Financial Regulation and Small Businesses: Why Think Small is Critical to Simplify Regulation and Enhancing Economies

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Abstract

The regulation on financial markets and institutions has tended in the main to focus on large companies and it appears there is an assumption that the regulation is also appropriate to small businesses. The phrase trickle down comes to mind which was related to the influence on the development of international financial report standards to SMEs. This phenomenon has resulted in significant burdens to small businesses.

Key Words: *Regulation; SMEs; European Union (EU); Proportionality; Think small first*

1. SME Contribution to Economies

Small and Medium Size Business Entities (SMEs) make a significant contribution to all economies worldwide. I will use the data from the European Union (EU) by way of illustration to demonstrate SMEs economic significance to their economies [1]. The evidence suggests that the size of SME affects their nature, characteristics and needs [2]. For this reason the EU adopted the following definitions of SMEs with reference to the number of employees [3].

Table 1 presents the classification of enterprises by number of employees as defined by the European Commission (EC) (2003).

Table 1: *Classification of enterprises by number of employees.*

Enterprise category	Number of employees
Micro enterprises	Up to 10
Small enterprises	Fewer than 50
Medium sized enterprises	Fewer than 250
Large enterprises	More than 250

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These definitions with specific reference to numbers of employees are frequently used in differentiating the size of enterprises due to their economic significance. The number of entities and their value added are also used but roughly reflect similar characteristics of contribution as to these three definitions of enterprises.

The European Commission (EC) SME annual report 2024/25 in terms of number of employees within these definitions, shows that 30.1% are micro enterprises, 19.5% small and 15.5% medium of the total numbers employed in the EU. This means 65.1% of the total employed in the EU are working in SMEs leaving 34.9% being employed by large companies employing over 250 employees. Whilst other economies around the world would not reflect a similar pattern within the categories of the definition of SME as the EU SMEs in all jurisdictions SMEs make significant contributions to their economies [4].

2. Regulation and SMES

The growth in regulation has for a long time been considered a worldwide phenomenon facing business [5]. It is commonly accepted that regulation may be necessary for the achievement of desired economic and social outcomes; however, regulation does impose costs on society and individual businesses. The concept of efficient markets and the prevention of market failure in finance is a driving force for governments introducing regulations. The cost of regulation which can include the cost of governments to administer, the cost of firms to comply and a multitude of indirect costs such as lost innovation and productivity or their interrelated opportunity costs have received much attention over the years.

SMEs and particularly micro enterprises have been shown for a long time to be disproportionately affected by regulation. The following are four aspects of regulation that SMEs suffer from most identified by the Federation of Small Business (FSB) in the UK [6]:

- **Higher relative costs to large companies:** A regulation that costs £10,000 to implement hits a 5 person firm far harder that a 500 person firm.
- **Administration overload:** Reporting, certification and compliance checks consume time that is more valuable to small firms.
- **Reduced innovation:** Complex rules slow experimentation and investment.
- **Barriers to scaling:** Regulations designed for large companies can discourage small firms from growing into new markets.

The core issue is that regulation is essential, but the burden falls unevenly. It is also widely recognized that most regulation is top down; that regulation is designed for large listed companies and then applied to small businesses. Often when regulation is applied to small companies in an attempt to lessen the burden the principle of proportionality is applied. This is sometimes referred to as a trickle down effect. Whilst this approach at least recognizes the harshness of regulation on small businesses the regulation may still be burdensome vis-à-vis large companies.

3. Think Small First

Although, the term think small first had been referenced in papers in early 2000 it was unclear as to its precise meaning until the European Commission (EC) in March 2009 defined the principle:
The definition of the "think small first" principle is that it implies policy makers give full consideration to SMEs at the early policy development stage. Ideally rules impacting on business should be created from the SMEs point of view, or in other words, SMEs should be

considered by public authorities as being their "prime customers" as far as business regulation is concerned the principle relies on the fact that "one size does not fit all" but a lighter touch approach can also be beneficial to larger businesses. Conversely, rules and procedures designed for large companies create disproportionate, if not unbearable burdens for SMEs [7].

Although these principles have been articulated at various times since by the EC, in practice however, EU organizations such as SME united, an umbrella organization representing crafts, trades and SMEs and advocating for over 22 million businesses in the EU, argues that the principle is still not fully implemented: rules are often designed for large firms, with exemptions bolted on later [8].

There is also a case to recognize the various sizes of businesses with the definition of SMEs as they will differ in needs, resources and culture. The building block/bottom up approach arguably should address these differences in the development of regulation. this approach views regulation on a continuum beginning with the consideration of regulation that would be applicable to the smallest business entities first and building on these for bigger entities. In so doing it treat large businesses as an "exception" to small business "rule," rather that the inverse.

4. Some End Thoughts

Clearly, regulation is important in the world of business however, differentiation should be made as to the size of business. However, this is a major area that needs to be explored further by researchers who would add to the debate and have impact on policy.

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