



Eurofound

Restructuring in SMEs: Estonia

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Introduction

The restructuring of small and medium-sized enterprises (SMEs)¹ as a topic for study has been largely overlooked in recent years. All too often the focus has been on large enterprises, ignoring SMEs, which have often undertaken ‘silent restructuring processes’ (Voss, 2007). In a small country such as Estonia, SMEs account for a large proportion of enterprises, and it is therefore important to consider the effects of restructuring on them.

There is a large number of SMEs in Estonia, accounting for 99.7% of the country’s non-financial business economy (NACE Sections C to I, and K) (see Table 1). SMEs, however, are less important in terms of their contribution to providing jobs and wealth: 79.2% of workforce are employed in an SME, while 73.2% of the non-financial business economy’s value-added was generated by SMEs. Furthermore, while the number of enterprises is comprised largely of micro enterprises (86.8%), the number of people employed and value added is more equally split between micro, small and medium-sized enterprises.

Table 1: *Key indicators for Estonian enterprises*

	Total	SMEs 1–249	Micro 1–9	Small 10–49	Medium 50–249	Large >250
Number of enterprises	56,095	55,932	48,692	6,054	1,186	163
Share in total (%)	100.0	99.7	86.8	10.8	2.1	0.3
People employed	417,281	330,345	114,881	111,556	103,908	86,936
Share in total (%)	100.0	79.2	27.5	26.7	24.9	20.8
Value added (EUR millions)	7,264.3	5,315.5	1,531.3	1,769.1	2,015.0	1,948.9
Share in total (%)	100.0	73.2	21.1	24.4	27.7	26.8

Source: *Statistics Estonia*

The SME sector has not always been structured this way. Micro enterprises have dramatically increased their importance in the share of total enterprises, from 66.6% of total companies in 1994 to 81% by 2004. At the same time, the shares of other SME groups have fallen. Micro enterprises doubled their shares in total employment from 10.7% in 1994 to 20.7% in 2004 (Venesaar and Loomets, 2006). This might be attributed to the small size of the Estonian population being reflected in the share of micro enterprises, to many people having more than one company (often inactive), and to an increase in entrepreneurship in general.

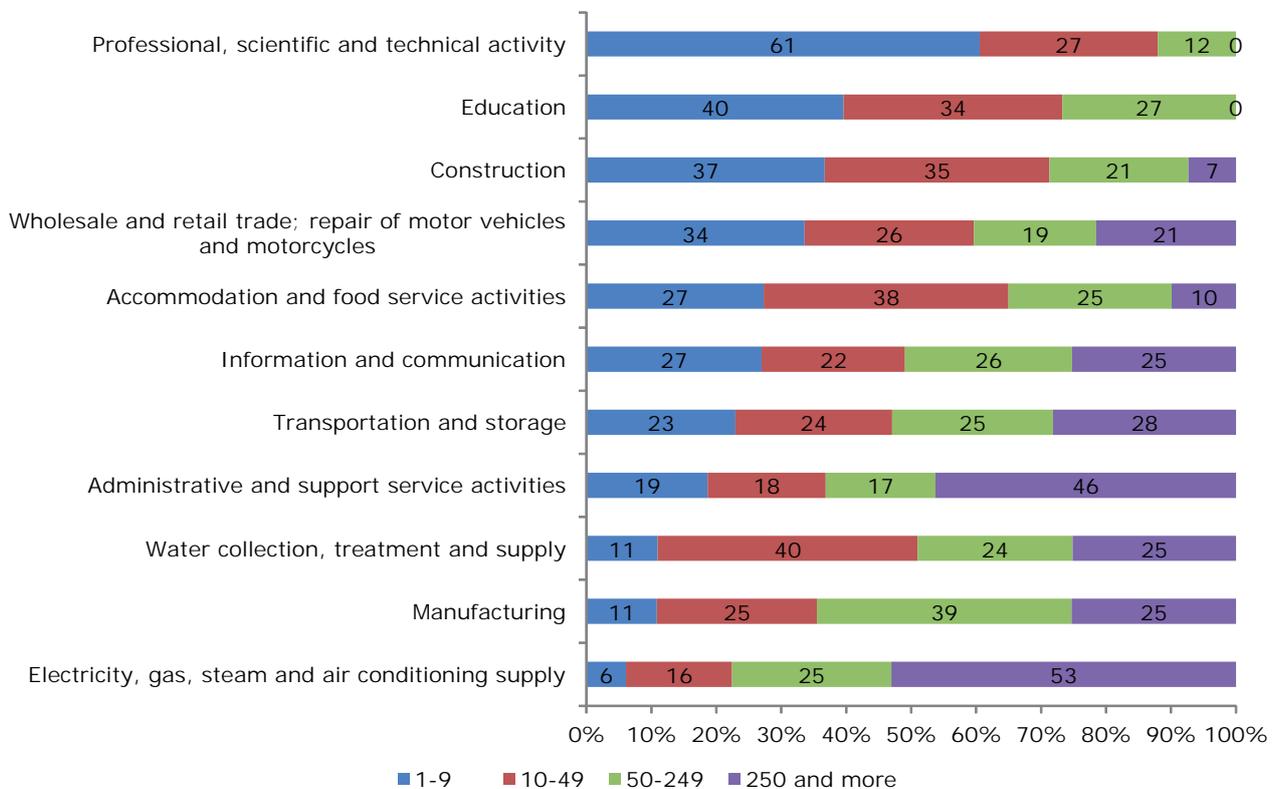
Although entrepreneurship in Estonia has developed relatively quickly and its competitiveness has improved significantly, the Estonian economy continues to be dominated by enterprises that operate in traditional (low technology) sectors and whose productivity and profitability per employee lag behind businesses in the developed industrial countries (Ministry of Economic Affairs and Communication, 2011). This is also reflected by a low share of high-tech employment and exports, a very low business expenditure on research and development (business enterprise research and development is a quarter of the EU25 average), and a low share of researchers in the business sector (Spin, 2010).

¹ For the purposes of this report, the European Commission definition of the SME sector will be used: micro enterprises (1–9 employees; turnover or assets of up to €2 million); small enterprises (10–49 employees, turnover or assets of up to €10 million); medium-sized enterprises (50–249 employees, turnover of up to €50 million or assets of up to €43 million). SMEs also include self-employed and family businesses, irrespective of their legal form, as long as they engage in economic activity and can be considered as autonomous entities. Large enterprises (not SMEs) are defined as 250 or more employees, with a turnover of more than €50 million or assets of more than €43 million (European Commission, 2003).

Since 2008, the global financial crisis has highlighted the need for SMEs to restructure in order to survive. Indeed, Estonia was one of the EU's worst hit countries with GDP dropping by 5.1% in 2008 and 13.9% in 2009 (SBA, 2011). Consequently, many enterprises undertook widespread restructuring as a way of trying to overcome the effects of the crisis.

The importance of the SME sector as a whole in employment shows itself most clearly in the research and education sectors (see Figure 1). Sectors which are dominated by micro enterprises also include construction, and the wholesale and retail trade sectors. In contrast, the small enterprise sector comprises the water sector, accommodation and construction sectors. Perhaps unsurprisingly, it is the manufacturing and energy sectors which have the largest share of employees, in medium-sized enterprises.

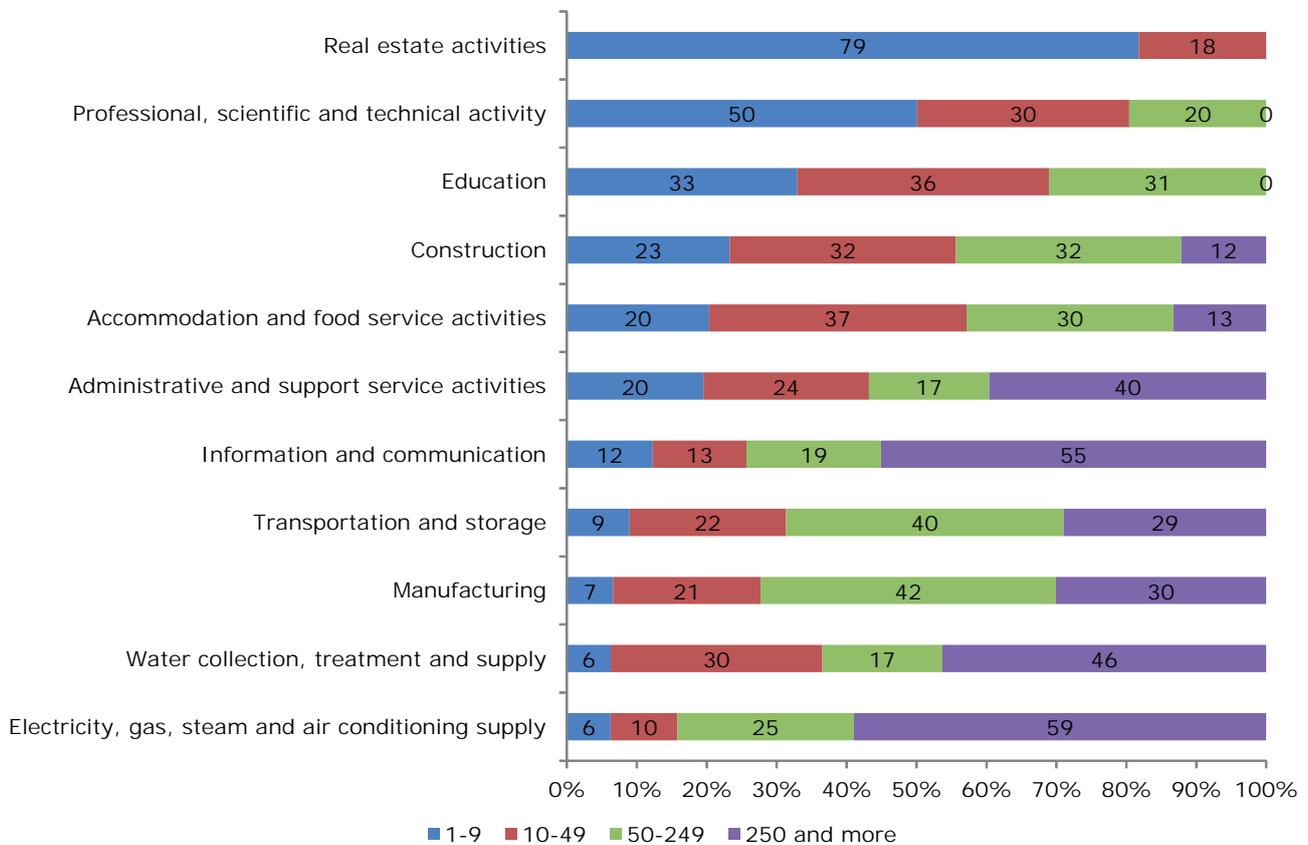
Figure 1: Share of Estonian SMEs in total employment, 2009



Source: Statistics Estonia

Turning to value added, in Estonia the smaller enterprises account for more of this in labour intensive sectors, such as research, education and construction sectors (see Figure 2). In terms of larger enterprises, the ICT, energy and water sectors are naturally the highest value added sectors.

