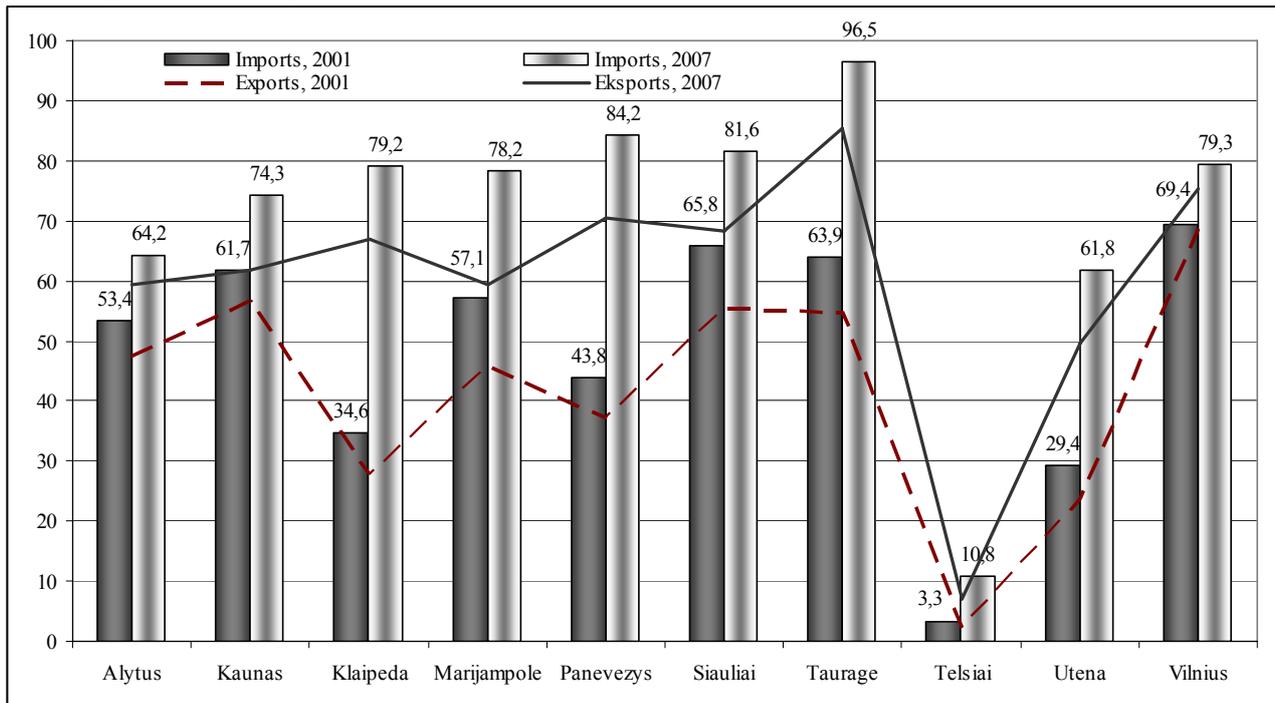
Hereby, the GDP per capita is one of the key indicators applied for complex description of social and economic developmental level of the region and constitutes the best way to reveal developmental differences among regions. Comparing to average the GDP per capita created by SMEs in three biggest regions in 2001 and 2007 accounted proportionately 136,4 and 149,1 percent in Vilnius, 97,9 and 97,3 percent in Kaunas, 110,3 and 104,4 percent in Klaipeda. There are several regions distinguishing by especially low indicators, including the regions of Alytus, Marijampole and Taurage. The the GDP per capita created by SMEs in other regions was nearly 80 percent, except the Taurage region with less than 50 percent GDP per capita comparing to average in 2007 (Bernatonyte, Juskiene, 2008).

Lithuanian regional development disparities are particularly pronounced. It could be stated here, that the total productivity growth could be further enhanced by the knowledge-based economy development in Lithuania as the main conditions for increasing productivity are further development of education and training systems. Despite public spending for education and high number of qualified employees there are mismatch between the skills and competencies needs in the business sector; higher R&D expenditure, which level is among the lowest in EU-27. As the largest share of small and medium-sized enterprises is concentrated in regions with the largest central cities, these are the areas with the most favourable environment for business infrastructure, scientific, technological and intellectual potential development for SMEs. Oppositely in the fringes, the predominant economic activity is agriculture, which is obtained with

economic benefits, but does not guarantee employment, sufficient income and livelihood areas of economic growth (Garuckas, Jatuliavičienė, 2008).

