

Third Annual Report

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The European Observatory for SMEs



THE EUROPEAN OBSERVATORY FOR SMEs

**Third Annual Report
Revised edition**

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FOREWORD

by Christos Papoutsis

Member of the European Commission responsible for energy, enterprise policy, commerce, tourism and co-operatives

The 'European Observatory for SMEs' annual reports provide a comprehensive, useful analysis of the situation and perspective of SMEs in the European economy, not only by their scope and structure but also by the gradual extension of their geographical coverage now encompassing most of the EEA Member States.

The contribution of SMEs to employment generation and sustainable growth in the EU is quite significant. Given the high levels of unemployment throughout Europe, SMEs will continue to play a vital role in stimulating economic recovery, and SME policy is becoming increasingly important for the creation of new employment opportunities. Successful problem-solving and policy-making in favour of the SMEs requires access to information which has not traditionally been readily available in all Member States. One of the strong points of these annual reports is their richness in quantitative and qualitative information, quite often in areas where data are scarce but vital for an effective analysis.

The third annual report, which I have pleasure in commending to you, like its predecessors is full of facts and useful information both for the entrepreneurs and those responsible for enterprise policy and small business development. Moreover, this report monitors the performance of the SMEs in various fields and examines internal market effects in key areas for the SMEs. There is disturbing evidence in this report indicating significant mismatching in the labour market where supply cannot meet the demand for skilled labour. Accordingly, the need to promote mutual consultation and joint co-ordination leading to the exchange of the 'best practices' between Member States in several fields is underlined.

The Council Resolution of 10 October 1994 gave full scope to the dynamism and innovative potential of SMEs. It also recognised that their development, and in particular their flexibility and adaptability to changing circumstances, was still being hampered by several problems and inhibited by various obstacles (externalities). Accordingly, a simple and coherent framework would be essential to a better understanding of the situation and in seeking ways for overcoming the difficulties and facing the challenges in the most effective way, building on the strengths of the SMEs. Therefore, I believe the publication of this report is timely. In a fast-changing business world, it clearly reaffirms the need to continue our commitment towards improving the business environment as well as supporting the development and adaptation of enterprises for the SMEs and the craft sector.

The European Union will endeavour to stimulate, innovate and supplement the range of existing actions in the new form of partnership as proposed under the Integrated Programme, which is an important factor in ensuring competitiveness of the SME sector. This should pave the way towards a second generation of enterprise policy. Its implementation clearly embodies major challenges as well as tangible promise for the future. I hope that the publication of this report will help towards meeting the needs on information for all those concerned with the future of SMEs and those involved in policy debates at both national and European Union level.

EXECUTIVE SUMMARY

INTRODUCTION

This is the executive summary of the Third Annual Report of the European Observatory for SMEs. The First Annual Report was published in May 1993 and concentrated on the structure of SMEs and their fields of operation. The Second Annual Report reviewed developments that affected SMEs and was published in April 1994. Both reports dealt with the twelve European Member States. In this year's report also Austria, Finland, Norway and Sweden are included, anticipating on the joining of these countries to the European Union on the first January 1995. Unfortunately Norway decided otherwise. So this Third Annual Report covers all countries of the European Economic Area, except for Iceland.

To a limited extent the structure of the Report has changed. The main part concerns the development of the SME Internal Market Monitor (SIMM). This monitor measures the effects of the completion of the internal market on SMEs. The completion of the internal market has influenced both the business performance and the business environment of SMEs. Therefore a distinction is made between information gathered on the Business Performance of SMEs (Part I) and information collected on the Business Environment of SMEs (Part II). The theme studies of this year's report (Part III) concern Administrative Burdens on SMEs and the Producer Services sector. Some of the information included in the last year's theme study on craft trades has been updated. In the last part (Part IV) conclusions are presented. This consists of the main results of the SIMM and an overview of the policy issues resulting from the information contained in the Report.

PART I

1 ECONOMIC GROWTH OF SMEs AND SECTORAL DEVELOPMENT

The size-class pattern of economic growth

Economic development in Europe-16 during the period 1988-1995 can be subdivided into a period of growth (1988-1990), a period of stagnation (1990-1993), and a recovery (1994-1995). In spite of differences in their overall growth rates, EU-12 and EFTA-4 show the same sectoral and size-class patterns of economic growth.

It appears that each stage of the business cycle has a different impact on SMEs and LSEs. The world wide economic stagnation hit the export oriented LSE-sector first, while SMEs were affected after a time lag. During the period of recovery the opposite process occurs. Because the recovery is strongly export led, LSEs have benefited first. From 1994 onwards, however, the increased industrial and consumer confidence has had a stimulating impact on economic growth. Domestic demand, however, is increasing only slightly because of moderate growth in real incomes.

The economic stagnation severely hit the labour market. The total number of private sector jobs in Europe was roughly similar in 1988 and 1995, but there has been an in-

crease in labour productivity. In the period 1988-1990 annual employment growth in SMEs was over 2%, while employment in LSEs increased only marginally. Employment in SMEs decreased by 1% annually, and in LSEs by almost 2%. During the initial stages of the economic recovery, employment growth recovered in LSEs first, followed after a time by SMEs. For SMEs especially, the process of job creation is expected to be slow due to over-capacity.

During the period 1988-1990 the number of enterprises increased strongly. The most rapidly expanding sectors were the wholesale trades, transport and communications, and producer services. In most countries the growth in the number of enterprises slowed down during the recession. During the period of economic stagnation the unfavourable economic conditions had a negative impact on the creation of new firms and also led to an increased closure rate amongst enterprises.

In the 1988-1995 period labour productivity of SMEs has increased by 2% annually, but productivity growth has accelerated since 1990. During the recession and the recovery greater international competition has forced both SMEs and LSEs to increase their efficiency. Increased labour productivity, together with only modest growth of wages, has resulted in a decrease in real unit labour costs, and this improved profitability.

Sectoral characteristics

The sectors with a relatively large average enterprise size are extraction, manufacturing, and, to a lesser extent, transport and communications. In construction and most service sectors the average enterprise size in Europe-16 is below the overall average of 6 employees. Generally, a positive correlation between capital intensity of production and enterprise size seems to exist. This can be explained by the fact that higher capital intensity gives rise to increasing economies of scale and to barriers to entry.

A small average enterprise size amongst SMEs in an industry corresponds with a high relative labour productivity amongst the SMEs in that industry. For example, in most sectors in trade and services SMEs have the highest labour productivity, while, conversely, in extraction and manufacturing, LSEs generally have the higher labour productivity. Therefore, the distribution of SMEs and LSEs over the sectors of industry appear to be efficient from a macro-economic point of view.

Over the 1988-1995 period growth rates have been highest in the export oriented sectors: extraction, manufacturing, and transport and communications. This holds for both SMEs and LSEs. This emphasises the importance of international integration and specialisation for economic growth. Construction, the retail trades, and personal services, which are highly dependent on domestic markets, achieved the lowest growth rates. Within most sectors SMEs experienced higher growth rates in value added than did LSEs. Only in manufacturing were LSEs more successful on this measure.

It is striking that sectoral differences in employment growth only correspond to a limited extent with differences in value added growth. The tendency towards cost reduction led to a decrease in employment especially in the export oriented sectors of manufacturing, and transport and communications. In these sectors enterprises increased their value added, while they decreased their employment. Therefore, the sectors that experienced the highest value-added growth also achieved the highest growth in labour productivity.

At the sectoral level it appears that a moderate growth in unit labour costs - as a measure of competitiveness - coincides with a relatively high growth rate in value added. This holds especially for LSEs but also, to a lesser extent, for SMEs. It is hypothesised that SMEs, which are less flexible in adjusting their stock of labour to changing demand, partly maintained their competitiveness by reducing profit rates during the years considered to a greater extent than LSEs.

2 BUSINESS DYNAMICS AND ENTREPRENEURSHIP

New enterprises trends

European countries have shown important differences with regard to trends in new enterprises formation over the past five years. In general there has been a slight decline in the rate of new enterprise formation in Europe.

The largest share of new enterprises were established in the service sector.

On average, of all European start-ups, 87% survive their first year, 68% survive for at least three years, and 55% survive to the end of their fifth year. However, European countries show important differences, for example, the five year survival rate varies from 45% in Luxembourg, to 63% in Germany.

