

# QUANTITATIVE AND QUALITATIVE CRITERIA TO DETERMINE THE SIZE OF ENTERPRISES AND SPECIFICITY OF SMES' OPERATIONS

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## Abstract

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Enterprises operating in the SME sector represent the majority of companies in the economies of highly industrialized countries. Economists, sociologists and politicians are unanimous about the socio-economic role that these entities play in a highly-competitive market economy.

**Key words:** enterprise, quantitative and qualitative criteria, SME sector

## Introduction

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In Poland the development of small and medium-sized entrepreneurship began in 1989, i.e. with the beginning of the political and economic transformation. Previously, the vast majority of enterprises were large state-owned companies that operated in conditions of economic scarcity and a centrally planned economy, and their activity relied mainly on mass production. At the time of transition to free market economy, large state-owned enterprises started to collapse (they were inefficiently managed and could not respond to the challenges of the then market) and new entrepreneurial initiatives took

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their place. It was the Act of 23 December 1988 on Business Activity (Dz. U. [*Journal of Laws*] No 41, item. 324, as amended) that had given rise to it. Currently, the SME sector plays an increasingly important role in the development of the region and generating gross domestic product. Therefore, the formation of such initiatives is particularly important for local communities, where SMEs fill the gap left by restructured state-owned enterprises, providing employment to many people. It should be remembered that companies of this type are most active in risk-taking, demonstrate high flexibility in response to changes and quickly adapt to changeable conditions. At the same time, these companies play important functions in the economy, starting from the fight against unemployment, through rationalization of the allocation of resources, to undertaking innovative activities.

## Quantitative criteria

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Both quantitative and qualitative criteria can be used to characterize the SME sector. In a quantitative approach, the number of employees<sup>4</sup>, the amount of income (annual turnover), and the value of fixed assets are most often taken into consideration. The annual turnover is the revenue related to the objects of the company actually pursued by an entity<sup>5</sup>, i.e.:

- revenues from sales of products, goods and materials;
- other operating revenues (e.g. revenues from grants, subsidies, derived from rents, sale of fixed assets, etc.);
- financial revenues (e.g. from the sale of stocks, securities, shares);
- extraordinary profits (e.g. damages)<sup>6</sup>.

The quantitative criteria can also be classified into the following:

- input criteria (land, labour, capital);
- result criteria (production, sales, profit)<sup>7</sup>.

Sometimes, to assess the size of a company, the criteria relating to the level of technology and market reach are also applied.<sup>8</sup>

The most commonly used indicator is undoubtedly the level of employment.

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<sup>4</sup> W. Bańka, *Zarządzanie personelem w małej i średniej firmie*, Adam Marszałek, Toruń 2002, p. 27

<sup>5</sup> Cf. Act of 29 September 1994 on Accounting, Dz.U.[*Journal of Acts*] No 121 of 1994.

<sup>6</sup> B. Mikołajczyk, *Instytucje wspomagające rozwój małych i średnich przedsiębiorstw*, ODDK, Gdańsk, 1998, p. 10.

<sup>7</sup> E. Małecka, *Determinanty działalności małych prywatnych firm przemysłowych w Polsce*, „*Studia Prawno-Ekonomiczne*”, 1996, no. 54, p. 141.

<sup>8</sup> W. Czternasty, *Małe przedsiębiorstwa w Polsce na tle przeobrażeń systemowych*, Akademia Ekonomiczna, Poznań, 1994, p. 112.

This indicator has a lot of advantages, since:

- it lend itself easily to statistical analysis;
- it is easy to imagine;
- necessary data are easy to obtain;
- it is easy to perform international comparisons;
- data do not become obsolete quickly;

but also disadvantages:

- limited objectivity due to differences in education, skills and effectiveness of employees (efficiency and commitment can stem from, for example, the use of different methods and techniques of production);
- the criterion does not work when comparing companies from different sectors, departments or groups;
- in statistical data, part-time employees are listed as full-time employees.<sup>9</sup>

On the other hand, the following arguments, among other things, speak for the application of the turnover criterion:

- ease of calculation;
- increase or decrease in the value of the annual turnover reflects the trends in the enterprise.