### Peculiarities of SMEs foreign trade and foreign direct as competitiveness of SMEs in regions

After entering the EU, Lithuanian exports were growing up and the structure has been changed from exports to Eastern markets to Western ones: almost a half of total exports over drafted to the EU and only about 15 percent to CIS countries (Purlys, 2007). Still, usually peculiarities in SMEs competitiveness level is supported by different indicators, nevertheless really important ones are concerning foreign trade and foreign direct investments of SMEs. Lithuanian SMEs foreign trade indicators by regions in the period of 2001 and 2007 are presented in Figure 3.



**Figure 3.** Percentage share of SMEs exports and imports in total country's exports and imports in 2001 compared to 2007

Source: Author's calculations, Department of Statistics to the Government of the Republic of Lithuania (2001-2008)

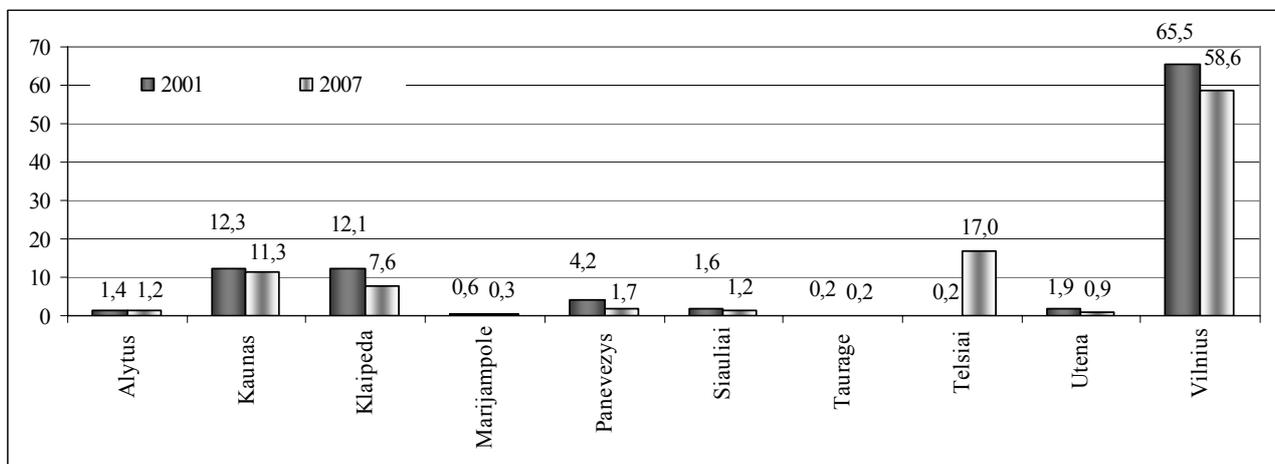
The comparative share of SME exports and imports in Lithuanian foreign trade significantly increased in 2007. This indicates the growing importance of SME to the national economy. Analysis shows that SME exports considerably less than they import. It signals that SME exporting capacities are lower than the exporting capacities of large enterprises. In 2007, export share of SME accounted for 58.2 percent of the total national exports and import share of SME – 67.7 percent of the total national imports. The comparative shares of SME exports and imports differ in different economic activities. The main share of exports and imports among enterprises engaged in tobacco, oil products, chemicals and chemical industry products, radio, television and communications equipment falls to large enterprises. On the other hand, there are types of activities (rubber and plastic products, office equipment and computers, transport vehicles, manufacturing of trailers) were the substantial share of foreign trade falls to SMEs (Department of Statistics to the Government of the Republic of Lithuania, 2001-2008).

It should be stated, that the EU membership has had a significant impact on the dynamics of whole Lithuanian foreign trade, as since the EU accession, the exports of goods excluding fuels have been accelerating. In 2008, compared with 2007, country's exports and imports increased by 28.4 and 18.0 percent, in addition to mineral products exports increased by 11.6, imports - 0.2 per cent. Lithuanian exports in 2008, compared to 2007, increased by 31.3 per cent, in addition to mineral products - 5.4 percent (MarketNews, 2009). The analysis of foreign trade of SMEs to the EU after Lithuania became the member of the EU shows that EU trade policy and implementation of its principles had influence to Lithuanian SMEs export and import marketable structure. It was identified that after eliminating duties for imported foodstuffs

and beverages from the EU countries the prices of these products decreased and consumption increased, so, for this reason importation of these goods increased (Bernatonyte, Juskiene, 2008).

SMEs exports and imports share in total volume of Lithuanian foreign trade by regions shows the growing importance of these enterprises for country's economy. However considerably less export share of SMEs compared to import share in the regions of Lithuania explores that SMEs exporting capacities are lower than the exporting capacities of large enterprises. The comparative shares of SMEs exports and imports are quite different in different regions: it is extremely big in Taurage, Siauliai, Vilnius, Klaipeda and Kaunas regions. It involves not only growing SMEs competition of those regions, but also natural advantages such as cheap labour force, geographical situation and sources of raw materials. For example, one of the basic factors of development of wood and articles of wood exports are cheap local raw materials.