New enterprises, job generation and growth

New enterprises account for an important amount of gross job creation in most European countries, but large differences exist between countries. Furthermore, the expansion of existing enterprises is, in most countries, a more important source of job generation than start-ups.

It should be stressed that a large majority of entrepreneurs are not interested in expanding their business; only a minority have growth ambitions.

The starter's profile

Whatever the country, the typical European business starter is a man, aged 35, who has previously experienced SMEs through middle-management or as a skilled worker, his level of education is similar to the average in his country's population.

However, important differences exist between European countries, for example in the share of women and the unemployed amongst new entrepreneurs. The entrepreneur's profile also varies according to the type of activities of the enterprise started.

Motives and success factors to start and expand an enterprise

Pull motives such as self-fulfilment, the wish to be independent, and the exploitation of business opportunities seem to be the most important motives to starting a new enterprise, alongside (the risk of) unemployment, a push factor which has become increasingly important in recent years.

Although many European studies indicate that prior managerial experience, commercial knowledge, positive motivation, strong confidence, and education, are important success factors, it should be noted that the choice of business and good pre-start-up preparation seem to be at least equally important.

Obstacles and barriers to start and expand an enterprise

A lack of capital is by far the most severe obstacle to both starting and expanding an enterprise. This is followed by market related problems, inadequate business skills, and level of taxes and social contributions.

3 LABOUR

SMEs and job generation

Recently the claim that SMEs, and especially micro enterprises, create most jobs in industrialised economies has been questioned. Among others, the Organisation for Economic Co-operation and Development (OECD) has pointed to the fact that problems related to data-acquisition and data-analysis might have led to an over-estimation of job-creation by SMEs.

This chapter deals in detail with the methodological problems concerning this issue. It concludes that in some studies there may have been some over-estimation of job-creation by SMEs in the recent past, but that the statement that SMEs generally create more jobs than LSEs remains valid.

In the recent discussion on the job-creation by SMEs, a theory has been developed that a large part of the growing employment-share in SMEs is the result of deliberate strategies of LSEs seeking to reduce uncertainties through flexible production and through the out-sourcing of non-core-business activities. This chapter assesses this argument, and deals with issues of flexibility and job-quality in SMEs.

Flexibility in SMEs

Patterns of labour flexibility in SMEs have several dimensions, of which part-time work and temporary work are the most prominent. Part-time working is growing in importance in most European countries. In general, women are more likely than men to work part-time, and services are more likely to use part-time workers than manufacturing.

The enterprise size dimension to part-time working is clearly linked to the sectoral dimension. For example, while in Denmark small enterprises are typically associated with part-time working in all sectors and large enterprises with full-time working, in the Netherlands SMEs use more part-time working in some sectors, like personal services, but the reverse is true in other sectors, for example construction.

Temporary working involves a significant share of the European workforce (10% of females and 7% of males) and has been increasing in absolute and proportional terms

over the period 1987-1991. In some countries (Spain, Denmark, and Portugal) the levels of temporary working are well above the European average.

There is some evidence that large enterprises are more likely to resort to temporary contracts, but when a small enterprise does use temporary contracts, a greater proportion of its staff tends to be covered by them.

Job quality in SMEs

SMEs generally employ younger and less educated workers than LSEs, segments of the workforce which are generally employed in poorer working conditions.

Other evidence regarding the quality of jobs in SMEs points in the same direction. The evidence shows that the incidence of enterprise level health and safety organisations increases steadily with enterprise size, but concerning work accident rates, sectoral influences are more important than enterprise size.

4 REGIONAL DISPARITIES

SMEs' share in industrial employment at regional level

Confirming previous Observatory Reports, this chapter shows that SMEs, and especially micro-firms, play a significant role in employment in the European regions. Moreover, it demonstrates that strong and significant regional disparities exist within countries in the role of SMEs in industrial employment. These disparities are largely explained by the sectoral specialisation of regions, being either regions with SME dominated manufacturing sectors ('dominated' in terms of employment), or being regions with LSEs dominated manufacturing sectors.

The highest intra-national differences are found in the Netherlands, Finland, France, Spain, Portugal, and Norway. Industrial employment in Objective 1 regions is especially SME dominated compared with other intra-national regions. The pattern is not so clear for the Objective 2 regions, and is even less clear for the Objective 5 regions. Finally, the 'border effect' described in the First Annual Report is confirmed, with SMEs' shares of industrial employment showing important differences either side of European borders.

Industrial employment change by size class at regional level

Most regions have experienced heavy losses in industrial employment during the 1988 - 1992 period. However, industrial employment decline has been more acute in LSEs than in SMEs, and micro-enterprises have performed especially well.

As far as the Objective regions are concerned, in most of these industrial SMEs have shown either an increase in their employment or a smaller decrease than LSEs. This pattern is especially true of micro enterprises.

Manufacturing employment decline has been greater in the large city regions than in the regions which specialise in traditional industries.

Self-employment and new enterprises at regional level

In those countries where data is available, evidence exists of large internal disparities in the regional rates of self-employment.

Although each country has its own geographical pattern, the evidence from France, Germany, Italy, Spain, and Norway, reveals that capital and large city regions have a lower rate of self-employment. The share of self-employed is generally higher in traditionally SME dominated regions. On the other hand, regions formerly dependent on heavy industries have a low rate of self-employment. A strong presence of a wage-earning culture, together with lower qualifications in the labour force, could explain this last pattern.

Data from France and Ireland also indicates that regional differences in the creation of new enterprises are closely related to existing differences in regions' economic and cultural environments.

5 EXPORT AND INTERNATIONAL ORIENTATION

Export by countries

In all sectors the share of enterprises that export increases with the number of employees. However, data from Portugal, France, Ireland, Denmark, and France indicates that the number of exporting small enterprises is increasing. Some sectors: manufacturing industry and the wholesale trades, tend to be more export-oriented than others, but due to internationalisation this seems to be changing. Data from the United Kingdom, the Netherlands, Spain, and Portugal shows that exporting by retailers and service enterprises is increasing.

Due to the internationalisation of production the number of small, particularly innovative, enterprises that export is rising, and these enterprises enter export markets with new products very soon after launching them in the domestic market.

Export intensity

The correlation between export intensity and enterprise size class for all sectors is not very strong. However, for manufacturing enterprises export intensity does increase with the size of the enterprise. SMEs in smaller countries usually have a higher export intensity than those in larger countries, but figures for the recent years indicate that differences are narrowing.

Export strategy

There is no single export strategy amongst SMEs, exporting behaviour is typically a mixture of learning-by-doing, strategic commitments, and random factors.

The quality of the product is the main determinant in the decision to export or not, but key factors for success in export markets are the management's capabilities and direct

engagements with that market, in brief, active exporting. These characteristics are more often found in large enterprises than in small enterprises.

The export barriers for SMEs are very closely linked to the barriers for growth and development. The main internal barriers are a lack of capital, and insufficient management skills. The main external barriers are technical trade restrictions and bureaucratic procedures, marketing and distribution problems, and, in the more peripheral countries, high transportation costs and communication problems.

Public procurement

The importance of public procurement is increasing considerably, but international procurement has not increased significantly in the 1990s. In 1993 only 2% of public procurement contracts were won by foreign enterprises. Tendering abroad raises several problems for SMEs, these relate to cultural differences, language problems, an insufficient knowledge about the market, and a lack of resources for promotion activities.

European Economic Interest Grouping (EEIG)

EEIGs are an interesting new legal form for trans-national business co-operation where the enterprises remain economically and legally independent. The number of EEIGs is increasing rapidly. The greatest number are located in Belgium, France, and the Netherlands. They are, however, mainly established among medium-sized enterprises active in services and manufacturing industry.

PART II

6 MACRO-ECONOMIC DEVELOPMENT

In the early 1990s the world economy was hit by a recession. GDP growth in Europe-16 fell back from more than 3% in the late 1980s to 1% in 1992, and reached an absolute low of -0,5% in 1993. In 1994 a remarkably rapid recovery began, which is expected to continue in 1995. Booming world trade is the driving force behind the recovery. Compared with the USA, growth in the EU is lagging, but growth in the EU exceeds that in Japan. Most EU countries experienced the nadir of the recession in 1993, the only exceptions being the Anglo-Saxon countries and Denmark. The magnitude of the downturn varied considerably. The southern European countries were especially hard hit, as were Germany, France, and Belgium. Investments and private consumption were particularly depressed in the early 1990s, but in 1994 there was a clear up-turn, and in 1995 a strong increase of investments is expected, but only a modest recovery in consumption.