However, this measure is not free from drawbacks:

- international comparisons are complicated due to different national currencies and different tendencies in the change of the value of money;
- this figure frequently becomes outdated;
- it does not respond to the relationship between the capital used and the labour;
- variations in this indicator are caused not only by the amount of goods sold but also by inflation;
- costs incurred for production are different in its subsequent phases<sup>10</sup>;
- it can be applied only when comparing companies from the same sectors, departments or groups.

The least reliable measure is the level of fixed assets, since it depends on:

- nature of technical progress;
- wear of equipment;
- value of the funds;
- changes in their prices;
- sources of funds involved.

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<sup>9</sup> Ibidem, p. 12; E. Małecka, *Determinanty działalności...*, op. cit. p. 140; T. Łuczka, *Kapitał jako przedmiot gospodarki finansowej małego i średniego przedsiębiorstwa prywatnego*, Politechnika Poznańska, Poznań, 1997, pp. 18–21.

<sup>10</sup> T. Łuczka, *Kapitał jako przedmiot...*, op. cit, p. 18–21.

It is often impossible to compare the types of machinery and equipment due to different technical parameters, the degree of wear, etc.<sup>11</sup>

Based on the effects-related quantitative criteria, the volume of production seems to be the most reliable, although the problems with its application are unavoidable. They may result from different principles of cost calculation or from the use of different values (production expressed in kilograms, units or in cash).

A quite clear view concerning the quantitative classification is expressed by Łuczka, who believes that “the classification of a company on the basis of quantitative characteristics is based on two important methodological assumptions (...). First, on the assumption that although the direct object of measurement is its quantitative characteristics, the ultimate goal is to extract the qualitative category – a typical middle class enterprise – as a type distinct from a large enterprise. Second, on the assumption that there is a specific adequacy relation between the quantitative characteristics that are measured and the qualitative characteristics, which means that it is possible to maintain and develop the quality characteristics defining its essence only within certain limits.”<sup>12</sup> However, Łuczka supports the quantitative criteria used in practice (number of employees, annual turnover), characteristic of small and medium-sized enterprises, pointing to the ease of comparison of these indicators.

## Qualitative criteria

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The above analysis shows that the quantitative criteria cannot provide a precise definition of small and medium-sized enterprises. Therefore, such qualitative criteria<sup>13</sup> as management<sup>14</sup>, research and development, finance, etc., must be used for the classification of these entities. These criteria often translate into the attributes of the SME sector, among which the following are the most prevalent:<sup>15</sup>

- A. social structure of the enterprise influenced by the character of the owner (manager);

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<sup>11</sup> W. Czernasty, *Małe przedsiębiorstwa w Polsce...*, op. cit., pp. 12–13.

<sup>12</sup> T. Łuczka, *Kapitał...*, op. cit., p.16.

<sup>13</sup> A. Griffiths, S. Wall, *Applied Economics*, Pearson Education, London and New York 1993, p. 67.

<sup>14</sup> Cf. R.V. Hornaday, *Dropping the E-words from Small Business Research: an Alternative Typology*, “Journal of Small Business Management”, no 28, 1990.

<sup>15</sup> S. Ślusarczyk, *Aktywność marketingowa małych i średnich przedsiębiorstw*, Poltext, Warszawa 2011, pp. 16–19.

- B. corporate social responsibility;
- C. understanding of the market and the size of the market share;
- D. special nature of financial management;
- E. special organizational structure.

Re A – social structure of the enterprise influenced by the character of the owner (manager) – this is probably the most characteristic feature of small and medium-sized enterprises. Owners participate very actively and directly in all areas of business activity, which leads to strict centralization of management and also excludes the possibility of the company's participation in the capital market. It can be also assumed that the owner of a small or medium-sized company is driven by personal motivations, such as: satisfaction, position, perspectives, seeking to fulfil his/her professional ambitions, financial security of the owner or of his/her family. The main features characterizing the owners include:

- self-confidence manifested in self-assurance, optimism, independence, enthusiasm and individualism;
- task orientation, i.e. a constant need for achievements, profit orientation, determination, consistency, perseverance;
- risk-taking – a flexible approach to risk, an ability to take risk;
- leadership: accepting criticism, listening to and working with people;
- originality, i.e. creativity, searching for information, innovation, resourcefulness, interdisciplinarity in action;
- future orientation – thought leadership, ability to predict<sup>16</sup>. These qualities often help the owner to create his/her company through the following: impact exerted on its individual units, influence on every decision, daily presence in the enterprise, which in turn shapes the relationship between employees and the employer (the owner), unique for every company<sup>17</sup>.