Figure 2: Share of Estonian SMEs in total value added, 2009

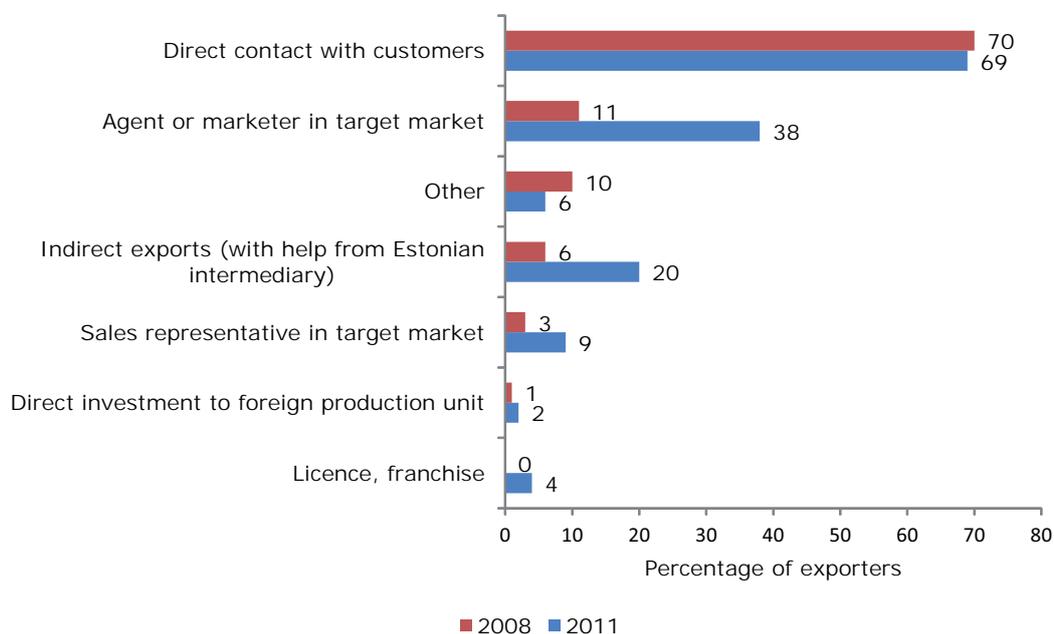


Source: Statistics Estonia

A 2011 national SME survey (Kaarna et al., 2012) confirmed findings from other reports that SMEs trade their products over a short distance and that SMEs from smaller countries are more internationally active. It also found that Finland is the main export target market for SMEs (61%), followed by Latvia (31%), Sweden (26%), Russia (16%) and Germany (15%).

The 2011 survey also found that Estonian companies primarily enter foreign markets through direct contact with clients, 69% (Figure 3). This has not changed greatly since 2008. However, between 2008 and 2011 there was a huge increase in marketing (from 11% to 38%) and indirect exports (from 6% to 20%). More established forms of internationalisation, such as licensing and franchising, or direct investments do not feature. The reasons for this include a lack of export-related knowledge and skills for potential and new exporters. The fact that one half of exporters are fulfilling ad hoc export orders is a source of considerable concern. Only every sixth company has an export strategy or export plan and export budget. Nearly a quarter of exporters claim that exports constitute a part of their general business strategy. Random export orders are mostly taken on by smaller companies (Ministry of Economic Affairs and Communication, 2011).

Figure 3: *Methods by which SMEs entered foreign markets, 2008–2011*



Source: *Kaarna et al., 2012*

SMEs are dynamic enterprises, yet their behaviour regarding restructuring is still not well understood. This may be partly because of a lack of public discussion and policy focus. This report aims to shed light on the findings of SME restructuring in Estonia and the implications for the sector. It will include the findings of various reports, statistical data and the Estonian surveys on SMEs² which provide in-depth information on the dynamics and characteristics of Estonian SMEs.

² In 2002, the Ministry of Economic Affairs and Communications (MKM) ordered a large scale survey on Estonian SMEs (hereinafter referred to as the national SME survey) to be undertaken (Emor, 2003). Since then repeat surveys have been taken in 2005 (Saar Poll, 2005), 2008 (Saar Poll, 2008) and 2011 (Kaarna et al., 2012). Although the surveys do not have fully standardised questions, many comparisons can nonetheless be made over time.

Relevance of different types of restructuring for SMEs

Overview

Eurofound's European Restructuring Monitor (ERM) has identified seven main types of restructuring:

- relocation;
- outsourcing;
- offshoring/delocalisation;
- bankruptcy/closure;
- merger/acquisition;
- internal restructuring;
- business expansion.

Each of these will be discussed in more detail. In Estonia, most of these categories apply, although detailed information on some, such as relocation and offshoring, is notably absent.

Relocation

Theoretically, SME relocation is more likely to occur in micro enterprises where the owner/manager moves to a different part of the country due to personal circumstances. Other possible reasons include moving closer to the capital city or a larger market, or due to business expansion. Relocation is negatively related to enterprise size – the larger the enterprise, the fewer proclivities there are to relocate. In Estonia, relocation is not a highly visible phenomenon for a number of interconnected reasons.

- The relatively small size of the country abnegates any need for relocation. Many Estonians are prepared to commute long distances to work: 23% of all workers and 48% of those living in rural areas commuted in 2000 (Hazans, 2004).
- The widespread use of IT solutions in business helps overcome many geographical problems, with the incidence of distance working in Estonia increasing (Ariko Marketing, 2002; Kallaste and Jaakson, 2009).
- The high share of sole proprietors (as owner-managers) and micro enterprises means their work is usually near home. Consequently, there is not much intra-national movement, and in this respect, the trends do not deviate from European norms.

Evidence from the 2011 national SME survey suggests that entrepreneurship activity in Harju County, where the capital city, Tallinn, is located, has changed since 2005. At the start of the recession, entrepreneurship (as measured by place of registration) in large towns outside Tallinn became more pronounced,³ although by 2011 registrations in Tallinn had risen again (to 40%), and decreased for the other towns (to approximately one third). Despite this, there was a surprising increase in entrepreneurial activity in the south of the country, as well as an increase in head offices located in villages, rising from 15% in 2008 to 27% in 2011. This shows that people are moving from cities to the villages, and that new

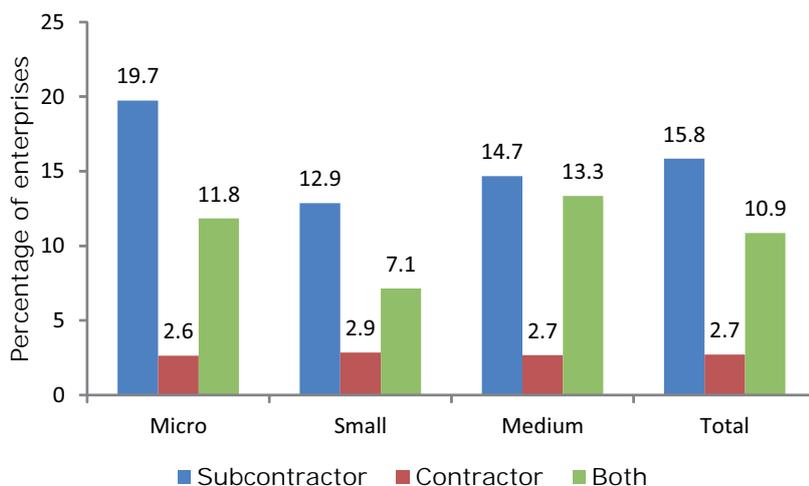
³ This finding is interesting in light of the fact that Tallinn accounted for over 50% of total Estonian GDP in 2009 (Statistics Estonia).

companies prefer to locate their headquarters in quieter areas. In the case of small enterprises, particularly micro ones, the address of the head office is the entrepreneur’s home address. As people tend to move from Tallinn to nearby villages, their enterprises move with them. This could be taken as an anecdotal indication of some relocation taking place, although it is still not clear to what extent this affects SMEs.

Outsourcing

According to the EIM/GDCC survey (2009), the number of contractors across all SMEs in Estonia remains very low, at less than 3%. However, nearly 16% of Estonian SMEs are involved in subcontracting (see Figure 4). This compares favourably with the EU, where between 15% and 21% of enterprises are subcontractors. In terms of size, small enterprises have the lowest share of subcontractors; 12.9%. Both micro enterprises and medium-sized enterprises have a larger share (19.7% and 14.7% respectively), although this could be due to greater flexibility in fulfilling orders (in the case of micro enterprises) and greater capacity (in the case of medium-sized enterprises). This would seem to corroborate the findings of the national SME surveys, which found that the level of exporters who are subcontractors has not changed greatly over time, rising slightly from 8% in 2008 to 9% in 2011 (Kaarna et al., 2012). The level of outsourcing is linked to the ever increasing level of foreign direct investment that Estonia attracts. Indeed, Estonia is the most attractive European country to outsource to, at eleventh place, according to the A.T. Kearney Global Services Location Index (2011).

Figure 4: Percentage of Estonian SMEs as subcontractors or contractors, by enterprise size, 2009

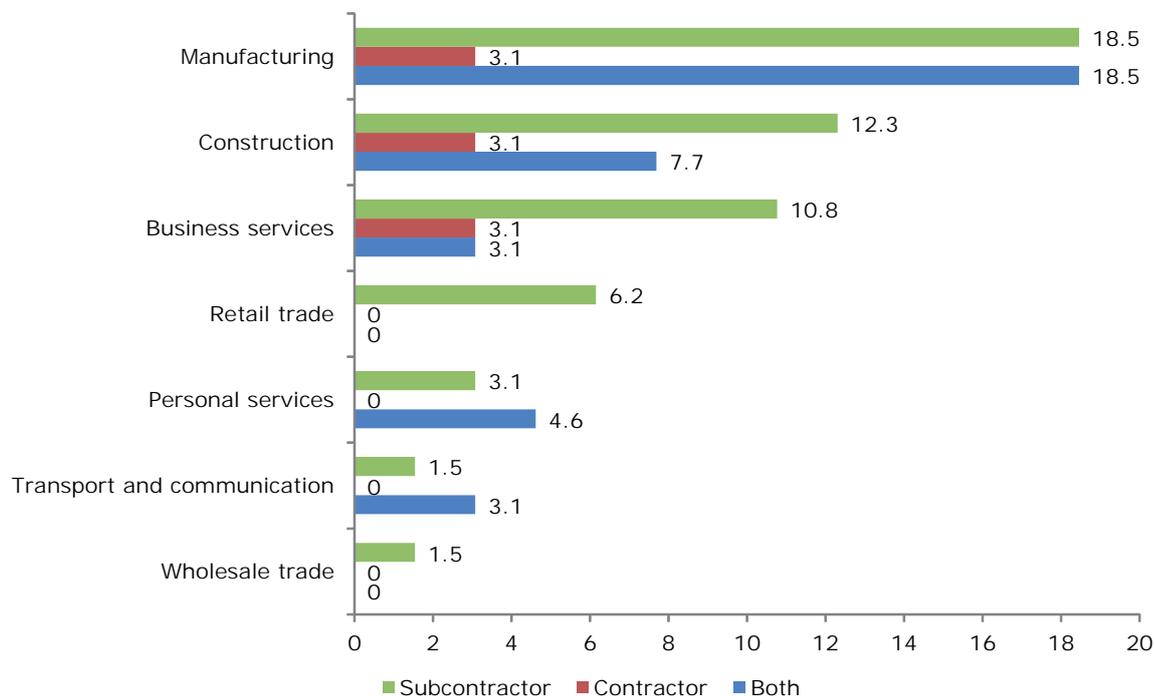


Notes: N=221

Source: EIM/GDCC Survey, 2009

Taken by sector, only manufacturing, construction and business are contractors, albeit at a very low level, 3.1% (see Figure 5). The largest share of subcontractors comes from the manufacturing sector, where over 18% of SMEs act as subcontractors. The service sector has the lowest share of subcontractors. However, these trends are to be expected given the nature of the industries.