Although growth is accelerating within the EU, inflation has declined to 2.5% (in 1994). Differences in inflation between EU countries remain considerable, but are diminishing. Inflation is highest in southern European countries. Except for 1992, interest rates in the

EU essentially followed the German rates. Short term interest rate declined in 1993-1994, but long term rates rose.

The labour market situation in the EU is still a cause for concern. In the 1991 to 1994 period employment in the EU declined sharply due to the recession. In 1995 a modest increase in employment is predicted with a continuing over-capacity of labour within firms. Wage increases in the EU have been small in recent years. Because productivity growth was high in 1994, unit labour costs have declined sharply, and through this, the price competitiveness of EU industries has improved. In comparison with the USA and Japan unit labour costs grew fastest in the EU over the period 1988 to 1993, but in 1994 the growth was lowest in the EU.

EU currencies have shown considerable volatility in recent years, partly due to political turmoil and budgetary problems. It is expected that currency markets will remain vulnerable in 1995.

Regarding government expenditures, the six highest spending governments of Europe-16 (as a proportion of GDP) are Sweden, Denmark, the Netherlands, Belgium, Italy, and Norway (all of these spend more than 55% of GDP). On average, Europe-16 government expenditures amount to 51% of GDP, compared with 38% in the USA and 31% in Japan. Government tax and social security receipts in Europe amount to 45% of GDP, compared with 34% in the USA and Japan. The large debts that many EU governments have built up over recent decades are a cause for concern. Only six countries presently comply with the EMU-criterion of 60%-debt. In Belgium, Greece, and Italy, government debts are over 100% of GDP. On average, net government borrowing in EU-12 amounts to 6%. In 1993 the largest budget deficits were in Sweden and Greece (both had deficits of 13% of GDP). Luxembourg is the only EU country with a positive government balance.

7 RECENT POLICY DEVELOPMENTS AFFECTING SMEs

Recent developments

The purpose of this chapter is to review recent policy developments that concern SMEs in the European Union. In particular, it highlights new directions of support from national governments.

Policies designed to strengthen SMEs include assistance with innovation, product development and risk taking investments, assistance with exporting, and better access to finance. To reduce SMEs' dependence on bank finance many countries have introduced schemes to encourage formal and informal investments in SMEs.

Administrative burdens are widely recognised as falling relatively heavily on SMEs. Government SME policies in Austria, Belgium, France, Italy, and the Netherlands pay special attention to this issue. Further information on this subject is provided in chapter 14.

Efforts have been made in connection with improving the human capital in firms (for example, in Denmark, Finland, Norway, Portugal, and the United Kingdom). These are mainly in the form of management and workforce training programmes.

The establishment of information and service infrastructures that complement the internal competencies of SMEs are a particularly significant development in the support available to SMEs. These are usual regional networks of information providers designed to be accessible and to provide transparent policy support to SMEs. They are a recognition that easy access to information is a key requirement of many SMEs.

Environmental policies

In the majority of countries there have been significant advances in environmental standards and policy, however, there are still major differences between the most environmentally advanced countries, particularly the Scandinavian countries, Austria, and Germany, and the less advanced countries. Taxes and subsidies are the most commonly used environmental policy instruments.

8 LABOUR MARKETS

The labour market: an overview

High and increasing unemployment in almost all European countries indicates a high supply of labour in quantitative terms. This could lead to the conclusion that SMEs' labour needs can be easily met, however, the labour market is experiencing increasing segmentation which disrupts this pattern of general over-supply.

Skill shortages and recruitment problems

A high supply of labour in quantitative terms does not mean that enterprises have access to a satisfactory supply of labour in qualitative terms. This chapter shows that in several sectors, and in several professions, SMEs in most of the European countries have experienced both quantitative and qualitative skill shortages.

At the same time SMEs do not generally report severe problems arising from these skill shortages. For example, they have not lead to reduced production in the short run. On the other hand, these problems may hamper SMEs future competitiveness, employment growth and production in the long run.

The causes of these skill shortages may be external, for example the education system may not provide a sufficient pool of highly skilled, or appropriately skilled, labour. But skill shortages may also arise out of internal shortcomings, for instance, SMEs often pay insufficient attention to the management of their human resources, through, for example, the inadequate use of vocational training courses.

Whether high replacement rates are, or are not, a problem for SMEs to cover their labour requirements is an important current debate. Although these rates differ widely amongst European countries, there is no evidence of a correlation between a high replacement rate (unemployment benefit as a percentage of previous earnings) and the existence of recruitment problems in SMEs.

Labour market policies

Very large differences exist in the amount spent nationally on active labour market policies. Expenditures on active labour market policies as a percentage of GDP range from about 1% in Luxembourg to almost 7% in Finland.

Most of the initiatives in active labour market policies are not especially designed for SMEs, but some are of special interest to SMEs.

In all the countries, active labour market policies include training activities, but expenditures on this kind of policy are especially important in Germany and Sweden. Active policies also include wage subsidies for the employment of target groups of the unemployed, for example young people or the long-term unemployed. In Belgium, France, and Germany, these schemes are especially used by SMEs. All the countries have also implemented schemes which provide grants to unemployed people who start an enterprise.

Finally, the discussion turns to two interesting Danish and French initiatives which aim to strengthen professional competencies in SMEs.

9 CAPITAL AND FINANCE

Information gaps in the SMEs market

Banks complain that they do not get sufficient information on SMEs. General economic information is often sporadic, or inadequately detailed, but is too costly for financial institutions to collect and analyse information on this scale by themselves. SMEs are themselves rather reluctant to give detailed information to financial institutions, for confidentiality reasons, and because they are simply not able to provide high-quality information. Therefore banks are setting up their own databases and, in addition, are gathering information from specialist information services such as enterprise databases with information from annual reports of enterprises. Increasingly credit rating mechanisms are being established in the EU, but these are not particularly useful for SMEs since rating is considered as a good measure for bond issuing companies which are rare amongst SMEs. It is very important that there is a long-term relationship between the individual SMEs and their bank, so that it becomes easier for the bank to judge the financial strength and capital requirements of the SME.

The appropriateness of the credit solutions

The majority of external financing for SMEs is provided by banks. The banking system for the financing of SMEs has always been characterised by a short-term approach, with secured lending, and risk averse investments. Small enterprises usually also have to pay higher interest rates than their larger counterparts. Therefore almost all governments have implemented a broad spectrum of programmes offering SMEs support with external financing, for example, by a loan guarantee scheme, or by stimulating the establishment of mutual guarantee systems.

Equity financing

Small enterprises are traditionally very independent and are therefore very reluctant to share equity. The governments of many countries are trying to improve the availability of equity capital to SMEs, which can be done through the availability of informal as well as formal venture capital. Informal venture capital has been stimulated by, for example, avoiding double taxation. With formal venture capital, one of the major problems is that venture capital companies are primarily investing in larger enterprises, and avoid start-ups. Reasons for this are the high risk and time consuming nature of such investments, combined with the low liquidity of the new companies. Governments have tried to solve these problems; in Greece and Portugal, for example, governmental agencies make co-financing instruments available to seed and venture capitalists.

To reduce some of the problems with external equity for SMEs some countries have established second-tier stock markets. However, these experiences have generally been unsuccessful, resulting in low levels of equity, and a limited interest from investors.

Management capabilities

SMEs are not provided with enough information on the available financial instruments, but sometimes also have underdeveloped managerial capabilities with which to handle financial matters themselves. However, this situation has improved through the development of training facilities.

10 INFRASTRUCTURES

SMEs and physical infrastructures

The establishment of a real trans-European network of infrastructures represents an important objective in the light of the achievement of the Internal Market. It should have a positive impact on Europe's SMEs not only because of the sub-contracting opportunities it implies, but also because of its possible impact on their competitiveness.

Regarding the initial endowment of infrastructures in roads, railways, and telephony, it should be recalled that European countries have different problems according to their level of economic development. Whilst the less advanced countries have a clear infrastructural deficit, both in quantitative and qualitative terms, the advanced countries face problems of saturation especially in their road networks. This said, convergence is increasing in these three fields.