However, it has to be noted that there may be fundamental differences in the conduct of business by the owner and the manager – “the entrepreneur owns the company and operates according to his/her own original principles; meanwhile, the manager works for a foreign owner and has obligations resulting from the contract of employment;

- the entrepreneur is responsible for the future of the company, therefore, he/she is able to make sacrifices for its sake; the manager's relationship with the company is temporary (it results from the contract

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<sup>16</sup> G.G. Meredith, R.E. Nelson, P.A. Neck, *The practice of entrepreneurship*, International Labour Office, Geneva, 1982, p. 3

<sup>17</sup> T. Łuczka, *Kapitał jako przedmiot gospodarki finansowej małego i średniego przedsiębiorstwa prywatnego*, Politechnika Poznańska, Poznań, 1997, pp. 7–12.

- of employment), therefore he/she does not have to identify with it;
- independent owners are liable for the company with all their assets and bear the economic risk, therefore they act according to their own rules, while the managers act and take risk on behalf of others (the owners), they obtain remuneration, which may or may not be related to the effects of their work;
  - the owners are the highest authority in the company, they may determine the rules of the company's operation, no one has the right to control them or correct their decisions; the managers are responsible for a certain specified area of the company's operation, they are only specialists and are only partly responsible for their activities, their performance can be controlled and their decisions can be changed<sup>18</sup>.

Re B – corporate social responsibility (the approach to the problem of corporate social responsibility may differ depending on the size of the enterprise. Large companies usually possess substantial financial resources which they use for the benefit of broadly understood stakeholders and operate on a much broader market, therefore their good business practices are recognized more often)<sup>19</sup>. The place and importance of CSR (Corporate Social Responsibility) depending on the size of the organization is shown in Table 1.

**Tab. 1. Discrepancies in the implementation of social responsibility among SME and large enterprises**

Social responsibility of large enterprises	Social responsibility of small and medium-sized enterprises
Towards whom?	Towards whom?
<ul style="list-style-type: none"> <li>– responsibility towards a wide range of stakeholders,</li> <li>– performing tasks for the widely understood society,</li> <li>– impact and need to take account of shareholders,</li> </ul>	<ul style="list-style-type: none"> <li>– responsibility towards a smaller and/or different range of stakeholders,</li> <li>– performing tasks for the local community,</li> <li>– small and medium-sized enterprises usually do not have shareholders,</li> </ul>

<sup>18</sup> I. Hejduk, *Jak startować w biznesie. Propozycja dla małych firm*, Orgmasz, Warszawa, 1992, pp. 57–58.

<sup>19</sup> A. Kaczmarek, Społeczna odpowiedzialność małych i średnich przedsiębiorstw [in:] A. Bielawska (Ed.), *Uwarunkowania rynkowe rozwoju mikro i małych przedsiębiorstw, Mikrofirma*, „Zeszyty Naukowe US w Szczecinie”, Szczecin 2011, p.111; O. Seroka-Stolka, *Współczesne determinanty funkcjonowania małych i średnich przedsiębiorstw*, PCz, Częstochowa 2013; A.Z. Nowak, B.Glinka, P. Hensel, *Competitionethics management*. Wydział Zarządzania UW, Warsaw 2011.

How?	How?
<ul style="list-style-type: none"> <li>– action is based on values and principles adopted by the company,</li> <li>– corporate social responsibility included in formal strategic plans,</li> <li>– pressure on operation based on standards and indicators,</li> <li>– pivotal role of experts in the field of social responsibility, risk mitigation</li> </ul>	<ul style="list-style-type: none"> <li>– action is based on the rules established by the owner – manager,</li> <li>– corporate social responsibility included in informal plans,</li> <li>– pressure on intuitive operation,</li> <li>– lack of persons specialized in social responsibility, risk avoidance,</li> </ul>
Examples	Examples
<ul style="list-style-type: none"> <li>– «spectacular» campaigns,</li> <li>– publicizing activities related to social responsibility</li> </ul>	<ul style="list-style-type: none"> <li>– local, small-scale actions (e.g., sponsoring a local football team),</li> <li>– actions taken are often not recognized as «socially responsible»</li> </ul>

Source: M. Rojek-Nowosielska, *Różnice w realizacji społecznej odpowiedzialności przez małe i duże przedsiębiorstwa*, [in:] M. Bąk, P. Kulawczyk, (Eds.), *Spoleczna odpowiedzialność biznesu w małych i średnich przedsiębiorstwach*, IBnDiPP, EQUAL, Warsaw, 2008, p. 96.