Figure 5: Percentage of Estonian SMEs as subcontractor, contractor or both, by sector, 2009



Notes: N=65

Source: EIM/GDCC Survey, 2009

Offshoring/delocalisation

Whilst offshoring might be the most prevalent form of relocation for larger enterprises, due to the lure of lower labour costs, this is not the case for Estonian SMEs. Indeed, very few enterprises have done this. This may be because of the lack of financing available for undertaking offshoring activities, although there is some evidence that outward investment has occurred (Masso et al., 2007), the majority of these enterprises having foreign equity shares. In these cases, it may be that such activity is not strictly offshoring, but rather represents expansion via local markets or an intra-organisational move or reorganisation.⁴

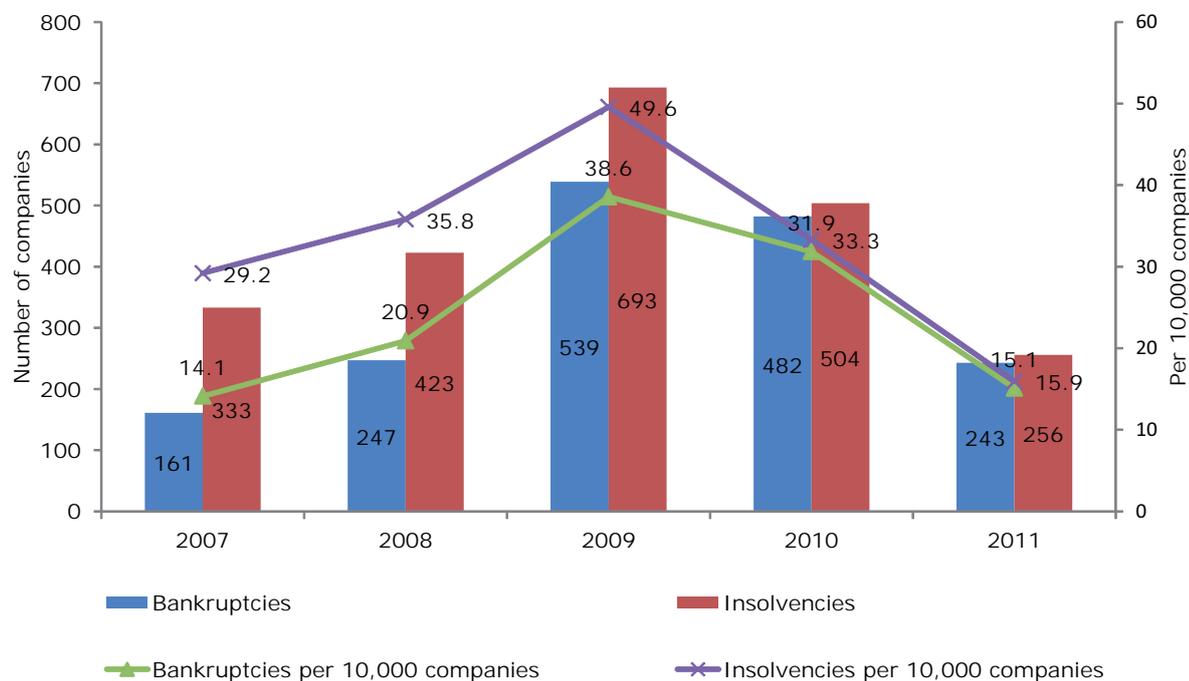
Bankruptcy/closure

Within Estonia, the recent global financial crisis has highlighted the difficulties in successfully running a business during times of adversity. Bankruptcies increased significantly in the aftermath of the economic downturn, only easing off in 2011 to 243 cases (Figure 6).⁵ Despite this, the number of bankruptcies remains low in comparison to the total number of enterprises, at only 15.1 cases per 10,000 companies in 2011. Cases of insolvency, although slightly higher than bankruptcies, have followed the same trends, peaking during 2009 and subsequently falling. In 2010, 6,300 jobs were lost due to insolvencies, falling to 1,500 in 2011 (Creditreform, 2011, 2012).

⁴ For example, in 2009 Coca-Cola HBC Estonia closed down production after 17 years with a loss of 63 jobs, stating it was moving bottling production to Ropaži, Latvia. See <http://www.neurope.eu/article/coca-cola-shifts-production-estonia>

⁵ The total number of enterprises also grew dramatically because of a demand to register all sole proprietors in the Central Commercial Register (Äriregister). Formerly it was enough just to register at the Tax Office.

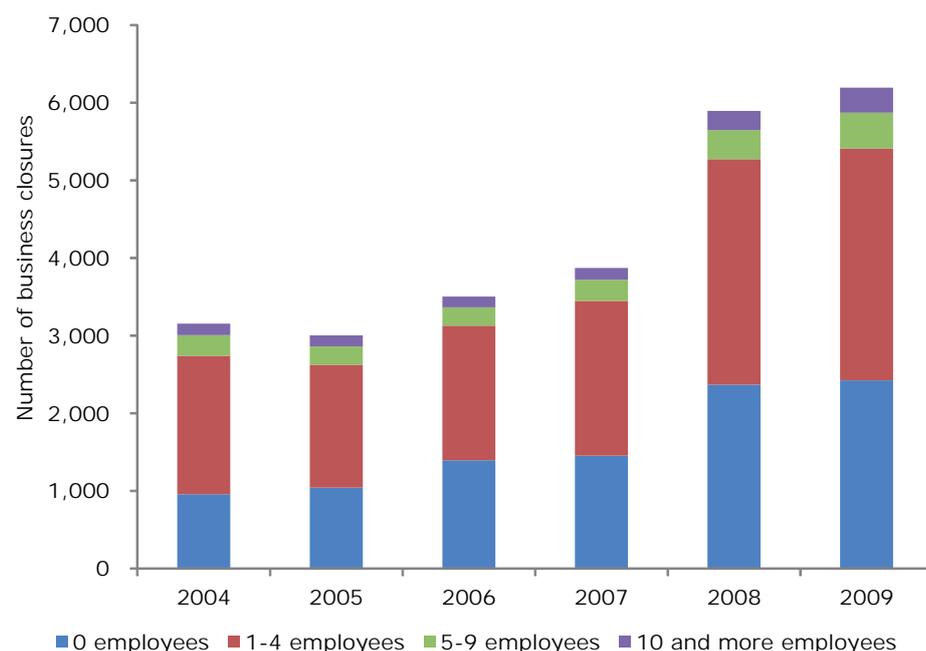
Figure 6: Estonian bankruptcies and insolvencies, 2007–2011



Source: Author’s calculations based on Central Commercial Register, Creditreform

The number of businesses closing has reflected the macroeconomic situation, whereby there was a significant increase at the start of the global financial crisis (Figure 7). Most businesses which close are the most volatile, with either no, or between one and four employees. However, although 63.2% of companies are still viable three years after registration, this figure also indicates that more than one third of companies are liquidated within three years of their foundation; in this respect Estonia is slightly above the EU average (SBA, 2010).

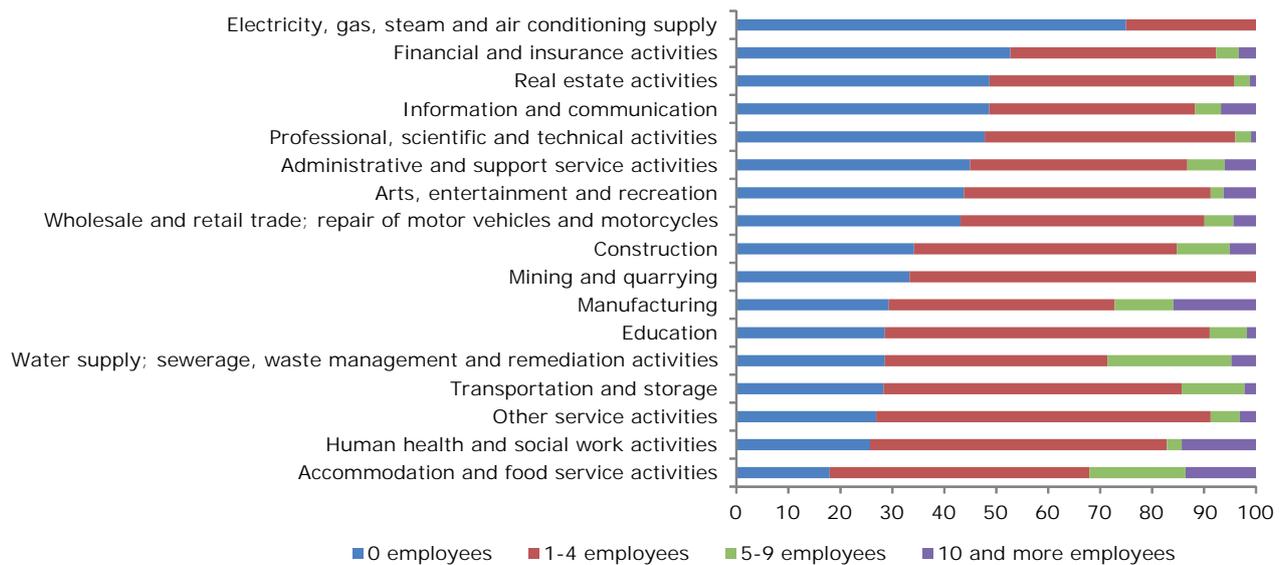
Figure 7: Number of business closures, 2004–2009



Source: Statistics Estonia

Disaggregating the data by sector, the number of closures of enterprises with zero or between one and four employees was highest in the energy sector, followed by several service sectors (Figure 8). Conversely, closures of enterprises with 10 or more employees were most prevalent in the manufacturing sector, health and social work and accommodation and food service sectors – all sectors which traditionally employ the most people. The effect of the global financial crisis on business closures was seen most clearly in a large share of small financial and real estate enterprises which had contributed to the bubble and which were hardest hit by the downturn.

Figure 8: *Business closures in Estonia by sector and class size, 2009 (%)*



Source: *Statistics Estonia*

Schrör (2007) found that in Estonia, in 2003, larger enterprises (with 5–19 employees and 20+ employees) that closed accounted for more than 60% of people made jobless in all enterprise closures, much higher than the EU average (around 37%). However, by 2005, the share of other enterprise sizes in the number of closures had increased, indicating a higher prevalence of micro enterprise failure (Schrör, 2009).

