

SOME ASPECTS ABOUT THE SMALL BUSINESS AND EU POLICY

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Abstract

Over the last two decades entrepreneurship and small and medium enterprises (SMEs) have emerged as the engines of economic and social development throughout the world. SMEs are now considered as important drivers behind the growth and creation of employment, economic growth and increased national and regional competitiveness in a globalised economy. Within the European Union the SME sector is seen as a major feature of the economy. SMEs are key to entrepreneurial spirit and innovation, and therefore crucial to ensuring EU competitiveness.

Key words: small business, EU policy, internationalization, EU enlargement

1. INTRODUCTION

Historically it was believed that larger firms were the dynamic forces behind economic growth. Work by Caves and Teece indicated the increasing role of large-scale enterprises in both domestic and international economies. Given that knowledge is expensive and that there are fixed costs to be faced by all firms, particularly in the area of internationalisation, it is not surprising to see large firms dominant in global markets, with SMEs at a distinct disadvantage. Despite this, entrepreneurship and the small-firm sector have emerged as major engines of economic growth and social development throughout the world.

What is critical in the newer approaches to industry evolution is the role knowledge plays and the dynamic, or flux, that occurs through this. Entry, growth, survival and the way enterprises and entire industries change over time are linked to innovation. The dynamic performances of regions and even entire economies are linked to how well the potential from innovation is used and the extent of entrepreneurial activity. There is also a two way relationship between the level of dynamism in an economy or region and innovation. Moreover, the more innovative an economy, the more likely there will be spillovers from this innovation to other firms, competitors and organizations in the supply chain. The SME sector also can be the initiator of innovation, which results in the growth of some of these companies into medium-sized or large companies, or in the innovations being purchased by large companies to improve their competitive positions.

SME sector important for economic growth:

- there are spillover effects from knowledge;
- entrepreneurship has a positive impact on economic output through increased levels of competition;
- entrepreneurship generates a greater diversity of firms and output.

More recent studies in the European framework found also that small firms were the main job creators, while it was large firms that were shedding jobs.

2. SIZE AND STRUCTURE OF EUROPEAN SMES

In the European there were approximately 19 million enterprises in 2003 providing work for almost 140 million people. There were only 40.000 large enterprises accounting for 0,2% of all enterprises. Therefore the great majority of enterprises in the Europe (99,8%) were SMEs [18].

In May 2003 the European Commission adopted new definitions of micro, small and medium-sized enterprises. This updated the thresholds of the financial ceilings for turnover

and balance sheet totals, and therefore will help this sector to get access to national and European support provisions. These new definitions came into operation on 1 January 2005 and can be seen in Table no. 1.

Table no. 1 – SME definition in the EU

Enterprise category	Employees	Turnover limit (million euro)	1996 turnover limit (million euro)	Balance sheet total (million euro)	1996 balance sheet total (million euro)
Micro	< 10	2	Not defined	2	Not defined
Small	< 50	10	7	10	5
Medium	<250	50	40	43	27

Source: European Commission, May 2003

Based on these definitions the great majority of business in Europe are micro enterprises (over 90%), with approximately half of these micro enterprises having no employees at all (that is, they consist of one self-employed individual).

The role of SMEs in exporting is less than large organisations (with more than 250 employees). European enterprises export an average of 17% of turnover, with micro enterprises having the lowest share of turnover (%) and large firms the greatest at 23% [11]. However, the area of internationalisation and the SME sector will be considered later in this chapter. It is also the case that labor productivity is lower in SMEs than in large organizations. This may be explained partly by the sectorial composition of firms. For example, a larger number of smaller organizations are to be found in the retail sector, and this sector tends to exhibit lower levels of productivity. If this sectorial difference is taken into account, the productivity differences between the small and large firm sectors almost disappear, though there is a lower level of productivity in micro firms.

Also tends to be lower in the SME sector, though once again, if sectorial differences are taken into account there is little to distinguish the profitability of the small and larger organizations. Once again, however, even allowing for sectorial differences the micro-firm sector has a lower level of profitability.

3. INTERNATIONALISATION AND SMEs

During the last decade we have seen enhanced international competition both for organizations with an export focus and for those that have focused more on their domestic markets. The growth in SME internationalisation can be seen in the context of political, technological and economic changes. Through the actions of the World Trade Organization (WTO), world trade has been liberalized, while in Europe markets have become more integrated, enlarged, liberalized and deregulated. Technology has improved access to information and communication, and also the management of scattered production. More efficient and low-priced transport has also aided the growth in internationalisation by SMEs.