Re C – understanding of the market and the market share – small and medium-sized enterprises operate mostly on a local or regional market. As a result of their relatively small (and sometimes negligible) domestic market share, these companies have virtually no impact on the widely understood environment, such as for example price setting or stimulating supply of products. Participation in the local market promotes the strengthening of social bonds and local ties to a given place.<sup>20</sup>

Re D – special nature of the financial management – the capital for the formation of a small or medium-sized enterprise comes mostly from family savings of the owners. Similarly, at the later stage of the enterprise operation – due to the owner's concern about and reluctance to take bank loans (which, according to them, could lead to a limitation or loss of independence), the only capital that can be allotted, for example, to investments is the capital from savings.<sup>21</sup> In addition, in the owner's opinion, financing from own funds guarantees self-reliance, independence, credibility of the company, and also stimulates activity and strengthens motivation. Often, access to external sources of financing is simply hampered by lack of information in this regard, or lack of sufficient collateral or credit history<sup>22</sup>. Presented below are external sources of company financing depending on the phase of development.

<sup>20</sup> T. Martyniuk, *Małe przedsiębiorstwo. Rejestracja, podatki, ewidencja, sprawozdawczość*, ODDK, Gdańsk, 2009, p.23.

<sup>21</sup> T. Łuczka op. cit., pp. 7–12.

<sup>22</sup> G. Michalski, *Płynność finansowa w małych i średnich przedsiębiorstwach*, PWN, Warszawa 2005, pp. 19–27.

Tab. 2. Availability of external sources of financing for companies in various stages of development

Stage of development	Available sources of financing
Concept of enterprise	Venture capital
Start-up of a company	Credit, leasing, venture capital
Small company	Credit, leasing, venture capital, factoring
Midsized company	Credit, leasing, venture capital, factoring, issue of shares.

Source: S. Ślusarczyk, *Aktywność marketingowa małych i średnich przedsiębiorstw*. Poltext, Warszawa, 2011, p. 17

Re E – particular organizational structure (the structures of SME are not too extensive, in an entity employing 1-2 persons the organizational structures do not actually exist, there is also no division of tasks, and activities of each employee are subordinated to the overall goals and objectives of the company. However, in most cases there are two or three levels of management from the boss to the ordinary worker, which favours the autocratic method of management (first of all, implementation of the objectives focused on the organization, the requirement to comply with the official orders from the boss, making decisions without communicating with the staff, more penalties than rewards – no motivating factor).<sup>23</sup> Moreover, the limited financial resources do not allow for hiring or even working with specialists, hence the share of employees with higher education in the total number of employees is rather small. The employment fluctuation is greater in companies operating in the SME sector than in large entities (e.g. corporations). This flexibility may result, inter alia, from the lack of supervision by trade unions.

In addition, in SMEs, due to the small employment level, the units for marketing, finance, etc. are undervalued or even are not recognised as separate functions in their own right. For example:

1. Marketing is most commonly supervised by the sales department, which means that it is not the object of an organized activity;
2. The research and development section is identified with the production (very often this section does not exist at all);
3. The management control and planning section usually does not exist.