Although the level of business closures is connected to the general macroeconomic environment in which the enterprises operate, the attitude of the population towards entrepreneurship should also be taken into account. The relatively low number of failures could be due to the general risk aversion of Estonians. Negative attitudes to entrepreneurial activity are also prevalent. A Eurobarometer survey (European Commission, 2010) found that, in Estonia, the percentage of respondents who felt that entrepreneurs who had failed should be given a second chance fell from 82% in 2007 to 69% in 2009, one of the largest drops in Europe. This figure compares unfavourably with the EU average of 81% for 2009. Similarly, in 2009, the percentage of respondents who felt that one ought not start a business if there was a risk of failure, was much higher than the EU 25 average (63% versus 49%). This can be traced to a cultural intolerance of failure.

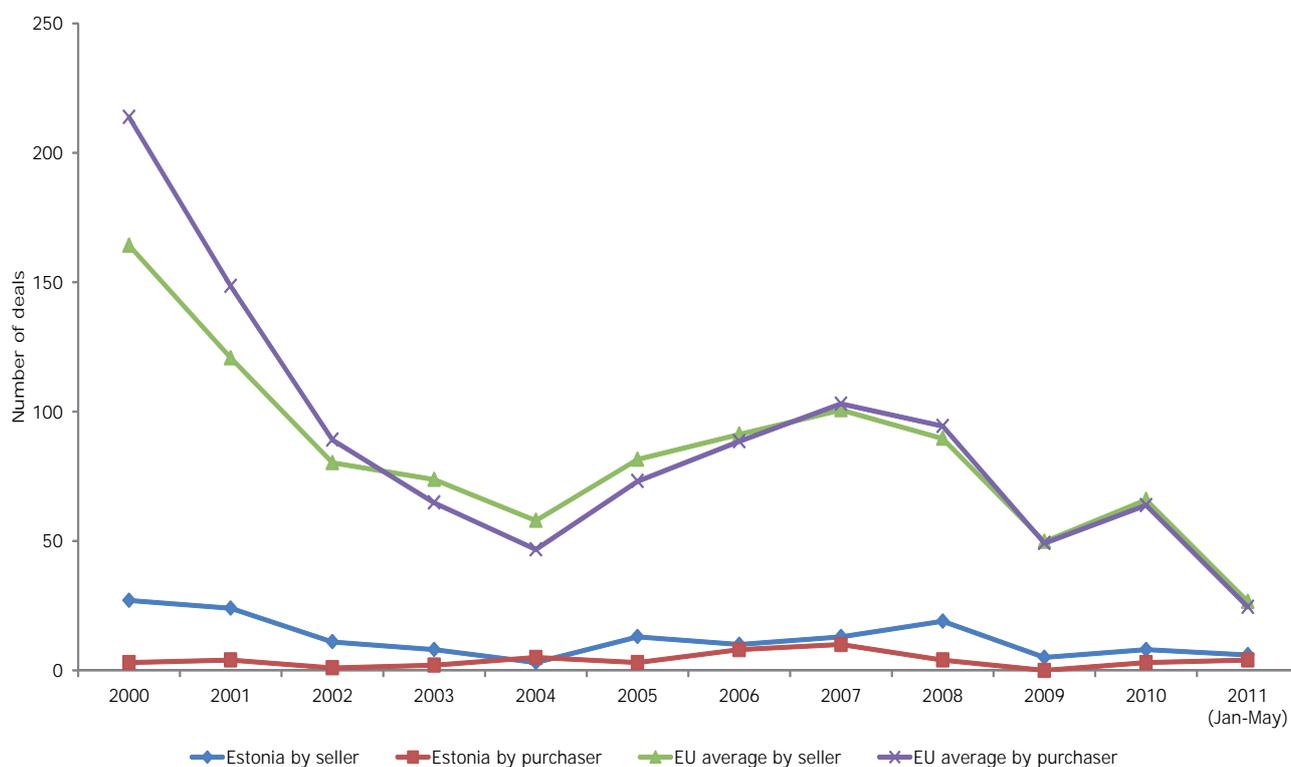
This attitude means many Estonians reorganise their enterprises rather than face bankruptcy. This is possibly due to the Reorganisation Act, adopted in 2008 to create an alternative to filing for bankruptcy that, as a rule, results in the liquidation of insolvent companies. The new type of proceedings enables companies to survive if they have temporary solvency problems. Compromises can be also reached within the scope of bankruptcy proceedings, but realistically, under these, companies facing solvency problems could only rarely be saved (SBA, 2009).

Merger/acquisition

Weitzel and McCarthy (2009) find that mergers and acquisitions are positively related to enterprise size, and, in SMEs, they are more often found in services and manufacturing, and least often in transportation and utilities. SMEs in Estonia have not engaged in mergers and acquisitions, with this kind of activity being primarily a preserve of larger enterprises. SMEs have undertaken networking instead, although there have been quite a few cases of high-tech start-up companies being acquired by private equity and venture capital companies.⁶

Although no information on mergers and acquisitions in Estonian SMEs exists, UNCTAD has published general data on the number of mergers and acquisitions which has been very low since 2000, at under 30 (Figure 9). This level is connected to the relatively low activity of the stock exchange in Estonia,⁷ which does not contribute to creating a climate for mergers and acquisitions. This might partly explain why the level of mergers and acquisitions by purchaser is lower than the level of this kind of activity by seller.

Figure 9: Mergers and acquisitions in Estonia and the EU, 2000–2011



Source: UNCTAD

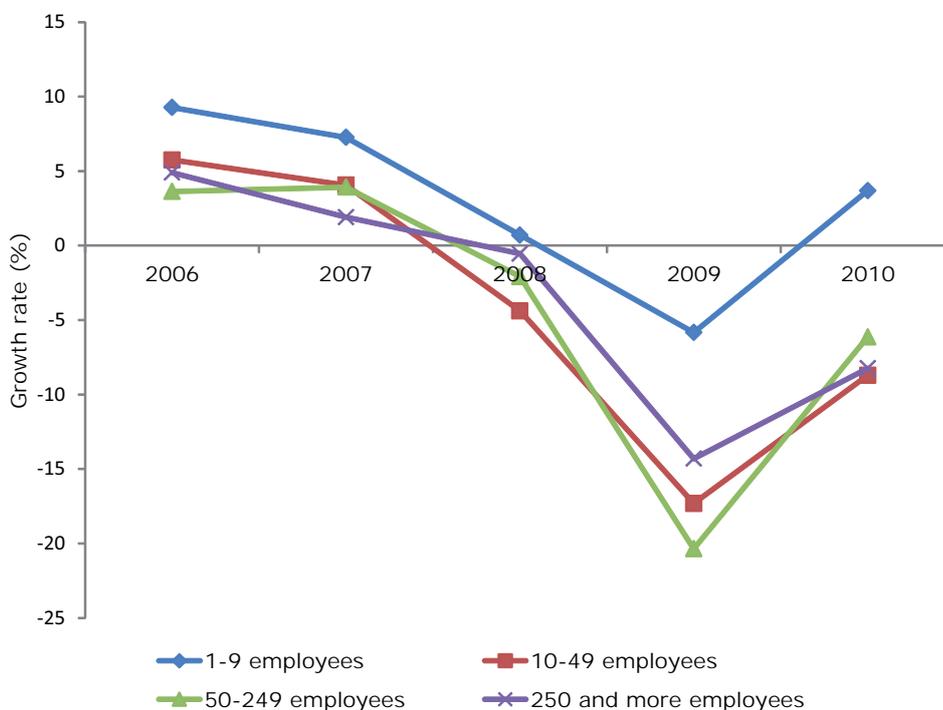
⁶ The Estonian Venture Capital Association has stated that of 120 portfolio companies, 18% have reached the buyout stage (as of September 2011). See <http://www.estvca.ee>

⁷ See, for example, <http://www.balticbusinessnews.com/article/2012/1/16/tallinn-stock-exchange-goes-into-hibernation>

Internal restructuring

Of all the different types of restructuring, internal restructuring is often the most under-reported phenomenon, given that it is frequently linked to secretive enterprise strategic planning and takes place out of the media spotlight. This is also particularly true of Estonian SMEs where it has been one of the most prevalent forms of restructuring (Nurmela and Vörk, 2010). In terms of employment downsizing, there has been some job destruction in recent years, which may be attributed to the financial recession. It is clear, though, that the loss of jobs has mostly been confined to medium and large enterprises (Figure 10). Indeed, micro enterprises contracted only slightly compared with other class sizes. One explanation for this is that, in times of downturn, smaller enterprises tend to maintain employment above an efficient level as they have fewer opportunities to lay off personnel and stronger personal ties with their employees (Voss, 2007).

Figure 10: *Growth rate of Estonian SMEs, 2006–2010*



Source: *Author's calculations based on data from Statistics Estonia*

One factor that led to employment restructuring in recent years has been a change in the law. During the recession, a new Employment Contracts Act took effect on 1 July 2009. It made redundancy easier and faster to effect by reducing the advance notice time to 30 days, reduced redundancy benefits and divided the financial burden between employers and the Unemployment Insurance Fund (Eesti Töötukassa) (Nurmela and Vörk, 2010). Consequently, many enterprises took the opportunity to shed labour in an effort to reduce costs.

In terms of business transfers, it is possible to alter the legal form of an enterprise and facilitate the transfer process (European Commission, 2011). Furthermore, there is a favourable taxation policy to provide incentives for reinvestment of profits made on the sale of a business to another enterprise not quoted on the stock exchange. Despite this, according to Eurobarometer surveys (European Commission, 2007a, European Commission, 2010), Estonians generally prefer to start up a new company rather than take over an existing one. This is in line with EU trends, although the level is much lower (Table 2). When taking into account the level of respondents who have some business experience, the results are

even more pronounced, dropping to 19% against 24% for the EU. The effects of the global financial crisis may be seen in a general drop in entrepreneurial activity as the level in 2007 was previously much higher than in 2009.

Table 2: *Percentage of respondents starting a business or taking over an existing one, 2007–2009*

	Estonia		EU	
	Starting new company (%)	Taking over existing company (%)	Starting new company (%)	Taking over existing company (%)
All respondents 2009	40	21	50	25
Respondents with some business experience 2009	54	19	61	24
All respondents 2007	51	20	52	28
Respondents with some business experience 2007	61	23	59	27
All respondents 2004	43	15	53	29

Source: *European Commission, 2007a, 2010*

Evidence of enterprise ownership change in Estonia shows that the most predominant change occurs from employee (insider) ownership to manager or domestic (outsider) ownership (Rozeik, 2008). This would also seem to confirm anecdotal evidence that business transfers are taking place. Furthermore, the national SME surveys found that the share of managers over 60 years old has decreased from 16% in 2005, to 10% in 2008 (Saar Poll, 2008). Consequently, it may be surmised that the number of business transfers will not grow in the foreseeable future.