Although exporting has been considered one of the main forms of internationalisation, there are other forms such as importing from a foreign supplier, the development of foreign partnerships, foreign investments and cross-border clustering. There is further evidence from Piggot [14] that a presence in foreign outlet markets and the possibility of delocalising part of the value chain allow SMEs to achieve more solidarity and durability in production than SMEs that develop an international strategy based solely on exporting. In other words the value chain has become an increasingly important aspect of the internationalisation of SMEs.

An ENSR [10] study indicates that 18% of SMEs had a foreign supplier as their only form of internationalisation, with a further 12% having imports in combination with exports, or foreign subsidiaries. Six per cent of SMEs were only involved in exporting, and just over 60 per cent had not internationalised. More firms had both import and export activities than only

exported, which suggests that having a foreign supplier somehow improves export-related activities. The level of export activity is also likely to have been understated since the ENSR study does not include indirect exporting, that is, where a domestic organization contracts with another domestic organization which then sells the product abroad.

While only 3% of SMEs noted that they had subsidiaries, branches or joint ventures abroad, the numbers were growing at a faster rate than for large enterprises. [8] Almost a third of those SMEs with subsidiaries abroad had no exports. Subsidiaries were therefore used not just as sales platforms but as a means of accessing cheaper labour via sub-suppliers or accessing knowledge and technology. In other words some SMEs are using subsidiaries as a way of improving their competitiveness and enhancing their value chains.

4. EUROPEAN POLICY TOWARDS SMEs

Encouraging entrepreneurship is seen to be central to creating jobs and improving competitiveness and economic growth throughout Europe. Thus the European Union has sought to support the SME sector in a number of ways. One of its first priorities has been to expand its knowledge of SMEs by improving the collection of statistics, since without knowing the size and distribution of SMEs within the European Union the Commission would be unable to estimate the knock-on effects of any policy changes and the cost of policy initiatives [9]. It is also acknowledged that SMEs have been affected by both direct and indirect policy initiatives, and these can come through what was initially a number of policy areas. Therefore in January 2000 the whole range of policies relating to the SME sector became the responsibility of the Enterprise Directorate-General (DG), which combines the previous directorates of Industry, SME and Information Society. Although the policy areas that affect SMEs are numerous, they can be divided into direct and indirect measures, and the following sections give a flavour of these.

One aspect of the changes in competition policy, such as the use of state aid, has been to reorientate state aid from sectorial and regional issues to policy decisions that have a more horizontal objective, such as the support provided to different-sized firms, including the promotion of SMEs. This objective was first endorsed by the Lisbon European Council in 2000, and reinforced at the Stockholm European Council in March 2001 and again at the Barcelona European Council in March 2002.

There has been block exemption for SMEs in state aid provision. This allows investment aid to be given to SMEs (15% of the total investment costs for small enterprises and 7,5% for medium-sized enterprises). SMEs can be aided with up to 50 per cent of eligible costs for consultancy and the same figure for costs associated with the participation in fairs and exhibitions. The European Union has also allowed governments to give risk capital to SMEs, and this is differentiated from state aid. The reasoning behind these approaches can be related to the special difficulties SMEs face with raising finance, networking and affording advice. [11]

SMEs have also been affected by employment and social policies. The employment guidelines in the European Union following from the Treaty of Amsterdam 1997 were based on four pillars: employability, entrepreneurship, adaptability and equal opportunities for men and women. The second pillar, on entrepreneurship, focused on the way jobs can be created. It concentrated on the ways businesses might be able to start up and grow. The *Joint Employment Report* (European Commission, 2002) considered member states initiatives to improve entrepreneurship, with measures to facilitate business registration, encourage self-employment and to develop an entrepreneurial culture, particularly among women.

In the area of corporate responsibility, the changes were driven initially by large businesses, but this is increasing seen as being relevant for SMEs. A project entitled 'Responsible Entrepreneurship for SMEs' (European Commission, 2002) was begun to consider the extent to which SMEs were involved in socially and environmentally responsible practices.

In the area of environmental policy, the European Commission launched a best practice project to determine the member states' best initiatives to promote environmental management

systems (EMSs) in SMEs. The tools of the sixth Environmental Action Programme 2001 -2010 have been specifically tailored to the needs of SMEs. SMEs have also been the main beneficiary of the Financial Instrument for the Environment (LIFE) programme. This financial support has a specific objective to contribute to the development of innovative and integrated techniques and methods, and to the further development of Community environmental policy, through the co-financing of demonstration projects (Infobase Europe Factsheet 2004).