As noted by W. Grudzewski and I. Hejduk, “the majority of small companies are not formalized, that is, they lack an organizational structure strictly defined in writing, and the owners performing managerial functions do not have a dedicated staff and line organizational units; such companies are also usually not hierarchically divided. We then say that the company

<sup>23</sup> *Zarządzanie strategiczne*. Joint publication, Wydawnictwo AE Wrocław, 1998, p. 193.



is “paternalistic” and its boss takes care of everything, which may pose a threat of getting lost in daily routine and lead to the inability to implement the corporate strategy.”<sup>24</sup>

The pertinent literature provides other lists of qualitative characteristics. For example, they are examined in the context of their impact on the allocative processes, and they relate to:

- “Limited economic risk arising from the relatively smaller expenditures on the implementation of specific investment projects;
  - shorter cycle of execution of investment;
  - relatively low capital intensity of production;
  - in many cases poor fixed assets per employee ratio;
  - much freedom of location of investment objects;
  - slight impact on environmental pollution;
  - ability to absorb and use dispersed and undeveloped material production factors;
  - productivization of local labour force reserves”.<sup>25</sup>
- } in comparison with a large company

If we accept the current operation of the company as a criterion, the SME sector will be distinguished from large companies by higher productivity of fixed assets and different structure of fixed assets.

In addition to the above qualitative measures, the characteristics specific to the SME sector include:

- legal and economic independence of the owner;
- limited amount of capital and limited credit worthiness;
- unity of management (management functions are delegated only occasionally or are not delegated at all, majority, and frequently all of the functions are performed by the owner);
- principle of personal management by the owner (the owner-employee relations are characterized by direct contact and personal acquaintance).<sup>26</sup>

A slightly different position was taken by the Institut für Gewerberforschung in Vienna, which presented 12 characteristic features of the SME:

1. “Personal independence of the entrepreneur which is manifested by the fact that the capital and the functions of company management are held by one person;
2. the company is the essential and often the sole basis of existence and source of income for the entrepreneur;

<sup>24</sup> W. Grudzewski, I. Hejduk, *Kierowanie małą firmą – wyzwania przyszłości*, „Ekonomia i Organizacja Przedsiębiorstwa” no1, 2000, p. 3.

<sup>25</sup> W. Czernasty, op. cit., p. 17.

<sup>26</sup> E. Schalek, *Eigenkapital beschaffungsmittelständischer Unternehmen über den Kapitalmarkt*, Bergisch-Gladbach- Köln, 1998, p. 20 after: T. Łuczka, *Kapitał...*, op. cit., pp. 7–12.

3. the company is characterized by work and full responsibility of the owner who bears all the risk at the same time;
4. apart from the owner, his wife and family members work for the company;
5. personal relationships between the owner of the company and the employees gives rise to a community of work, characterized by mutual contacts;
6. the upper limit of the size of a small and medium enterprise is determined by the owner's ability to handle all its matters, including commercial, technical and specialist issues, as well as the smallest details and routine work;
7. the lower limit of the small and medium-sized enterprise is determined by the requirements of its owner; the size of the company must guarantee the owner full employment and adequate income;
8. the company is financed predominantly with own and family resources, personal loans and special lending; the company has no direct access to the capital market;
9. when it comes to the legal form of the company, sole proprietorship or partnership prevails;
10. opportunities for the division of labour within a small and medium-sized enterprise are limited;
11. a small and medium-sized enterprise adapts to economic fluctuations more easily and faster than a large one;
12. a small and medium-sized enterprise generally does not employ specialists, which applies to both economic and technical areas of the company's operation"<sup>27</sup>.

The above list shows that qualitative characteristics are necessary to complement quantitative criteria and at the same time they point to the advantages of small and medium-sized enterprises, which include:

- SMEs demonstrate the highest risk-taking activity;
- they are characterized by a high degree of flexibility with respect to changes implemented (most frequently changes apply to the strategy used, organizational structure, production structure);
- fast adaptation to changing conditions;
- communication not constrained by formal protocols (both “up” and “down”)<sup>28</sup>;
- better utilization of the means of production and workforce;

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<sup>27</sup> Der Mittelstandsbrief, Bonn 1965, 2, p. 26.

<sup>28</sup> W. Bańka, *Zarządzanie personelem w małej i średniej firmie*, Adam Marszałek, Toruń 2002, p. 28.