Attention should be paid to the fact that infrastructures are a necessary but not sufficient condition for economic development, and more particularly, for the development of SMEs. The possible negative effects of new infrastructures should also be assessed.

SMEs and communication and information technologies

The information revolution and 'information highways' already exist and will develop further in the future changing the way of life, and the working environment, across Europe.

SMEs can already gain great advantages through the opportunities offered by the new communications technologies, even if LSEs appear to be making greater use of them at the present time. It should be noted that the costs of introducing and first using these services, and weaknesses in the internal capabilities of small enterprises constitute barriers to their use by SMEs.

Nevertheless, case studies in different European countries reveal the great potential for SMEs of the new and existing communications technologies. Southern countries could benefit from the experiences that the northern countries have gained through the introduction and application of new information products and services.

Together, distance learning, tele-working, electronic tendering, and telematic networks offer numerous opportunities to SMEs. These include access to various on-line information services, the exchange of information with main contractors, and the management of bank accounts.

11 TECHNOLOGY AND INNOVATION

Contribution of SMEs to the innovative output

This chapter shows that SMEs play a major role in innovation. There is strong evidence that this is true in both high-technology and traditional industries. In traditional industries, innovative SMEs rely mainly on inputs such as technical change embodied in equipment, and the adoption of technologies developed in other sectors. Therefore, it is shown that SMEs can be innovators even though they may not undertake formal R&D activities. This changes the established image of the innovative contribution of countries such as Italy or Spain, which have large numbers of SMEs in traditional industries, but which have low national R&D expenditures as a proportion of GDP.

SMEs, innovation and the business environment

As regards business environment, case studies in several European countries support conclusions about the positive impact on innovation of geographical concentration of SMEs that belong to the same sector of industry. These, so called industrial districts, play an especially important role in the traditional industries of Italy, Spain, and Austria, and in other countries, such as the United Kingdom, science parks allow high-technology SMEs to strengthen their relationships with the scientific infrastructures. Whilst traditional industrial districts may be long-established and the result of "natural" economic processes, the phenomenon of science park is more recent and dependent on a deliberate policy intervention.

National technology policies

Most European countries have implemented policies, both at national and regional levels, which aim to stimulate innovation and the technological capabilities of SMEs. The instruments used include tax incentives, subsidies for R&D and innovation, and support

for technology transfers. France and Germany are two countries with very developed technology policies.

SMEs and European RTD programmes

European RTD programmes play an especially important role in the less-advanced countries, and are generally becoming more accessible to SMEs. However, it should be stressed that recent European RTD programmes are still more relevant to high-technology SMEs and LSEs, rather than to SMEs in traditional industries.

12 EDUCATION AND ENTREPRENEURSHIP

Education in European countries

Compared with the northern countries, the southern countries of Europe still have a lower share of their populations with a high level of education, however, this difference will probably narrow in the future as almost all the countries now offer the same education opportunities for young people.

As regards the student participation rates, the differences between countries are now largely restricted to the percentage of students in tertiary education (from 4% in Portugal to 10% in Finland). It is also at the tertiary level that gender differences exist. In general women are more involved in non-university based tertiary education, and there are more men in university based education. Furthermore men are much more involved than women in science and engineering courses.

Level of education, behaviour and performance of entrepreneurs

In all the countries for which data is available, entrepreneurs and starters show a higher level of education than the average of the labour force, but most have had no specific education in entrepreneurship.

In particular, innovative and high-technology starters are generally better educated than the average business starter.

This chapter also shows that for some sectors the survival rate of enterprises is better when the level of the entrepreneur's education is higher. This could be due to the fact that these starters tend to be better prepared.

Furthermore, positive links exist between the level of the entrepreneur's education and the growth orientation of the enterprise, its tendency to network, and its likelihood to export.

The approach of entrepreneurship in the educational system

Education has the potential to cultivate an entrepreneurial spirit, and there are good reasons why it should. First, education recognises the socio-economic importance of SMEs. Second, it acknowledges that it can stimulate entrepreneurship by developing a number

of entrepreneurial skills. Third, students and graduates show an increasing interest in entrepreneurship. Finally, co-operation with SMEs could improve the attention to entrepreneurship within the educational system.

There are however a number of barriers which must be overcome. First, education is too theoretical is not sufficiently adapted to business or SMEs. Second, education is not sufficiently multi-disciplinary in approach. Third, too little emphasis is put on the development of personal skills which are desired by businesses, and the managers of small enterprises in particular. Fourth, education in general devotes much more attention to large institutions and a wage-earner culture than SMEs or entrepreneurship. And finally, teaching staff are insufficiently familiar with entrepreneurship and SMEs.

13 LEGAL ENVIRONMENT

Legal forms

The legal forms of enterprises generally have the same broad characteristics in all European countries. Sole traders exist in most countries (except Luxembourg and Sweden) and are the legal form most frequently used by the self-employed, and amongst businesses in the retail trades and services. However, statistics on legal forms show important differences between European countries.

In particular, while sole traders are very dominant in Portugal, Spain, Greece, and Germany, limited liability companies account for a large share of businesses, including small businesses, in Sweden, Luxembourg, Norway, the United Kingdom, France, Finland, Belgium, and the Netherlands. Partnerships are very important in the United Kingdom, Italy, Finland, Austria, Greece, and to a lesser extent in Sweden, and the Netherlands, but they are not prominent in the other countries. For five countries (France, the Netherlands, Spain, Austria and Sweden) there is data on legal forms by size class. In all of these countries except for Sweden, the majority of micro-enterprises are sole traders. The share of sole traders decreases as the enterprise size class increases. Most enterprises with more than 10 employees are limited liability companies or public limited companies.

Legal form by size and sector apart, there are two areas in which important differences exist between European countries: the rate of tax on profits, and capital requirements for companies. These factors help to explain the different legal forms favoured in the different Member States. For example, it is clear that a differential between the income tax rate and the rate of corporation tax which clearly favours the latter will encourage the businesses to have limited liability status. Other important factors such as the social security system may also explain the choice for a limited liability status.

Norms

Although the implementation rates of European norms and standards are high in most countries, SMEs remain sceptical and misinformed about the harmonisation process and

the advantages it produces. It should, however, be pointed out that this process is probably most favourable to LSEs in the large advanced countries.

Quality assurance

An important share of European SMEs remain reluctant to gain quality assurance certification. SMEs are more often "pushed" into getting ISO certification than approach this in a voluntary manner. Furthermore, barriers such as the costs involved, the time required, loss of flexibility, and the many administrative burdens, raise problems for certification in SMEs. Although the cost of certification increases with enterprises size, the cost per employee is greater amongst SMEs than for large enterprises.

PART III

14 ADMINISTRATIVE BURDENS

Administrative burdens are defined as 'compulsory administrative procedures resulting from legislation that enterprises are obliged to carry out'.

In the chapter two main legislative areas are distinguished which create administrative burdens on enterprises, these are legislation relating to all enterprises (burdens for 'being an enterprise') and employment related legislation (burden for 'having employees').

The study finds that administrative burdens that arise for 'being an enterprise' cause between 60 and 70% of all administrative burdens. The areas of corporation tax, tax on dividends, revenue taxes, the annual accounts, VAT and excise levies cause the greatest share of these administrative burdens.

Administrative procedures that result from having employees cause between 30 and 40% of the total administrative burden. In particular the levying of wage tax and payment of social premiums cause most of these burdens.

Although thorough research on administrative burdens is scarce within the Member States of the EU, it has been possible to estimate the total cost to private non-primary enterprises that arise through compulsory administrative procedures. The total amount of administrative burdens on enterprises in Europe is estimated at between 3 and 4% of GDP per annum, which is between 180 and 230 billion ECU a year.

The total costs arising from compulsory administrative procedures are higher in large scale enterprises than in small and medium sized enterprises. However, the costs per employee are higher in SMEs.

At the European level as well as in individual Member States initiatives are being taken to reduce the administrative burdens on enterprises.

At European level, the most important strategies, policies, and measures to reduce administrative burdens are actions regarding the improvement of information and advice,

the replacement and simplification of existing laws, and the attention to possible administrative burdens connected to new legislation.