The increasing internationalization of Lithuanian economy is characterized with the development of foreign direct investments (FDI) to the country. The increase of inward FDI made Lithuania improve its global ranking concerning inward FDI stock as a percentage of GDP (Tvaronavičienė, Grybaite, 2007). As increased implementation of innovations into production has an influence on growth of economy, it composes the increasing importance on FDI. As the provisional data on direct investment in 2008 are published on April 2009, we analyze the period in the year 2001-2007 (see Figure 4).



**Figure 4.** Comparative share of FDI in total volume of Lithuania in 2001 compared to 2007

Source: Author's calculations, Department of Statistics to the Government of the Republic of Lithuania (2001-2008)

Figure 4 elucidates, that not all Lithuanian regions are equally engaging for investments. The comparative share of direct foreign investments is extremely high in Vilnius region overcoming half of country's FDI. Other three regions Kaunas, Klaipeda and Telsiai (only in 2007) hold one third country's FDI. Figure 4 shows, that possibility of economic growth in other regions of Lithuania are not exploited fully. Surely, such tremendous inequities demonstrate that there exist many problems purposing to reach regional sustainability and cohesion in Lithuania. The situation is caused by many reasons that are the object of authors' nearest future research.

Resumed executed analysis explores, that the main potential of Lithuanian foreign trade and investment is concentrated in limited number of regions: Vilnius, Kaunas and Klaipeda as these regions are the main exporters and importers of production. Analysis shows that interregional contradictions are increasing in consequence of unevenness of territorial development. Therefore, in order to improve the current situation, it is necessary to assume the measures for development of Lithuanian foreign trade conditions.

The role of SMEs should become even important in the period of economic crisis in the nearest future, as small business is more flexible to admit market changes. Still, it is a discussion point in terms of coming economic slump as large enterprises clearly have the advantage of mass production in capital-intensive processes and high volume products, but smaller enterprises have an advantage in niche markets and geographically restricted markets.

## Conclusions

The research leads to the main conclusion that SMEs remains the main driving force for the development of the whole economy and regional development in Lithuania. Still, there exist big differences in Lithuanian regions. Firstly, the bigger share of all operating SMEs, e.g. over 60 percent of all SMEs, is condensed in the three biggest Lithuanian regions Vilnius, Kaunas and Klaipėda. Secondly, following the above summarized conditions, the biggest share of GDP, e.g. over 60 percent, SMEs produced in the same three regions. Thirdly, despite the regional differences in inhabitant density, parallel conditions could be observed by the GDP per capita created by SMEs indicator in regions. With a decrease in the number of people employed in traditional agricultural business, still larger attention should be devoted to the development of SMEs and the encouragement of entrepreneurship in rural areas.

Lithuanian integration into EU has had a significant impact on the dynamics of whole Lithuanian foreign trade, as since the EU accession, the exports of goods excluding fuels have been accelerating. Considerably less export share of SMEs compared to import share in the regions of Lithuania explores that SMEs exporting capacities are lower than the exporting capacities of large enterprises. The comparative shares of SMEs exports and imports are quite different in separate regions. Hereby, Lithuanian regions are unequally engaging for foreign direct investments, as the comparative share of FDI overcome half of country's FDI. That means that possibilities of economic growth in other regions of Lithuania are not exploited fully.

The accomplished analysis explores interregional contradictions increase which leads to uneven development of territories. Due to this, regional policy performed by the state must pay attention to peculiarities of their development. It is clear enough that not separate ones, but the whole complex of means to enhance security of stability and sustainability of development in Lithuanian regions are necessary. In decreasing interregional contradictions special role may be played by purposeful support provided to export by the state that would help to diversify its marketable structure and extend assortment of imported ready production. As SMEs have in particular an advantage when it comes to provide a lower volume of products or specialized products and they are also more flexible and can easier adapt to changes in demand and technology than large enterprises.

Despite the SMEs significance in the economy the rising inflation rates and economic crisis will surely change the main economic indicators, as economy is slowing down during the past months. In the face of recession, business sentiment among SMEs has been increasingly worsening. While high raw material prices continue to squeeze their profit margins, an increasing number of SMEs are also facing financing difficulties as banks tighten their lending standards. SMEs are confronted by a much graver and longer-lasting problem capable of dwarfing the current short-term cyclical business downturn and prolonging for ten or twenty years.

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