- failures in the operation of a small enterprise do not affect the state of the economy so strongly as they would in the case of a large company;
- small production lots contribute to faster capital turnover;
- direct management of the company by the owner or a group of co-owners;<sup>29</sup>
- seizing economic opportunities by enterprising managers who can use their advantage over the competitors in the market and are willing to take risk;
- efficient flow of information within the company in order to best adapt to changes and external requirements;
- better use of specialists with a broader range of knowledge, who have considerable expertise not only in modern technologies, but also in the market, competitors, etc.;
- easy entering into co-operative agreements through quick creation of new jobs.<sup>30</sup>

The definition of small and medium-sized enterprises currently in force in the EU<sup>31</sup> is based on both qualitative (degree of relationship) and quantitative criteria, as shown in the table below.

Tab. 3. **New definition of small and medium-sized enterprise in the European Union**

Enterprises	Micro	Small	Medium
Employment <sup>32</sup>	> 10	>50	>250
Net revenues from sales	Up to EUR 2 million	Up to EUR 10 million	Up to EUR 50 million

<sup>29</sup> T. Domański, *Uwarunkowania tworzenia małych przedsiębiorstw*, Uniwersytet Łódzki, Łódź, 1992, p. 22.

<sup>30</sup> M. Strużycki, *Zarządzanie małym i średnim przedsiębiorstwem. Uwarunkowania europejskie*, Difin, Warsaw, 2002, pp. 20–21.

<sup>31</sup> The definition of a small and medium-sized enterprise (SME) entered into force on 1 January 2005, pursuant to Commission Regulation (EC) No 70/2001 (OJ L 10, 13.01.2001, p. 33), as amended by Regulation 364/2004 (OJ L 63, 28.02.2004). On 6 August 2008, Commission Regulation (EC) No 800/2008 was issued declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (OJ L 214, 9.08.2008, p 3), which applies to the granting of public aid to SME. The definition of SME applies to all policies, programs and actions that the European Commission implements for small and medium-sized enterprises (SME).

<sup>32</sup> The level of employment is a key value for the classification of a company. This figure refers to full-time and part-time employees and seasonal workers, and includes:

- Employees;
- People working for or subordinate to an enterprise, and deemed to be employees under national law;

Total balance sheet assets	Up to EUR 2 million	Up to EUR 10 million	Up to EUR 43 million
Relationship	– autonomous enterprises, – partner enterprises, – closely related enterprises.		

Source: K. Wach, *Więcej dla mniejszych*, „Rzeczpospolita”, no. 3 (6686), 2004, p. B8.

The new definition was intended to:

- simplify and speed up administrative procedures on the basis of which enterprises are classified;
- promote entrepreneurial initiatives (mainly creation and development of micro-enterprises);
- facilitate access to the capital;
- assist in the implementation of innovations;
- avoid circumvention of the requirements set out in the definition of an SME.<sup>33</sup>

However, the European Commission has already issued a statement informing that changes in the definition of small and medium-sized enterprises are inevitable – the classification criteria should be adapted to the present conditions, such as for example inflation or labour productivity<sup>34</sup>. At the same time, the work on the new definition has not been considered a priority.

## Conclusions

In Poland, as in other countries in which the command and control system existed, largest state-owned enterprises were established in the post-war years. Entrepreneurial initiatives of the Poles (setting up their own compa-

- Owners – managers;
- Partners (shareholders) engaged in a regular operation in the enterprise and obtaining measurable financial benefits (profit share) from such activities.

However, the number of employees does not include apprentices, students, trainees and employees taking maternity or child care leave. The employment level is expressed in annual working units (AWU). Every person who works full-time in the company or on its behalf during the entire reference year counts as one working unit. The work performed by persons who have not worked for the whole year, part-time employees and seasonal workers is treated as fractions of the unit. (Guide to EU definition of SME, retrieved from [http://ec.europa.eu/enterprise/policies/sme/files/sme\\_definition/sme\\_user\\_guide\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf), p. 15 on 8 February 2014)

<sup>33</sup> P. Marquardt, *Pomoc publiczna dla małych i średnich przedsiębiorstw*, LexisNexis, Warsaw 2007, pp. 151–152.

<sup>34</sup> <http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/> retrieved on 10 February 2014.

nies) did not win favor with the local authorities, as a result of which there was virtually no competition in the market. Meanwhile, behind the “iron curtain” national economies of individual countries was developed through an expansion of small and medium-sized enterprises. For many years companies operating in that environment learned what competitions and how to effectively struggle with market opponents. Polish entrepreneurs are still learning the skills.

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