At national level, different strategies, policies, and measures are being used to reduce administrative burdens in different countries. For example, in Belgium and Greece the focus is on the simplification of forms and reporting requirements. In Finland and Norway the focus is on administrative procedures and the institutions which process this information. In Portugal, Sweden, and the United Kingdom, existing laws are being replaced by new laws which reduce the compulsory administrative procedures required of enterprises. And, in the Netherlands, and the United Kingdom, attention is paid to the possible administrative burdens caused by new legislation.

15 PRODUCER SERVICES

Producer services are defined as service activities whose outputs are, in the main, purchased by enterprises. These services are intermediate or auxiliary to the production processes in other industries. They include business and professional services, financial services, insurance services, and real estate services.

SMEs are involved in a highly competitive environment; the use of producer services is a crucial factor in their competitiveness by: promoting access to technological information, the development of product and process innovations, the growth of exports, and for improving market access. However, the demand for external services by SMEs is concentrated in the most mainstream services such as accounting. Amongst SMEs the demand for other producer services such as marketing, and education and training, still seems to be relatively low. An important reason for this is that managers and entrepreneurs in SMEs are often unable to identify problem areas which could benefit from the use of external services, and are unaware of the extent of the services available. Another reason may be the fact that many services have been developed to meet the requirements of large firms, and are not well designed for use by smaller enterprises.

Small firms are characterised by a high degree of internal service provision, with services often being provided by the entrepreneur himself, or informally through his personal contacts. The demand of external producer services is higher amongst medium sized enterprises, which are more capable of interacting with external providers and can more easily afford these services. Large firms can afford to tailor internal services to their specific needs, but they also develop synergies between providing routine capabilities in-house and seeking specialist external services. The degree of combined internal and external provision is therefore highest amongst large enterprises.

Producer services account for about 11% of Europe's total private non-primary employment. Within producer services business services usually have the highest share of employment. The supply of these services is dominated by SMEs in every country. However, banking and insurance are dominated by large firms.

Between 1988 and 1994 producer services have shown the highest average annual growth rate of any sector in terms of employment, a slightly below average growth rate in

terms of value added, and the lowest performance in terms of productivity. Regarding employment, micro firms in producer services showed the highest average growth rate, followed by small enterprises.

In various countries there is an extraordinary degree of concentration of producer services within the most developed regions, and the central areas with the main cities. This is partly due to the availability of supporting infrastructures, opportunities for face to face contacts, the availability of qualified personnel, and to the prestige of being located in the central areas. However, the areas that are gaining the greatest increase in producer services are often those just outside the major agglomerations, where congestion and rents are lower, but which remain within easy reach of the client base.

There does not seem to be an explicit public policy toward the development of these service activities in any country, but several programmes have stimulated both the supply and demand of these services. Public authorities are also designing new policy schemes which, through the development of technology and service provision, aim to improve the quality of the local environment in which SMEs operate.

16 CRAFT TRADES

Characteristics

Craft enterprises are characterised by a high labour intensity in production, and being small scale but with a relatively high proportion of highly skilled workers. They are mainly independent in status, with combined ownership and management, and there are usually close links between the enterprise and the family.

Importance

At the European and national levels the importance of the craft sector is becoming increasingly recognised as a factor in economic stability, as the foundation of vocational skills, and as a source of new entrepreneurship. However, the amount of attention paid to the craft sector differs between the Member States. This is one of the reasons for the diversity in available statistical data. Even in countries in which great attention is paid to crafts, and in which crafts are legally defined, statistical data on crafts may be scarce as the definition is often profession-oriented, while genuine economic statistics are sector-oriented.

Towards a common concept

To make European-wide statistical monitoring possible, steps are being taken to develop comparable statistics for the Member States. In the Second Annual Report of the European Observatory for SMEs a first attempt was made to develop a common delineation of Craft Dominated Sectors which would allow sensible cross country comparisons. Indeed, this non-comparability of national craft statistics became a prominent issue during the preparation for the Berlin Crafts Conference. The European Commission organised a pre-conference on craft statistics in June 1994 in Göttingen and a preparatory confer-

ence on craft definitions and statistics in September 1994 in Rome. Finally, at the Berlin-conference in September 1994 it was concluded that the development of comparable statistics on the craft trades should be pursued in the near future.

Craft trades and the Berlin Conference

Conclusions from the twelve pre-conferences, which preceded the Berlin Conference, resulted in the 'Outline of the Twelve Pre-Conferences', on which the European Commission drew the working paper: 'Craft Industries and Small Businesses'. Subjects of major interest to the craft trades and small businesses were discussed, problems were listed, and recommendations made.

Towards an adequate policy

Since the first Conference on Crafts in Avignon the European Commission has proposed the Integrated Programme in favour of SMEs and the Craft Sector with new approaches targeted at mutual consultations and the exchange of experiences between the Member States, and collective efforts between them to improve the business environment for enterprises. However, the means at the disposal of crafts and small enterprises, in terms of information, financing, or training remain insufficient to allow them to fully benefit from existing actions and programmes. The Second Annual Report of the European Observatory for SMEs set out the problems and made recommendations. The Berlin Conference did the same later on.

The main points of the Second Annual Report and the Berlin Conference were similar, recognising the general problems that confront small and craft enterprises. Both called for:

- a common European identity of crafts and small enterprises, and the need to enhance the knowledge of the role and the economic importance of the craft sector through detailed studies and sectoral analysis;
- a sensible training policy, attuned to business practice with post-apprenticeship training and the international exchange of experiences and trainees;
- harmonising regulations, taxes, and administrative and social obligations;
- easier accessibility to finance, with similar conditions in all Member States;
- the stimulation of trade associations for greater co-operation at the national and international levels.

PART IV

17 SME INTERNAL MARKET MONITOR

In the 1988-94 period employment growth in SMEs, although favourable in comparison with LSEs, was disappointing given that value added in SMEs grew substantially more rapidly than employment. Indeed, value added growth in SMEs has been productivity

led, giving rise to the observation that, although there certainly has not been a jobless growth in SMEs, growth in SMEs has been job-extensive.

The analysis of the SME Internal Market Monitor (SIMM) pointed to the fact that this job-extensive growth can - partially - be explained by two factors, being the unsuitability of mainstream labour market policies, forcing entrepreneurs to 'choose' a labour-extensive growth-path given current recruitment problems and the fact that SMEs more and more are playing on global and exposed markets rather than on domestic and sheltered markets.

SIMM points to the fact that, in general, the business environment in which SMEs have to operate is converging in the EU-12. Concerning government policies, fiscal and monetary policies are converging; labour market policies in the Union are diverging. Regarding general market conditions in the EU-12, the strength and prosperity of the Member States have converged over the 1988-94 period, as have the conditions in the capital and labour markets, and domestic efforts related to technology and innovation.

The dynamics of SMEs have also been converging, as has profitability, but the performance of SMEs (in terms of value added, employment, and exports), has diverged over the 1988-94 period. This is mainly due to the deviant behaviour of SMEs in Italy and the United Kingdom.

In general the business environment, business dynamics, and SME-performance in the EFTA-4 countries has become increasingly similar to the EU-12 over the 1988-94 period. The distance between the EU-12 and the EFTA-4 countries nevertheless remains substantial.

In SIMM some analyses have been carried out to explain SME-performance in terms of the business environment, thereby extending the practical utility of SIMM to policy-makers.

The analysis suggests that government policies, especially fiscal and monetary policies, have a definite role in stimulating SME-performance, current labour market policies are not well suited to the needs of SMEs, and government R&D policies seem to be almost entirely geared to the large scale enterprise sector. These may even crowd out small scale modes of production.

The industrial relations indicators did not influence SME-performance.

Finally, SIMM provides some preliminary conclusions on the development of the quality of the business environment, from the viewpoint of SMEs, and on the convergence of the EU-12. An assessment of the business environment concluded that this has improved in the 1988-94 period, at least for SME-performance, and there is also evidence that the convergence of the business environment in the Member States of the European Union has had a positive effect on SME-performance.

In the previous reports much attention was devoted to policy recommendations aimed at stimulating the growth of SMEs and craft trades, and to the creation of jobs. In this report the policy issues refer to the basic relationships between SME performance, the functioning of markets, and the business environment of the more unified Europe.

These policy issues refer principally to the European level of policy, however, they may be useful for national and regional policy approaches as well.