Energy policy has impinged on SMEs in a number of ways. The most direct way has been through the improvement in the conditions for competition in the energy markets, making energy available at competitive prices. The adoption of the directive on energy performance on buildings is likely to lead to job creation in the SME sector, through the certification and installation of more energy-efficient equipment. The ALTENER programme to promote renewable energy and SAVE to develop energy efficiency both benefit some SMEs greatly, since the renewable energy industry is mainly made up of SMEs (European Commission 2003).

As of March 2005 the Working Time Directive applies to further aspects of the transport industry. This has imposed restrictions on the working time of employed drivers. Self-employed drivers, who comprise a large part of the road transport sector, are affected but for SMEs there is a delay in bringing in the directive until 2009. The development of the Trans-European Network (TEN), whose guidelines were adopted in 1995, has seen approximately €16-20 billion invested every year. Contracts have gone to SMEs for a significant part of the programme in the area of the extension of road, rail, seaport and inland waterways. The TEN will also improve infrastructure links that will aid the performance of SMEs (European Commission 2003).

SMEs have further received support from EU structural funds. Around 11 per cent of the total structural funds have helped this sector, and this is due to rise to 20 per cent between 2000 and 2006. In member states where regions have been given objective 1 status, SMEs have also benefited from this funding. For example, in Belgium about a quarter of the funding goes to SMEs, and in a number of countries such as Italy and France funding has been used to develop advisory services (European Commission, 2003).

The European Union has sought to develop entrepreneurship skills among its citizens. It has attempted to benchmark a range of European entrepreneurship training curricula, particularly concerning entrepreneurship among women and ethnic minorities. This has been financed in part through the various Leonardo da Vinci and Socrates support programmes. In this way the European Union hoped to improve the rates of start-up and development of new businesses.

The European Union has also been concerned more directly with start-ups. The difficulties experienced with starting up a business can constrain entrepreneurship. Following on from the Lisbon European Council a series of best practice exercises were undertaken within member states to explore ways of reducing the delays facing start-ups.

The European Union has also sought to improve the skills and competitiveness of the SME workforce. SMEs play an important part in lifelong learning, and a key role in EU competitiveness and employment, yet they undertake less training than large firms. An ambitious set of goals for training and education systems has been agreed and should be reached by 2010 (European Commission 2003). In addition the European Union has sought to address some of the financial matters that face SMEs. A Risk Capital Action Plan has been developed, and a code of conduct for banks and SMEs is in preparation. Work on best practices in micro lending is under way and a benchmarking exercise of business angel policies in member states has been undertaken (Europa 2002). With respect to financial problems, developments in the internal market have improved the framework for cross-border payments and there have been further developments to help late payment. Furthermore a benchmarking exercise of business angel policies was undertaken in 2002, and a pan-European database of investment opportunities has been established.

A number of financial instruments managed by the European Investment Fund (EIF) have been operational since the beginning of 2002. These are the start-up scheme, the SME Guarantee Facility and the Seed Capital Action. In addition to these instruments there has been work on the financing of innovation, and the technological capacity of SMEs has been strengthened. The sixth Framework Programme for Research and Technological Development also attaches great importance to the participation of SMEs.

To overcome the barriers that some SMEs have with ICT and e-business, the Europe Action Plan has been developed to highlight the actions necessary in relation to legislation, e-skills, inter-operability, and trust and confidence that have constrained the SME sector. Finally, to help the SME sector to get the highest-quality business support services, a best procedure project was carried out in the early part of the millennium to study the support services for micro, small and sole-proprietor businesses. The Support Measures and Initiatives (SMIE) databases are an important reference tool on business support measures for SMEs and good practice in this area.

Therefore both directly and indirectly the European Union has sought to develop and remove the barriers faced by the SME sector, the main creator of jobs in the region (European Commission, 2003). The removal of a number of these barriers may also be apposite as the European Union's SME sector faces a new challenge and a range of opportunities from the EU enlargement process.

5. SOME ASPECTS ABOUT EU ENLARGEMENT AND SMEs

The impact of EU enlargement has implications for SMEs both in the EU21 and those in the new accession countries following 1 May 2004. The enlargement process has resulted in the removal of many barriers to the flow of goods, services, capital and labour, and also provided new market opportunities, increased competition in domestic markets, and permitted access to new sources of inputs, especially low-cost labour, as the case study below indicates.