Business expansion

SMEs have been crucial in generating further employment. The number of jobs in the Estonian economy is set to increase after a few years of negative growth. The Bank of Estonia (2011) predicted that employment growth would recover, but that it would be short-lived due to the subdued growth in external demand and increasing insecurity. Year-on-year, domestic employment growth is expected to decrease from 7.1% in 2011 to 1.1% in 2012 and to 0.6% in 2013. There have been some cases of Estonian enterprises expanding and creating further jobs, although since the global financial crisis this has become a less common form of business expansion. This has been confined to the micro enterprise sector, which grew at 4% in 2010 (Figure 10).

In terms of internationalisation, Estonia, as a small open country, is drawn towards becoming export-oriented due to the constraints of the domestic market. Consequently, the share of Estonian companies which export rose from 7% in 1999 to 15% in 2003 (Venesaar and Loomets, 2006). According to the 2002 national SME survey, one in five SMEs were involved in sales, by sector this ranged from 17% of very small firms, to 35% of small firms to 55% of medium-sized enterprises (Smallbone and Venesaar, 2006). The 2011 national SME survey concluded that SMEs involved in exporting had decreased significantly, from 32% in 2005 to 30% in 2008 and 23% in 2011 (Kaarna et al., 2012). Furthermore, in 2011, 60% of enterprises did not export at all, whilst 11% no longer export. These trends can be explained by the fact that, during the economic boom, enterprises did not export because they were satisfied with their domestic market (Saar Poll, 2008). However, as the economic crisis was affected by external demand, the number of exporting enterprises was evidently affected (Kaarna et al., 2012).

Other reports have also highlighted the large share of exports. Indeed, the European Commission (2007b, p. 14) reported that, in 2005, 23% of companies had some turnover from exports, compared with 8% for the EU average. Furthermore, only 3.7% of companies gained any turnover from subsidiaries or joint ventures abroad, lower than the EU average of 4.8%.

These findings are echoed by the EIM/GDCC Survey (2009) which found that over half of all Estonian SMEs undertook direct exports during 2006–2008 (Table 3). There, a positive relationship between enterprise size and exports was found. This would seem to highlight the role of Estonian SMEs within the global economy and value chain as being somewhat limited, especially in light of the low share of subcontracting and contracting.

Table 3: *Percentage of Estonian SMEs involved in international business, 2006-2008*

	Micro	Small	Medium	All SMEs
Direct exports	51.3	57.1	60.0	56.1
Investing abroad	9.2	10.0	17.3	12.2
Technological cooperation with enterprises abroad	25.0	21.4	33.3	26.7

Source: *EIM/GDCC Survey, 2009*

Drivers of restructuring

There is very little evidence to indicate that the drivers for restructuring in Estonia differ greatly from other countries. However, they seem to be linked to, and predominantly stem from, two main sources: market fundamentals and government policy.

Undoubtedly, a significant driver is the limited (that is, restrictive) scale and scope of the domestic market. In many sectors there are a few enterprises which monopolise the market, crowding out the smaller ones. Consequently, this has pushed many Estonian entrepreneurs to set up export-oriented enterprises from the start ('born globals'), or focus more on export-oriented sales, which provides them with further market opportunities. This is of particular significance to policy-making and is seen as vital to eliminate old dependencies and stimulate economic development (Smallbone and Venesaar, 1998).

Current government policy, which specifically targets high-growth, export-oriented enterprises, has reinforced this trend by forcing many enterprises into restructuring to adopt this profile, in order to benefit more from government support. (Ministry of Economic Affairs and Communication, 2011). In recent years one of the main causes for restructuring has been the global financial crisis, which has caused companies to seek new ways to generate further income and improve efficiency. Small open markets suffer the most during times of economic downturns, and Estonia has proved to be no exception. There is decreased demand in the domestic market, further pushing SMEs to internationalise as a way to maintain their sales levels.

The main reasons for companies going bankrupt, recorded by the courts, were changed markets, management problems, unprofitable operations, a particular event or the general economic crisis (Lukason, 2010).

Beyond this, Estonian enterprises have suffered from a lock-in to low value-added activities for many years (Ministry of Economic Affairs and Communication, 2011). The economic structure does not conform to that of a knowledge-based economy, which is a goal of government policy. Industry and services are still heavily based on cheap labour, primarily through construction, commerce and hotel services, rather than manufacturing, business services or financial intermediation (Tiits, 2007). Combined with increasing global competition and a small domestic market, this has provided yet another cause for SMEs to reorient their business activities. This is another reason why the government has targeted raising exports as a means to circumvent this problem (Ministry of Economic Affairs and Communication, 2011).

Estonia is facing an acute demographic change, which will shape societal trends in the near future (Lauristin, 2011). The specific effects are the ageing population and high levels of emigration compared with other EU countries. Although the ageing rate is not as high as other EU countries, it will still have an effect, amongst other things, on the business successions of SMEs. The high rate of emigration, and in particular a 'brain drain', is a more pressing issue. A consequence of this demographic change is that, aside from a decrease in potential GDP, the labour supply will become scarcer for SMEs. This will, in turn, exacerbate the relative lack of skilled labour, as despite the high qualifications of the Estonian workforce overall, the skills required by employers are typically in short supply. Consequently there has been much internal restructuring of human capital in an effort to raise the standard of skills (see also the above section on internal restructuring).

Finally, it should be noted that restructuring is mostly caused by the need to overcome certain barriers. For example, many surveys point to the inability to access to finance as being a major barrier to restructuring (see chapter on main challenges).

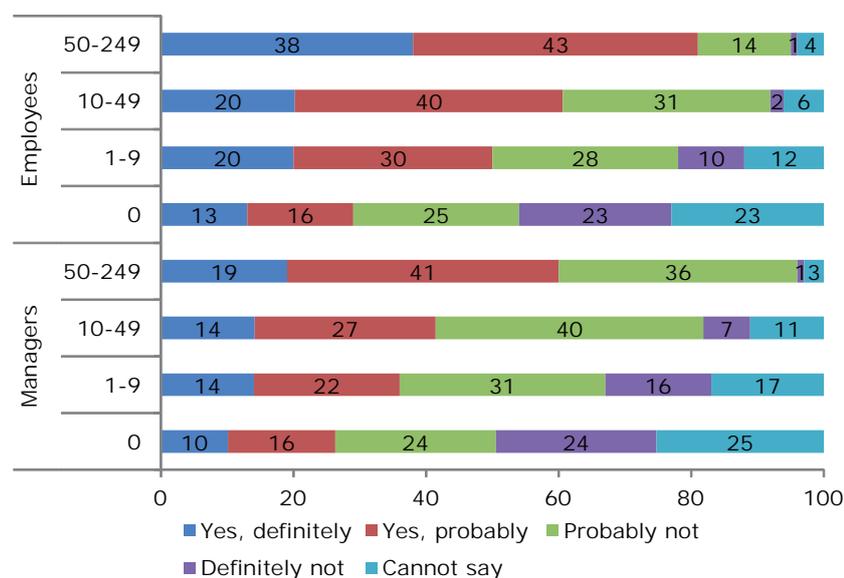
Distinctive characteristics of restructuring in SMEs

Anticipation, planning and preparation of restructuring events

Businesses in Estonia operate primarily in the short-term, which results in SMEs generally being more reactive towards restructuring, rather than proactive. For example, immediately after the economic crisis started, companies reduced jobs at a huge level, as an initial reaction to the worsening macroeconomic situation.

Forward planning plays some role in the skills' upgrading of SME employees. The national SME survey asked whether training was needed within enterprises. The results showed that there is a positive relationship between enterprise size and desire to undertake training for managers and employees (Figure 11). However, it is apparent that employees are more in need of training than managers. The difference between the need for training managers and training employees is greatest in medium-sized enterprises (19% for managers and 38% for employees), and less so in smaller enterprises.

Figure 11: SMEs' employee or manager training needs in the next 12 months, by enterprise size (%), 2011



Source: Kaarna et al., 2012

In terms of internationalisation, Estonian SME exporters often fulfil sporadic random export orders (Ministry of Economic Affairs and Communication, 2011), which is in line with findings from other countries (Jakobsen and de Voss, 2003). Furthermore, according to the EIM/GDCC Survey (2009), many SMEs which have not previously undertaken different forms of international cooperation planned to do so. The highest percentage opted for making direct exports, at over 81%, whilst the lowest was for technological cooperation, at just under 58% (Table 4). It is notable that investing abroad and technological cooperation is negatively correlated with enterprise size.

Table 4: *Estonian SMEs planning international business activities, 2009–2011*

	Micro	Small	Medium	All SMEs
Direct exports	81.1	76.7	86.7	81.4
Investing abroad	78.9	77.1	56.0	70.6
Technological cooperation with enterprises abroad	61.8	61.4	50.7	57.9

Source: *EIM/GDCC Survey, 2009*

The 2011 national SME survey asked enterprises about the sources of extra financing they would seek during the next two years (Kaarna et al., 2012).

- Roughly one third of respondents said they planned on taking extra financing.
- One half did not plan on doing so.
- A quarter did not say anything about their plans.
- 42% hoped to receive state support.

Generally, there is a higher share of medium-sized enterprises in the manufacturing sector, which is accustomed to receiving such support. Just over one third of enterprises hoped to secure leasing or a bank loan (37% and 39% respectively). This is considered more for small and medium-sized enterprises which operate primarily in sectors such as construction, wholesale trade and transportation and storage. Enterprises plan to expand their business with the help of domestic investors (39%) and foreign investors (31%).

In terms of strategic planning, Estonian enterprises rely on financial rather than market factors such as size, demand, products. Economic indicators and opportunities are the most cited reasons for changing strategic plans, and future market factors have a smaller effect. This shows that realistic opportunities are more important to businesses than vision and technological trends. Thus, when planning, past indicators are taken into account; a reactive process. However, it is not possible to say whether this is the enterprise's reaction to the economic crisis or whether it is a longer trend which characterises Estonian enterprises in general. Most plans are very short-term (ones for more than three years are very rare). Indeed, in many fields plans are notably absent: internationalisation and export plans are missing in half of the enterprises, with no labour and marketing plans in more than one-fifth of the enterprises (Vadi et al., 2011).

Managing restructuring

Labour restructuring is a long process, involving many actors (Nurmela and Vörk, 2010). Smaller enterprises are less encumbered by legal commitments to their employees and can therefore respond much quicker to changing conditions.

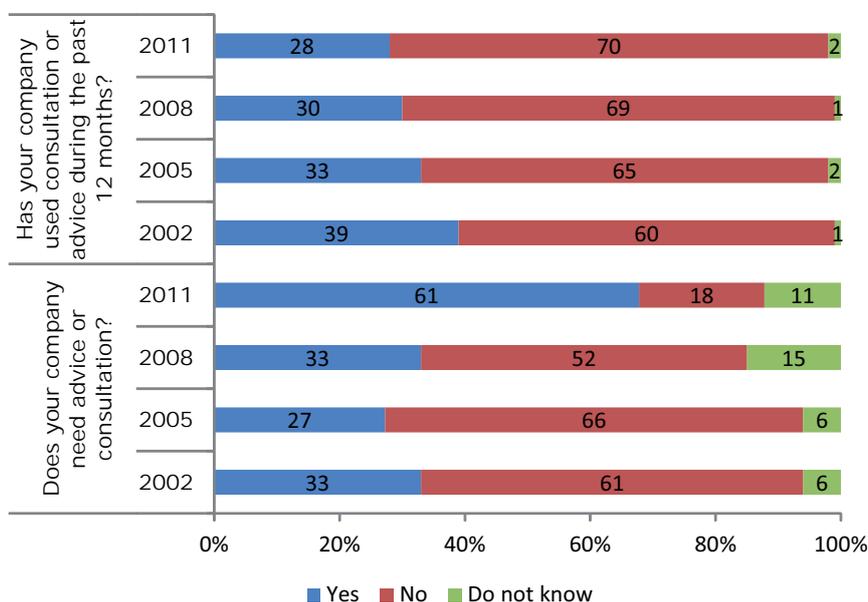
SME internationalisation is usually a staggered and sequential process, taking many years (Jakobsen and de Voss, 2003). SMEs often first undertake sporadic exports, then export via independent representatives, then establish their own sales subsidiaries abroad, followed by production facilities abroad. The findings from the national SME surveys and other reports would seem to suggest that Estonia is in the initial stages of SME internationalisation development.