Competition in markets seems to differ widely by sector and by country, as can be seen from entry, exit, and survival rates. These differences in competition, or the functioning of markets, both affect, and are affected by, the economic position of SMEs.

The process of cross border trade deregulation has been followed by a strong tendency to deregulate markets more thoroughly, both at the national level, and at the European level.

These deregulation policies, which aim to remove rigidities in business operations, are primarily focused on the better functioning of markets. It is expected that by creating more competition in local, national, and international markets, the enterprise sector will become more competitive in world markets. Consequently this will lead to more business opportunities, and the creation of jobs.

A well balanced strategy for the design of policies in the area of deregulation and competition policy should be sought.

Conflicting features of these policies which lead to reduced entry barriers on one hand, but also to business strategies geared to the formation of larger entities on the other, should be well considered within the overall aim of having markets function optimally. Policy strategies should be stimulated to lower the artificial entry barriers that have been created by governments in an attempt to protect existing firms rather than to optimise the functioning of markets.

Referring to creating a more favourable business environment in which SMEs can start, survive, and grow (and thus create jobs), more policy attention should be devoted to the legal framework in which SMEs have to operate, the availability and use of modern infrastructures, the administrative burdens on them, the availability and use of producer services, and the supply of management and entrepreneurial training.

A special policy trajectory should be developed to focus on the issue of administrative procedures and their impact on business. The development of appropriate strategies for reducing the impact of administrative procedures on enterprises, and in particular the micro, small and medium-sized businesses, is advocated. More concerted action should be taken through the exchange of experiences gained in individual Member States.

Instruments to improve this situation include the development of an objective and comparable Administrative Burden Indicator. Such an indicator could be used as a target to be applied by policy makers in the design of new policies.

The use of new technologies such as EDI, and considering the use of relatively new organisational concepts for the collection of social premiums, for example, should be stimulated to help combat the burden of administrative procedures.

INTRODUCTION

GENERAL

This is the Third Annual Report of the European Observatory for SMEs. The project was established in 1992 by the Directorate-General XXIII (Enterprise Policy, Distributive Trades, Tourism and Co-operatives) of the Commission of the European Communities. A major objective of the Observatory is to provide the Commission with structured information for its policy making activity in relation to SMEs, including the craft sector. The official 'Communication' of the European Commission following the Second Annual Report (COM (94) 352 final) stated that 'the Observatory can surely act, by means of its future reports, as one of the most important analytical sources on which are to be considered practical proposals for implementation of the Integrated Programme in favour of SMEs and the Craft sector'. Besides this, the information should also be of value to national governments, and to intermediary organisations in the business sector.

The aim of the project is to prepare *an independent annual report* which gives a structured overview of European SMEs and the craft trades, in both quantitative and qualitative terms.

The First Annual Report was published in May 1993 and concentrated on the *structure* of SMEs and their fields of operation. The Second Annual Report reviewed *developments* that affected SMEs, and was published in April 1994. This Third Annual Report also reviews *developments* that relate to SMEs, and in particular that have arisen through the completion of the internal market. This report also contains theme studies on the Administrative Burdens on SMEs and on the Producer Services sector.

ORGANISATION

This report has been produced by the European Network for SME Research (ENSR) and was co-ordinated by the main contractor, EIM Small Business Research and Consultancy in the Netherlands. The ENSR is a network, covering all the European Union's Member States and Norway, of leading organisations that specialise in SME research. In 1994 the ENSR-Network was extended to include partners from Austria, Finland, Norway and Sweden. Names and details of the partner organisations are listed on page 3. This expansion means that this Third Annual Report provides information on 16 countries. *So, only a few months after the enlargement of the European Union this report presents a quantitative and qualitative picture of SMEs in all 15 Member States, as well as in Norway, which means in all countries of the European Economic Area, except for Iceland.*

Each chapter of the report has been co-ordinated by a partner of the Network. Names of partner organisations responsible for chapter co-ordination are mentioned at the top of each chapter.

A Reference Group was established in the first year of the project to reflect on the research findings and to advise ENSR. This Reference Group is composed mainly of representatives of *European* organisations that are generally active in the field of SMEs, the craft trades, or the wider business sector. The participating organisations in the Refer-

ence Group are listed in Annex I. Representatives of the European Commission (Directorate-General XXIII) attend the meetings of the Reference Group as observers.

As the main contractor EIM Small Business Research and Consultancy bears full responsibility for the contents of this report, including the policy issues. Member organisations of the Reference Group are not responsible for the contents, although their assistance has been of great value.

As last year, the project co-ordinators have had frequent discussions with DG XXIII, especially with Mr. Carlos Tenreiro. His comments on earlier drafts of the report were greatly appreciated.

Mr. Bruce Tether and Dr. Robert Cressy from the SME Centre of Warwick University have assisted with the final editing of the English version of the report.

This main report is available in English, French and German. The French partner (APRODI) and the German partner (IfM Bonn) in the ENSR were responsible for the French respectively the German translation of the report. Their help is greatly appreciated.

CO-OPERATION AND INFORMATION SUPPLY

One of the objectives of the Observatory project is 'networking', and the European Network for SME Research (ENSR) is the main network used within the framework of the project. The strength of this network is in the quality and experience of its partners, the large number of specialist SME researchers involved, and its wide geographical base. Nevertheless, on specific issues co-operation with other institutions has proved to be fruitful and has contributed to the quality of the report.

The Eurostat project 'Enterprises in Europe' has once again been a cornerstone of the project. The co-operation of Eurostat has been a great help.

The greatly valued co-operation of DG XXIII of the European Commission has already been mentioned. The First and Second Annual Reports were also commented upon by other Directorates-General. Their suggestions were very helpful during the development of this Third Report.

We also like to thank the European Parliament and the Economic and Social Committee for their reaction to the Second Annual Report.

The contribution of Austria has been financed by the Austrian 'Bundesministerium für Wirtschaftliche Angelegenheiten', that of Finland by the Finnish Ministry of Trade and Industry, that of Norway by the Norwegian Research Council, and that of Sweden by the Swedish National Board for Industrial and Technical Development (NUTEK). We would like to express our gratitude to these institutions for facilitating the inclusion of these countries in the Report.

Austria's contribution has been co-ordinated by the 'Institut für Gewerbe- und Handwerksforschung'. Other members of the Austrian working group were the 'Institut für Absatzwirtschaft/Warenhandel', the 'Institut für Tourismus und Freizeitwirtschaft', the 'Institut für Betriebswirtschaftslehre der Klein- und Mittelbetriebe der Wirtschaftsuniversität Wien' and the 'Wirtschaftsförderungsinstitut der Wirtschaftskammer Österreich'.

For the chapter on Craft Trades the information on Germany was collected by the 'Seminar für Handwerkswesen an der Universität Göttingen'.

A major difficulty in carrying out the Observatory project is the lack of harmonised information. However, as the burden on enterprises of surveys and other questionnaires is already great, additional business surveys must be avoided as much as possible. Therefore several interviews have been carried out among experts on the SME sector through face-to-face interviews as well as by telephone. We are very grateful to the experts of Chambers of Commerce, Ministries, National Offices of Statistics, research organisations for their willingness to co-operate.

THE CONTENTS OF THE THIRD ANNUAL REPORT

To a limited extent the structure of the Report has changed. The main part of the Report concerns the development of the SME Internal Market Monitor (SIMM). This monitor measures the effects of the completion of the internal market on SMEs. The completion of the internal market has influenced the business performance as well as the business environment of SMEs. Therefore a distinction is made between information gathered on the Business Performance of SMEs and information gathered on the Business Environment of SMEs. The report is divided in four parts, Part I to III form the input to Part IV, which can be read independently.

Part I contains chapters on business performance:

Part I Business Performance

- Chapter 1. Business Dynamics and Entrepreneurship
- Chapter 2. Economic Growth and Sectoral Development
- Chapter 3. Labour
- Chapter 4. Regional Disparities
- Chapter 5. Export and International Orientation

Part II contains chapters on the business environment:

Part II Business Environment

- Chapter 6. Macro Economic Environment
- Chapter 7. Recent Policy Developments affecting SMEs
- Chapter 8. Labour Market
- Chapter 9. Capital and Finance
- Chapter 10. Infrastructures
- Chapter 11. Technology and Innovation
- Chapter 12. Education and Entrepreneurship
- Chapter 13. Legal Environment

The theme studies of this year's report concern the Administrative Burdens on SMEs and the Producer Services sector. In addition, some of the information included in last year's theme study on the Craft Trades has been updated.