The impact of the enlargement process is however felt unequally by SMEs. It is likely to be larger in the new entrant countries than in the original EU21, and also likely to vary by sector and region. For example the SMEs in the new entrant countries are likely to benefit more through increased export opportunities to the EU21 as markets are opened up. This flow will greatly exceed the flow from the SMEs in the original EU21 to the markets in the new entrant countries. The sectors that are already benefiting are those where liberalisation of trade rules have taken place, and thus SMEs in the manufacturing and wholesale sectors are expected to be the main beneficiaries from enlargement, particularly in the new entrant countries. Even in these two sectors evidence from the European Observatory (2007) suggests that medium-sized enterprises should benefit more than small enterprises, with their increased export flows.

Over time these two sectors and others can expect to lose their relative wage cost advantages as real wages increase in the new entrant countries. However, to compensate for real wage increases, the SMEs in the new entrant countries can expect to benefit from catch-up in the areas of productivity and technology use. This may greatly favor medium and high-technology SMEs. SMEs in bordering regions may also be expected to benefit more than SMEs in other areas of the European Union (ENSR 2007).

The growth in trade that will be experienced by SMEs and large companies in both the EU21 and the new member countries will open up new opportunities for transport companies in the newly enlarged Europe. SMEs in the new entrant countries might benefit from the cabotage liberalisation that has taken place in the EU21, but at the same time transport companies in the new entrant countries will now have to adhere to EU21 standards and therefore they might lose some of their cost advantages [1].

For the construction sector, SMEs in the new entrants are expected to benefit from infrastructure developments in these countries, while the SMEs in the original EU21 can be expected to benefit from access to a greater quantity of resources as well as cheaper resources. As

integration proceeds it might be expected that cross-border construction services will be provided, and this will increase competition particularly for those SMEs in border regions and those that use low levels of technology [1].

The move to market-based economies and the increased requirements of data on marketing, legal advice and translation are likely to improve the demand for professional business services. Information technology services are required to develop and modernise the infrastructure in the new member countries, and there is increased demand for civil engineering services and recycling. The evidence from the European Observatory again indicates that the SMEs rather than the micro industries in the EU27 are likely to benefit more from enlargement in this area, since size appears to be a crucial factor in gaining contracts.

One problem for SMEs in the new entrant countries is that meeting the *acquis communautaire* can be costly, and the cost burden may threaten the existence of some SMEs. The compliance burden associated with the *acquis communautaire* is also more heavily weighted on smaller firms.

Larger companies in the new member states are better prepared and informed. In the lead-up to enlargement there was a major shift in the foreign direct investment (FDI) entering the new member states (Fallon, Cook and Jones 2004). This represented a range of new clients for these countries' SMEs through the supply chain networks, and some SMEs may have benefited through improved transfer of technology and the transfer of management skills. Conversely foreign companies increase the competitive environment in the new member countries and may drive some of these countries' existing SMEs out of the market.

For their part SMEs in the EU27 were hoping that the enlargement process would lead to an improvement in the level of, and skills of, their work forces. Conversely, some SMEs in the new member countries were concerned about the loss of some of their best-skilled workers, particularly those in border regions.

Enlargement of the European Union therefore provides both opportunities and threats for SMEs in the original EU27 and the enlarged union. Their business environment has changed. The introduction of the free movement of labour and capital along with the free movement of goods and services increases market access and the availability of new resources. At the same time competition in domestic markets will increase. For some countries at least there will be more winners than losers, and various forms of SME support may have to be addressed.

6. CONCLUSION

SMEs are the most prevalent type of business unit in the developed and developing world, and their role and importance in internationalisation is increasing. It may still be that in quantity terms, large firms dominate in the field of internationalisation, yet SMEs are increasingly becoming the dynamic forces behind economic growth, by filling market niches, and being associated with supply chains and other networks. This chapter has revealed that the level of entrepreneurial activity varies between countries. The Lisbon Conference in 2002 put forward a proposal that the European Union was to be seen as one of the most dynamic areas by the year 2010, and in this context the European Union has sought to develop a range of policies which have both directly and indirectly affected the level, and development, of entrepreneurial activity within the Union.

Enlarging the Union in 2007 also provided a number of opportunities for SMEs, though it also posed a number of threats. These opportunities and threats were not likely to be equally distributed by country or by sector.

Many see the SME sector as providing a cornerstone of EU competitiveness for the future, and the European Union faces an important balancing act between encouraging SME activity through a range of support policy, allowing some derogations, and at the same time introducing a range of regulatory provisions to protect both consumers and employees.

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