Actors involved

Advice for SME restructuring comes from self-sought sources. Many companies do not hire a consultant, partly because they lack the necessary capital. Indeed, the national SME surveys found that the majority of enterprises do not use

business consultation, falling from 39% in 2002 to 28% in 2011 (Figure 12). Perhaps unsurprisingly, there is a positive relationship between the use of business consultation and enterprise size, from 23% for enterprises with zero employees to 51% for medium-sized enterprises (Kaarna et al., 2012). The fields that have most used consultation are transport and communication, construction and manufacturing. However, the need for consultation is higher than actual use, increasing between 2005 and 2008 (27% and 33% respectively). The most popular consultation fields are accounting, sales and marketing, and legal advice. In 2011 the need for consultation rose across all fields since 2008, indicating possible effects from the global recession. In terms of enterprise size, a positive relationship is also found between the need for consultation and SMEs (Saar Poll, 2008). Although Estonian businesses are prepared to use consultation services, actual use is still infrequent because entrepreneurs are not used to consultants and have had no experience with them (Ariko Marketing, 2005).

Figure 12: Consultation in Estonian SMEs (percentage of respondents), 2002–2011



Source: Emor, 2003; Saar Poll, 2008; Kaarna et al., 2012

Top managers are usually in charge of planning. If it is middle managers who have this responsibility then other parties also tend to become involved, such as top managers, specialists, low-level workers, and consultants. If owners are in charge then middle managers are not usually involved. In smaller enterprises planning has a more modest role than in large enterprises and usually the owners play a big role in planning. It is common for the owners' participation in planning to be done in isolation from the managers. In enterprises where owners make decisions, they do it anonymously without involving any other parties (Vadi et al., 2011). Trade unions and workers councils do not play a big role in SME restructuring given their declining share of membership, especially in smaller companies (Eurofound, 2011).

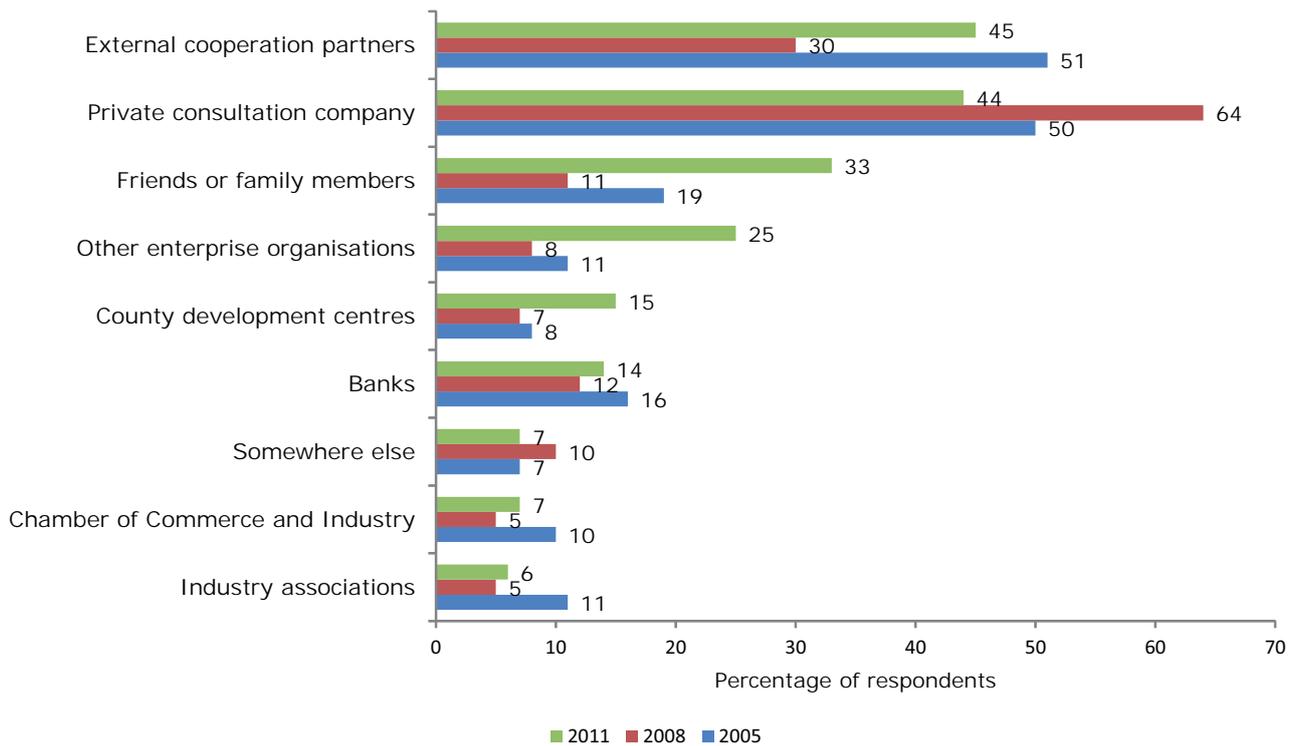
The main sources of advice are from unofficial sources such as friends and family (33%). Surprisingly, industry associations, the Chamber of Commerce and Industry, and banks are all less approached for advice. Reasons for this include:

- they are too expensive;
- they prefer to represent larger companies rather than SMEs;

- their membership is very small and hence they are weak;
- they have relatively few resources, and little ability to give sound advice.

Over the years there has been a large change in the use of consultation services by private companies, rising from 50% in 2005 to 64% in 2008, before falling to 44% in 2011.

Figure 13: *Main sources of consultation in SMEs, 2005–2011*



Source: *Saar Poll, 2005, 2008; Kaarna et al., 2012.*

Main challenges and constraints facing SMEs in restructuring

A Eurobarometer report (European Commission, 2010) found that entrepreneurs in Estonia ranked amongst the lowest in Europe in agreement to the question, 'If I see something I do not like, I change it'. This would seem to suggest that Estonians are somewhat averse to change.

In Estonia, the national SME surveys have continually found that the most predominant constraints have been connected to the external, or macroeconomic, environment. The main barriers are:

- a high tax burden;
- the need to deal with a lot of legislation and bureaucracy;
- customers not paying bills;
- shortage of employees and their low competence (Table 5).

Each of these factors were identified by at least 23% of respondents. Furthermore, there has been an increase in the perception of barriers, although this could be partly attributed to the effects of the recession. Even the perception of barriers which should be relatively unaffected by the recession, such as administration, increased. The largest increase in the barriers during the recession has been in the ability to access loans, and taxation, although this is to be expected. Only crime levels, product development, technology transfer and quality of products have continuously improved since 2002.

Taken by enterprise size, in 2008, the high tax burden was less problematic for larger enterprises. This is due to the fact that they have a greater share of qualified labour. Customers not paying the bill was more of a problem less for small enterprises. This can be attributed to the economic crisis, which brought about reduced liquidity, constraining the potential for further restructuring. The shortage of employees and their lack of skill was mostly a problem for medium-sized enterprises.⁸ Self-employed and micro enterprises do not see this as a very big problem as they rely on their owners' personal qualifications. Access to loans is a bigger problem for smaller enterprises. The percentage of companies for whom access to capital is the biggest obstacle to development dropped from 34% (2002) to 21% (2005), but increased again to 25% by 2008 (Kaarna et al., 2012). These problems have contributed to the relatively inactive entrepreneurial mindset in Estonia (Ministry of Economic Affairs and Communication, 2011).

⁸ Another survey (European Commission, 2007b) reported that in Estonia, in 2006, finding appropriate co-workers for vacant positions was a significant challenge – 12% of job openings remained vacant, compared to 5% for the EU.

Table 5: *Selected barriers to Estonian SME development (%), 2002–2011*

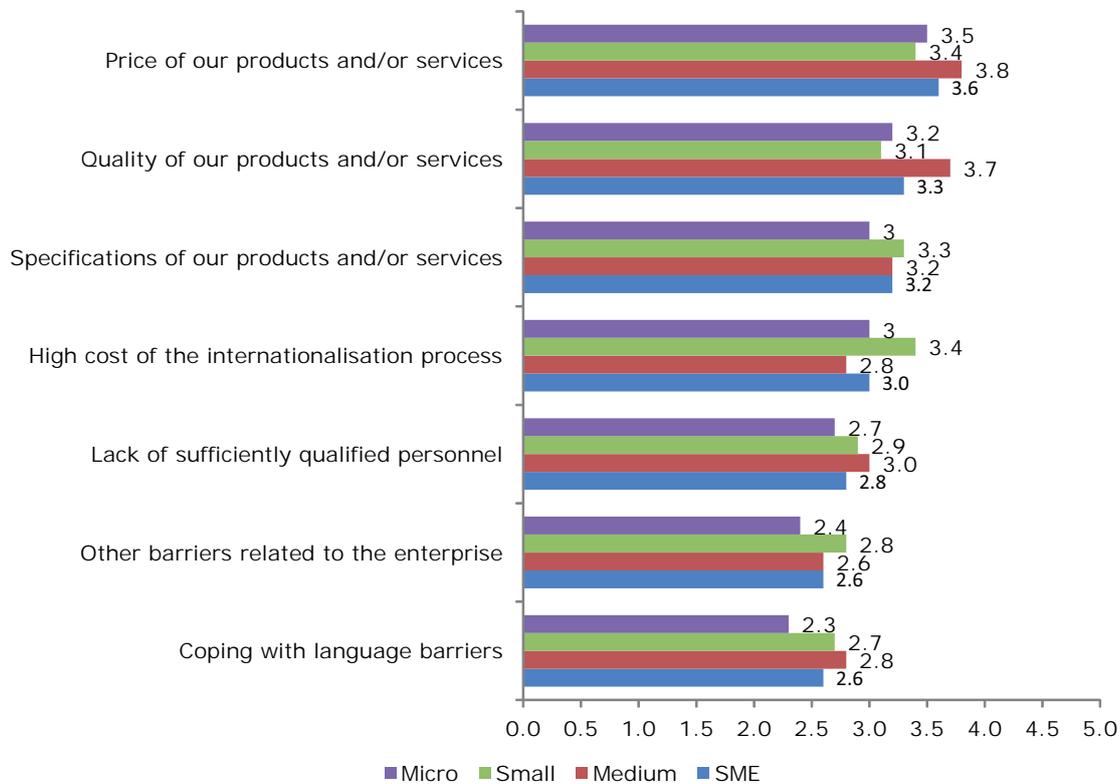
Barrier	2002	2005	2008	2011
High taxation	36	47	46	56
Marketing product/services	42	30	34	43
Delayed and missing payments	-	41	43	39
Burdensome legislation and bureaucracy	-	42	44	38
Access to loans	34	21	25	34
Lack of skilled labour	-	-	41	27
Unskilled labour	26	23	33	24
Low productivity compared to salary raise	-	-	40	17
Product development and technology transfer	17	15	13	11
Poor quality of products	18	13	13	11
Poor infrastructure	12	12	14	10
Language-culture related problems	-	-	10	9
Poor working environment	15	12	13	-