Part III Theme studies

Chapter 14. Administrative Burdens

Chapter 15. Producer Services

Chapter 16. Craft Trades

In the last part conclusions are presented. This consists the main results of the SIMM and an overview of the policy issues resulting from the information contained in the Report.

Part IV Conclusions

Chapter 17. SME Internal Market Monitor

Chapter 18. Policy issues

Two annexes are attached to the report. As noted above, four new countries have joined the Observatory project this year. Additional information on these countries is included in a special annex.

Annex I About the Observatory report

Annex II New partners

Note to the reader

It should be stressed that - wherever possible - this report has made use of data provided by Eurostat in its publication 'Enterprises in Europe'. Eurostat data is the only source of harmonised data on enterprises by size class in the 16 countries included in this Report. As far as Eurostat-data are not fully comparable between countries (especially as a result of gaps in these data) additional estimates have been made by EIM. For further details on these estimates, see Appendix 1 to Chapter 1. This means that data used in the report may differ from that commonly used in the individual countries. In some cases the differences are considerable. Discrepancies may stem from differences in the definition of enterprises, the way enterprises are registered and the treatment of establishments.

The harmonised approach has the considerable advantage of providing comparable data between countries but the disadvantage that national experts may not always recognise the data as it applies their country.

PART I BUSINESS PERFORMANCE

1 ECONOMIC GROWTH AND SECTORAL DEVELOPMENT

Co-ordinated by EIM Small Business Research and Consultancy

MAIN POINTS

Structure of non-primary private enterprise in Europe-16

- Europe-16 had 16,4 million enterprises in 1990 (excluding the New German 'Länder'). Of these, 99.9% employed less than 500 employees and are considered to be SMEs. Of the total number of SMEs 93% are micro enterprises, 6% are small enterprises, and only 1% are medium-sized enterprises. By 1993, the number of enterprises had increased to 16.7 million.
- Total employment in non-primary private enterprise is over 100 million. SMEs have a significant share of this employment: micro-enterprises account for 31% of the total employment, small enterprises for 25%, medium-sized enterprises for 15%, and large enterprises for 29%.
- There are striking differences between countries in the size of their enterprises. The average enterprise size in Europe-16 varies between 3 and 13. Enterprises are generally smaller in southern European countries (Greece, Italy, Spain, Portugal). Countries with relatively large enterprises are Denmark, Germany, Luxembourg, the Netherlands, and the EFTA-4 countries (Austria, Finland, Norway, and Sweden).
- Generally, a positive correlation seems to exist between the capital intensity of production in industrial sectors and enterprise size. This can be explained by the fact that higher capital intensity gives rise to increasing economies of scale as well as to entry barriers.
- A small average enterprise size amongst SMEs in an industry corresponds to a relatively high labour productivity amongst SMEs in that industry. For example, in most sectors in trade and services, SMEs have highest labour productivity, while, conversely, in extraction and manufacturing, LSEs generally have the highest labour productivity. This confirms that efficiency is one of the determining factors of the distribution of SMEs and LSEs over sectors of industry.

continued

continued

Development of non-primary private enterprise in Europe-16 during 1988-1995

- The economic development in Europe during the 1988-1995 period can be subdivided into a period of growth (1988-1990), a period of stagnation (1990-1993), and the recovery (1994-1995). This business cycle is clearly reflected in growth rates of turnover and value added of both SMEs and LSEs. Over the whole period the real average growth rate of turnover and value added was 2% for both size-classes.
- Each stage of the business cycle has a different impact on SMEs and LSEs. The world wide recession hit the export oriented LSEs first, and SMEs were affected by the recession slightly later. During the period of recovery, the opposite process occurs. The economic recovery is strongly export led and therefore LSEs have benefited first. From 1994 onwards, the increased industrial and consumer confidence has had a stimulating impact on investments, which positively affects SMEs. Consumer demand is, however, only increasing slowly.
- The labour market was severely hit by the recession. During the initial stages of economic recovery employment growth recovers only marginally. In SMEs especially, the process of job creation in 1995 is expected to be slow due to present overcapacity. Over the whole period 1988-1995, the total number of private sector jobs in Europe remained stable because of an increase in labour productivity. However, in LSEs employment decreased, while employment in SMEs slightly increased.
- In most countries the growth in the number of enterprises slowed down during the recession. In this period, the unfavourable economic conditions had a negative impact on incentives to start new enterprises on the one hand, and led to an increase in closures on the other.
- Although economic integration in Europe proceeds, and all countries have become increasingly sensitive to the international business cycle, there are still considerable differences between the economic performance of different countries. The new Member States and Norway in particular differ significantly from the EU-12 countries.
- In spite of differences in overall growth rates, EU-12 and EFTA-4 show the same sectoral and size-class patterns of economic growth.

continued

continued

- SMEs are more strongly involved in the international economy than their share of exports indicates. The reason for this is that SMEs do not just sell goods and services abroad directly, they are also highly involved in intermediate deliveries to exporting LSEs.
- Over the whole period overall labour productivity increased by 2% annually. The increased international competition forced both SMEs and LSEs to increase efficiency. During the periods of recession and recovery the increased labour productivity together with only modest growth in wages resulted in a decrease in real unit labour costs. This improved profitability.
- Over the 1988 -1995 period growth rates have been highest in the export oriented sectors (extraction, manufacturing, and transport and communications). Construction, retail trade, and personal services, which are highly oriented towards domestic markets achieved the lowest growth rates.
- In most sectors, manufacturing being the exception, SMEs experienced higher growth rates in value added than LSEs.
- At the sectoral level it appears that moderate growth in unit labour costs - a measure of competitiveness - coincides with relatively high growth rates of value added. However, this holds especially for LSEs. It is hypothesised that SMEs - which are less flexible in adjusting their stock of labour to changing demand - partly maintained competitiveness by also reducing their profit rates during the years considered.
- The sectoral differences in employment growth only partly correspond to differences in value added growth. Sectors that experienced the highest value-added growth also achieved the highest growth in labour productivity.

1.1 INTRODUCTION

This chapter provides an analysis of structure and development of non-primary private enterprise in Europe-16, with a strong emphasis on size-class aspects. First, the structure of the non-primary private enterprise sector will be presented, paying attention to differences by size-class, countries, and by industrial sectors (section 1.2). Next, section 1.3 presents an analysis of developments between 1988 and 1995. In both sections the analysis starts with the presentation of general patterns at the Europe-16 level, and subsequently disaggregates by countries and by sectors of industry.

No unique formal definition of small and medium-sized enterprises (SMEs) exists. In this study, as in the previous Annual Reports of the Observatory, SMEs are defined using the number of employees as a criterion. Within the non-primary private enterprise sector - that is, all private enterprises except those in agriculture, hunting, forestry and fishing - SMEs are defined as enterprises employing less than 500 employees. Within the SME-sector, the following size-bands can be distinguished:

- micro enterprises, employing less than 10 employees. This group also includes enterprises without employees, which only provide employment for the self-employed;

- small enterprises, which employ between 10 and 99 employees. This group of enterprises can be further subdivided into 10 - 19, 20 - 49 and 50 - 99 employees;
- medium-sized enterprises: between 100 and 499 employees (this group can be subdivided into 100 - 249 and 250 - 499 employees).

Non-primary private enterprises employing 500 or more employees are regarded as large scale enterprises (LSEs).

A detailed disaggregation into size-classes is necessary, since for different purposes, different size-bands are appropriate, for example:

- the organisational structure of an enterprise changes significantly at about 15 to 20 employees;
- some rules for state aid differ for enterprises employing less than 250, and over 250 employees¹;
- VAT-collection and other administrative procedures are often somewhat simpler for smaller enterprises (see chapter 14 of this report).

The analysis concentrates on the following variables:

- the number of enterprises;
- employment. Employment is defined as the number of persons working at least 15 hours weekly and includes the self employed;
- turnover;
- value added².

More precise definitions of variables, as well as information on sources of data and the way various estimates have been produced, can be found in Appendix 1 to this chapter³. It should be noted from the outset that 'Enterprises in Europe' - a joint publication of Eurostat and DG XXIII - has been the statistical cornerstone of this chapter.