Note: Not all barriers were mentioned in all years (-). Numbers in red indicate the top 5 barriers for each year
 Source: *Emor, 2003; Saar Poll, 2005, 2008; Kaarna et al., 2012*

Two significant and interconnected issues affect the procedures for business closures. Firstly, the time necessary to close an enterprise (three years) is much longer than the EU average of two years (SBA, 2010). This is caused by the inadequate procedures for debt recovery under the Debt Restructuring and Debt Protection Act of November 2010, as well as a lack of sufficient expertise by judges and short supply of liquidators. Therefore, it could be surmised that the high level of bankruptcies in 2009 and 2010 could be attributed to earlier troubles. Secondly, it is extremely expensive to bring about a bankruptcy – around 50% of the residual value of an enterprise is spent in formal debt recovery procedures, compared with less than 10% in the best performing OECD countries (OECD, 2011). It could also mean that the number of reported bankruptcy cases is much lower than the actual number of failing enterprises, given their reluctance to undertake debt recovery procedures.

In terms of internationalisation, the EIM/GDCC Survey (2009) found that, in Estonia, the greatest barrier is price of products, followed by their quality (Figure 14). It is clear that these barriers to internationalisation do not decrease with enterprise size. There is a positive relationship between company size and coping with language barriers, and a lack of sufficiently qualified personnel. One cause for this is that a larger company size indicates increased bureaucracy. Estonian companies are very quick to react to any changes. It is easier to find qualified labour in smaller companies as their skills are often more aligned to the work tasks, while large companies employ more generically skilled workers.

Figure 14: Importance of internal barriers for SME internationalisation, average score from 1 (unimportant) to 5 (very important), 2009



Notes: N=221

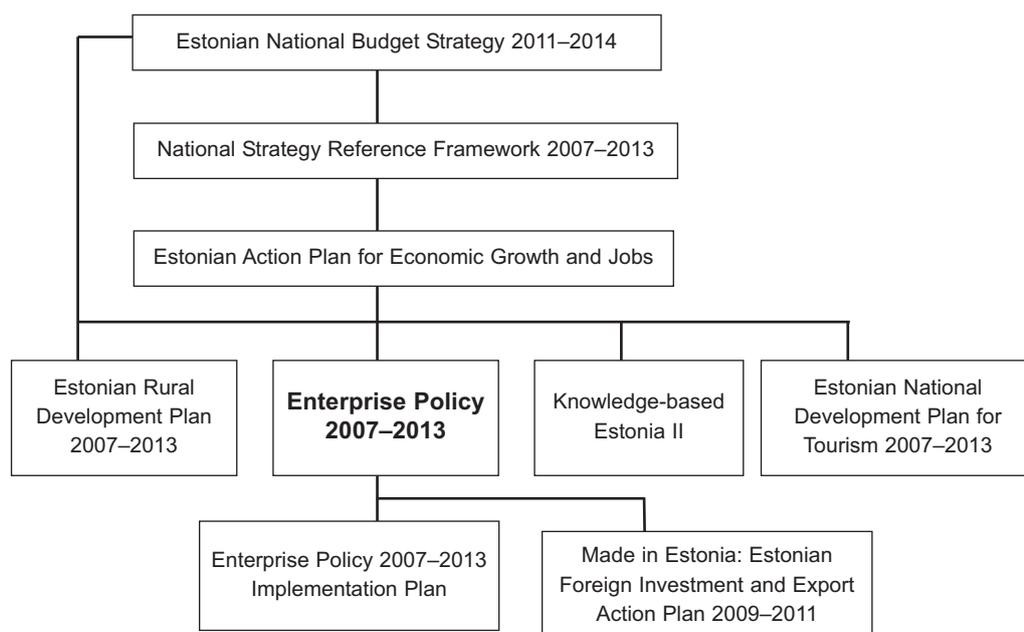
Source: EIM/GDCC Survey, 2009

Business support from public and private sources

Supply

There are some policy support measures for SMEs, although they are not explicitly targeted and are therefore somewhat piecemeal. The key organisations involved here include MKM which makes policy, and the public agencies Enterprise Estonia (EAS) and the Credit and Export Guarantee Fund (KredEx) which implement policy support programmes. MKM runs a general national strategy for the support of entrepreneurship and the knowledge based economy, Enterprise Policy 2007–2013 (Figure 15).⁹ At the same time, there is an action plan for supporting the development of exports and foreign investments ‘Estonian Foreign Investment and Export Action Plan 2009–2011, Made in Estonia’ (Ministry of Economic Affairs and Communication, 2009). An innovation policy document (‘Knowledge-based Estonia II’) outlines the key targets (Ministry of Education and Research, 2007). Access to finance, an important issue for micro enterprises, is not particularly well covered, although KredEx offers several loan and guarantee instruments for export-oriented enterprises with high growth potential.¹⁰

Figure 15: Links between enterprise policy and other national strategies and development plans



Source: Ministry of Economic Affairs and Communication, 2011

⁹ In 2002 MKM implemented a policy designed specifically for SMEs (Enterprising Estonia: National Policy for the Development of Small and Medium-sized Enterprises in Estonia in 2001–2006), although this was not renewed in subsequent years, being replaced instead by the more general Enterprise Policy 2007–2013.

¹⁰ See <http://www.kredex.ee>

EAS, as the policy implementing body, has long had objectives to promote entrepreneurship, to create new jobs and to enhance the competitiveness of Estonian enterprises. It does so through a number of support programmes, such as the:

- start-up and development grant;
- product development grant;
- competence centre grant;
- innovation voucher grant;
- export marketing grant.

In 2010–2011, EAS organised four contests for projects aimed at business development, raising business awareness and creating positive attitudes towards entrepreneurship (SBA, 2010). Nearly all of the EAS grants are cofinanced by various European development funds. Indeed, Estonian entrepreneurial policy is based on the distribution of supports from the European Union, but the state does not invest money in enterprises from its own revenues. In 2010 money from the European Union constituted 90% of enterprise supports (National Audit Office of Estonia, 2010). The recent recession did not really change the policy stance towards SMEs, although it did introduce some extra business support measures. The main problem was access to funding and thus the state support package focused on measures aimed at facilitating this. The measures were targeted at exporters, as promoting exports is considered crucial for Estonia's economic survival. The limits for export guarantees and business loan guarantees in the support package were increased by approximately €128 million and €45 million respectively. Three new measures were introduced:

- a subordinated loan with interest depending on the success of the enterprise;
- a credit line;
- a project-based loan facility for banks (Ministry of Economic Affairs and Communications, 2011).

However, the extent to which these support measures benefit SMEs, especially smaller ones, is debateable given the theoretical increase in competition this creates. Furthermore, the support package developed during the crisis was targeted at enterprises which were already exporting and had considerable growth potential, thus excluding the smaller domestic oriented enterprises.

In August 2009, EAS introduced a measure specifically targeted at micro and small enterprises: support for training in micro and small companies. The aim was to increase their competitiveness by enabling better access to training services. The support covered job-related training expenses to a maximum of EEK 15,000 (about €959) per company. Although this measure proved successful, it ended in August 2010.

Major problems with these support policies include their:

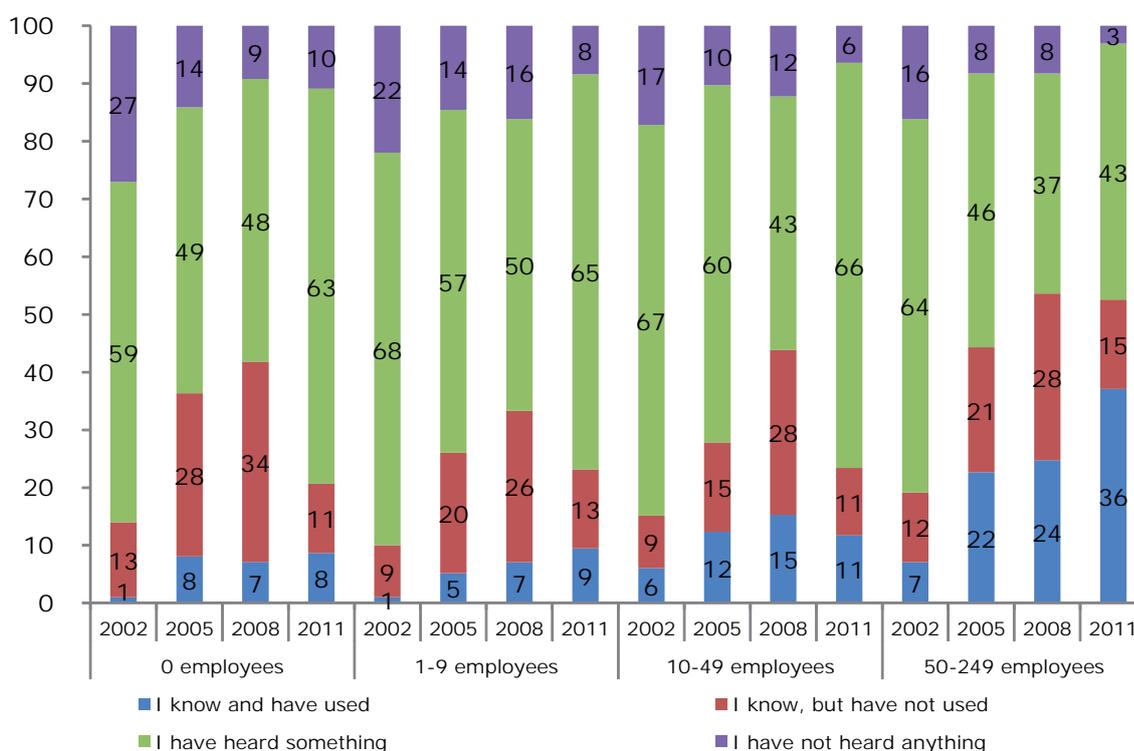
- relative lack of ex-post analyses;
- description of rationale;
- independent external evaluation;
- transparency.

It is hardly surprising, therefore, that the SMEs have such little knowledge of available support policies. Some studies have attempted to assess the results of measures implemented for SME and entrepreneurship support policies (Jürgenson et al., 2003; Kuusk and Jürgenson, 2007, National Audit Office of Estonia, 2010), although these are still far from being widespread, and many of the recommendations are yet to be taken up by MKM. Significantly, the National Audit Office of Estonia concluded in 2010 that the business support measures have not improved competitiveness in the field in to which they are applied.

Demand for public support from firms and/or employees affected

The national SME surveys show that, although enterprises have become much more informed about enterprise support programmes, awareness of these is still relatively low. In 2002, between 9% and 13% of respondents had heard something about public support measures (but not used them), while by 2011 it had risen to 11%–15% (see Figure 16). Furthermore, the level of enterprises which had not heard anything about support measures decreased from between 27%–16% in 2002 to 10%–3% by 2011. At the same time, the number of enterprises who use available support has also increased. In 2002 only 1% of micro enterprises and 7% of medium-sized enterprises used support, rising to 8% and 36% in 2011 respectively. This would seem to highlight a positive relationship between enterprise size and the use of support. Possible reasons why larger enterprises are more active in using support may be that bigger companies acknowledge their more acute need for the support; and can also afford to devote more resources to searching for it, whereas smaller companies are too busy with day-to-day operations (Värno, 2004).

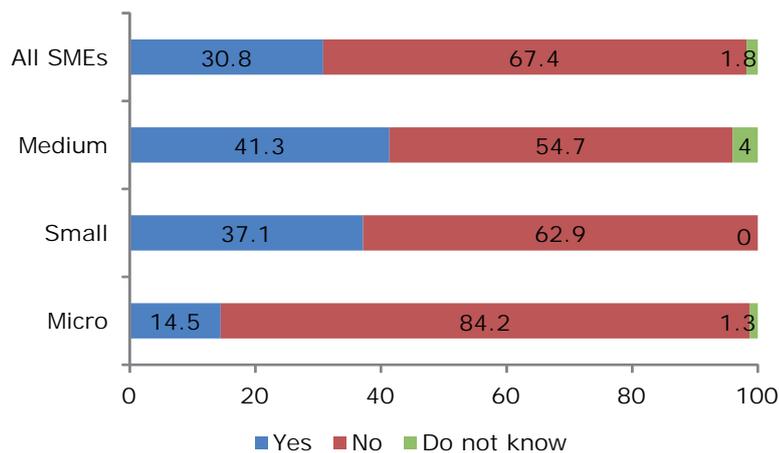
Figure 16: General knowledge of support measures in SMEs, by enterprise size (percentage of respondents), 2002–2011



Source: Emor, 2003; Saar Poll, 2005, 2008; Kaarna et al., 2012

The EIM/GDCC Survey (2009) found a clear positive relationship for Estonia between awareness of support for internationalisation and enterprise size, with 30.8% of SMEs showing some knowledge of existence, ranging from 14.5% in micro enterprises to 41.3% in medium-sized enterprises (see Figure 17).¹¹

Figure 17: Percentage of SMEs aware of public support instruments for internationalisation that could be used by their enterprise, 2009



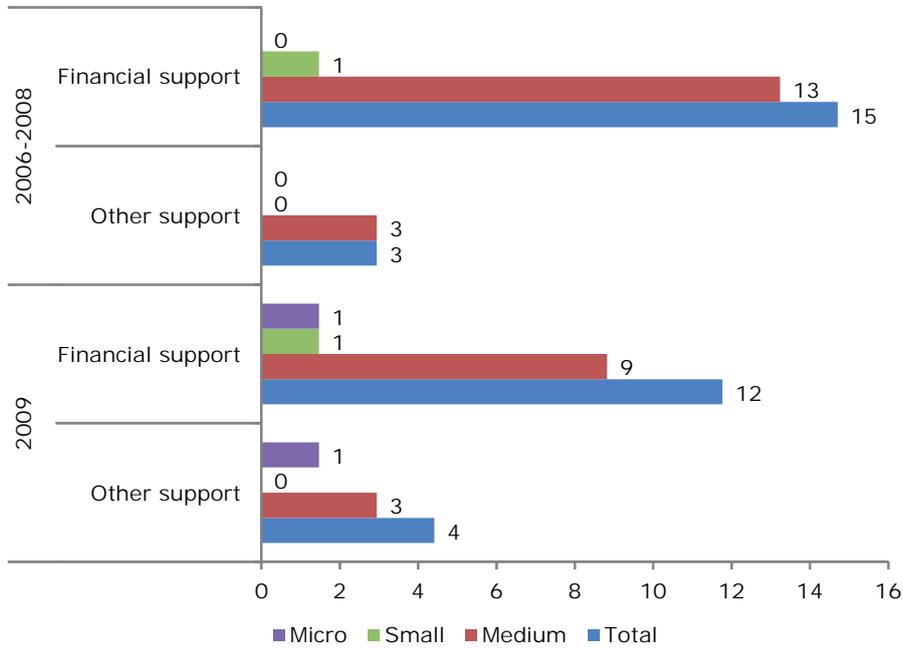
Source: EIM/GDCC Survey, 2009

A consequence of this lack of knowledge is that there has not been much uptake of the available support measures. These findings have been consistently confirmed in subsequent surveys. The EIM/GDCC Survey (2009) found that, in Estonia, only 14.7% of SMEs used the available support instruments in 2006-2008, dropping to 11.8% by 2009 (see Figure 18). There seems to be a greater preference for financial support than other government support across all sizes of enterprise, which would highlight access to finance as a major barrier to restructuring.¹² Micro enterprises barely considered using any support measures for internationalisation. However, this low level may be partially attributed to the Estonian trait of strong reliance on market mechanisms and self-reliance, especially by and within small enterprises.

¹¹ Värno (2004, p. 624) similarly found a negative relationship for the share of companies who have not heard anything about state support programmes.

¹² As Selliov (2004) notes, there is a strong dependence between access to finance and technological development, as many SMEs require extra funds in order to develop their products.

Figure 18: Percentage of SMEs that used government support instruments for internationalisation, by enterprise size, 2006–2009



Source: EIM/GDCC Survey, 2009

Outcome of restructuring events

It is difficult to provide any general information on the outcomes of SME restructuring, as there is no direct research evidence available. However, the National Audit Office of Estonia (2010) undertook an evaluation of the competitiveness of enterprises which received the support measures. This provides some information as to the impact of restructuring, albeit indirectly from a policy perspective.

Organisational effects

It has been found that Estonian companies with foreign ownership have higher export shares, the highest growth in employment and higher productivity (Rozeik, 2008). It could be inferred then that enterprises which undertake internationalisation could also expect to have correspondingly high shares.

More specifically, The National Audit Office of Estonia (2010) found that the EAS support measures designed to increase the level of exports had a significant effect on 57.6% of support recipients, although this level is considered reasonably low as the support measures are aimed at exporting enterprises. The growth of productivity was also the aim of all the EAS export supports but not a single measure of support has had a notable impact on the growth of productivity. Of those enterprises receiving the EAS export support, 21.2% said the impact on productivity was significant. Furthermore, those enterprises which had received support, and detected a positive impact, reported, on average, a growth in productivity twice as large as enterprises which did not detect any impact. The reason for the small impact of enterprise supports is a rigid, untargeted and dispersed system of supports which tries to deal simultaneously with many problems of entrepreneurship and very often does not consider the actual needs of enterprises.

Employment effects

SMEs theory would seem to suggest that SMEs are more reluctant to dismiss workers during restructuring, partly due to their more destructive impact. Despite this, in recent years, there has been an increasing number of redundancies and bankruptcies, precipitated by the global financial crisis.

Interestingly, it has been reported that, in the Estonian manufacturing industry, there was an increase in productivity after the economic crisis, so that not as many employees are needed in the sector compared with the period before the crisis.¹³ This would confirm that, although internal restructuring during times of economic downturn is detrimental in terms of employees, for enterprises it is worth undertaking in order to ensure long-term growth.

Despite this, the National Audit Office of Estonia (2010) found that the national support measures designed to increase the productivity of companies had the desired effect only for one-fifth of enterprises.

¹³ See http://inseneeria.eas.ee/images/stories/inseneeria_29/pdf/40-41_tootlikkus.pdf

Conclusions and policy Issues

Some general conclusions may be made regarding the restructuring of SMEs in Estonia. The prevalence of SMEs in a small country, such as Estonia, cannot be overstated. It is clear that although the profile of Estonian SMEs is heterogeneous, there are still many commonalities.

SMEs in Estonia form an extremely large share of the economy, although they are low in absolute figures compared with other EU member states, given the small size of the Estonian economy, which makes it difficult to differentiate any measures directed specifically at them. Indeed, government policy is not to single them out, but rather to encompass the whole range of enterprises. Whilst this inclusion is helpful in supporting the SME sector, it is clear that there could be a more specifically directed policy to help smaller enterprises or specific sectors.

The small size of the country plays a very large role in SME restructuring. It has pushed many SMEs to restructure, but also plays a role in the barriers to restructuring. Consequently, some types of restructuring play a marginal role or are not very relevant (such as relocation), while other types are more prevalent and important (such as internal restructuring and business expansion). Furthermore, different forms of restructuring are undertaken by different class sizes; for example bankruptcies are mostly experienced by micro enterprises.

There is a very high share of exporters within Estonian SMEs, although they are rather random. The arbitrary nature of exports, on the basis of relatively low labour costs, combined with a relative lack of other forms of internationalisation, indicates Estonia is still situated within the lower value chain positions. It is clear that, despite government policy and restructuring to increase exports, there has been very little impact on upgrading the chain position. Further innovative activities could help overcome this barrier to greater internationalisation.

The prevalence of micro enterprises in Estonia has highlighted their lack of anticipated restructuring. There is a relative lack of long-term strategic plans and understanding that SMEs need consulting for this.

Positive relationships between enterprise size and exports, desire to undertake training, business consultation and awareness of business support would indicate and reinforce the limits smaller enterprises have in effecting any restructuring. Consequently, this poses very challenging questions for the policymakers which should be addressed to ensure further growth.

Kaarna et al. (2012) made several recommendations for policymakers which are relevant to SME restructuring:

- Entrepreneurs say that one of the most important obstacles to enterprise development is the shortage of skilled labour, although official statistics say otherwise. To support the development of SMEs it is necessary to develop cooperation between the government and the private sector to alleviate problems in the labour market.
- State support measures are used mainly by medium-sized enterprises and those from the manufacturing sector. The service sector, micro and small enterprises have less access to support. In designing support measures, it should be taken into account that smaller enterprises have higher costs in obtaining grants.
- As many enterprises are not adequately capitalised, it is necessary to provide them with advice, knowledge (especially about the benefits and risks of using various financial instruments) and experience to give them the opportunity to develop.
- Entrepreneurs say one of the main factors restricting the expansion of exports is little knowledge of foreign customers' preferences. As SMEs export to neighbouring countries it is important to continue introducing more distant markets and to move their products and services to new target markets.

- The service sector accounts for over 70% of Estonian SMEs, although their readiness to export is small. Awareness should be raised in the service sector and service-based enterprises encouraged to plan first then promote the export of services.
- Availability of information about entrepreneurship is good, but it could be better, especially for micro enterprises and start-ups. More seminars, training programmes and mentoring clubs should be offered, where experienced entrepreneurs can share their experience on how to get information about new markets, customers and cooperation partners.

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