1.2 STRUCTURE OF ENTERPRISE IN EUROPE-16, 1990

Section 1.2.1 presents the main characteristics of non-primary private enterprise, disaggregated by size-class, in Europe-16. Then, sections 1.2.2 and 1.2.3 analyse in more detail differences in the size-class structure between countries and between sectors of industry, respectively.

1.2.1 Size and characteristics in 1990

Table 1.1 provides information with respect to the number of enterprises, employment, turnover and labour productivity⁴ for Europe-16 in 1990. As can be seen, non-primary

¹ See EC, Official Journal, C213 of August 19, 1992.

² This is a new variable in the Observatory.

³ It should be noted from the outset, that the analysis focuses on the Europe-16 enterprise sector, and therefore, a dataset is used that is to some extent harmonised over countries (see e.g. Eurostat/DG XXIII: Enterprises in Europe, Third Report, 1994). This implies, however, that the definitions used in this report sometimes differ from those used most often in various individual countries. Appendix 1 deals with this in more detail.

⁴ Contrary to the First and Second Annual Reports of the Observatory, adapting to information from Enterprises in Europe as well as other sources enables it now to analyse labour productivity (value added per occupied person, instead of apparent labour productivity (turnover per occupied person)).

private enterprise in Europe-16 comprises over 16 million enterprises. Of these, 99.9% employ less than 500 employees, and should thus be considered as SMEs. 93% of all SMEs are micro firms; 6% are small firms, and only 1% is medium-sized.

Total employment in non-primary private enterprise equals over 100 million; therefore, the average enterprise has 6 jobs, varying between 2 in micro firms (including the self-employed) and over 2,000 in large enterprises. SMEs provide jobs for 72 million people (71%). Micro firms account for 31% of employment, small firms for 25%, medium-sized firms for 15%, while 29% of all jobs are found in LSEs. Thus, SMEs have a dominant share in total employment.

The average Europe-16 enterprise has a turnover of ECU 750,000. Turnover per enterprise, however, varies between ECU 190,000 in micro enterprises, and almost 275 MECU in LSEs.

The size-class pattern of labour productivity - value added per employee - follows an inverted V-shape, being highest for medium-sized enterprises at ECU 45,000. Labour productivity in LSEs is about 10% less than this, while in micro and small enterprises, average labour productivity ranges between ECU 25,000 and ECU 30,000¹

1.2.2 Structure by country

According to the scale of enterprises there are striking differences between countries. The average enterprise size varies between 3 and 13. Enterprises are relatively small in southern Europe: Greece, Italy, Spain and Portugal. In Greece, Italy, and Spain micro-enterprises are dominant. The scale of enterprises increases in northern Europe. Countries with relatively large enterprises are Denmark, Germany, Luxembourg, the Netherlands, and the EFTA-4 countries (Austria, Finland, Norway, and Sweden). The average enterprise size is 6 for EU-12 and 12 for EFTA-4. Thus, the average EFTA-4 enterprise is twice as large as the average EU-12 enterprise². In the First and Second Annual Reports a correlation between GDP per capita and average enterprise size was found. A high GDP per capita corresponds with a high degree of concentration, and, therefore, with a relatively large scale of enterprise.

¹ The same inverted V-shape pattern can be found with respect to apparent labour productivity (turnover per occupied person; see the Second Annual Report). However, value added per occupied person is a better measure of labour productivity, since it does not include the purchased value of merchandise and the value of intermediate consumption, and is neither disturbed by indirect taxes and subsidies.

² See The European Observatory for SMEs, Second Annual Report, section 2.5, Zoetermeer, 1994.

Table 1.1 Main indicators by size-class, Europe-16*, 1990

	SME									LSE	
	Micro		Small			Medium-sized				Total	
	0-9	10-19	20-49	50-99	10-99	100-249	250-499	100-499	0-499	500+	Total
Enterprises (1,000)	15,210	605	370	70	1,045	60	15	75	16,335	15	16,350
Employment (1,000)	31,450	8,250	12,250	4,950	25,500	10,400	5,100	15,550	72,450	28,900	101,350
Average enterprise size	2	14	33	71	24	168	367	204	4	2,064	6
Turnover per enterprise (ECU 1,000)	190	1,550	4,250	10,000	3,050	26,650	62,050	33,200	550	273,750	750
Value added per occupied person (ECU 1,000)	25				30			45	30	40	30

* Excluding the New German Länder.

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat/DG XXIII: Enterprises in Europe, Third Report.

Between countries some striking differences in the relative labour productivity of SMEs can be observed. For example, in Austria the relative labour productivity of SMEs was only 79% of the overall average, which means that LSEs have a much higher labour productivity than SMEs. Conversely, in countries like Belgium, Denmark, Germany, and Norway, the relative labour productivity of SMEs was equal to that of LSEs, or even higher. The differences between countries in the scale of enterprise do not correspond to the differences in the relative labour productivity of SMEs. In EU-12 and in EFTA-4 relative labour productivity of SMEs is almost equal.

Table 1.2 Size-class structure by country, 1990

	Enterprise (x 1,000)	Average enterprise		SMEs relative labour productivity ^b
		size	Size-class dominance ^a	
Belgium	490	6	SME	108
Denmark	170	9	SME	100
France	1,980	7	SME	90
Germany ^c	2,290	9	SME	102
Greece	690	3	Micro	94
Ireland	130	8	SME	91
Italy	3,920	4	Micro	90
Luxembourg	15	10	SME	94
Netherlands	420	10	SME	99
Portugal	600	5	SME	88
Spain	2,460	4	Micro	92
United Kingdom	2,630	8	SME	83
EU-12	15,780	6	SME	91
Austria	180	12	SME	79
Finland	110	12	SME	98
Norway	130	10	SME	102
Sweden	150	13	SME	95
EFTA-4	570	12	SME	93
Europe-16	16,350	6	SME	92

a. A country is micro-, SME- or LSE-dominant if either micro-enterprises, SMEs (in restricted sense: 10-499 employees) or LSEs have the largest share in total employment of that country.

b. Calculated as labour productivity in SMEs as % of total labour productivity in that country.

c. Excluding the New German Länder.

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat.

1.2.3 Structure by industry

This section focuses on some characteristics of industries, such as average enterprise size, SME presence, labour productivity, and the degree of export orientation. First, structure at the Europe-16 level will be discussed. Next, a comparison between EU-12 and EFTA-4 will be presented.

Characteristics at the Europe-16 level

Extraction

Extraction includes 150,000 enterprises, which can generally be regarded as large. The average enterprise size equals 28, which is greatest amongst all broad sectors. Within extraction, enterprises are most large-scaled in Energy and the Production of Metals. Only Production of Other Minerals can be regarded as an SME-dominant sector. Probably differences with respect to average firm size in the sectors within extraction are positively correlated with the capital-intensity of production.

Labour productivity of SMEs in extraction is generally below average. However, this holds only for Public Utilities, the Production of Metals and the Production of Other Minerals. On the other hand, SMEs in the Extraction of Coal and the Extraction of Natural Gas and Oil have, on average, labour productivity well above the sectoral average.

The proportion of total turnover sold abroad is only slightly above the average of all enterprises. The Extraction of Coal, and Public Utilities especially, sell most of their output in domestic markets.

Manufacturing

Manufacturing has a rather large average firm size as well. The average enterprise size amongst the 1.8 million manufacturing enterprises has 16 employees. This is almost three times the overall average for private enterprise, but here too differences between sub-sectors are large. The Manufacture of Metal Articles and the more traditional industries, such as Other Manufacturing Industries, Textiles, Leather and Clothing, and Food/Drink/Tobacco have an average firm size below the manufacturing average. Here too, the relation between firm size and capital intensity of production seems to exist.

In manufacturing as a whole, as well as in its subsectors, SMEs labour productivity is below the corresponding sectoral average, but generally, this is less so in the more traditional industries mentioned.

Manufacturing industries are generally rather strongly oriented towards exports. This holds especially for the Manufacture of Office Machinery, Mechanical Engineering and the Manufacture of Motor Vehicles. The Food/Drink/Tobacco industry and Other Manufacturing Industries sell a relatively large proportion of their total production in domestic markets.

Construction

In construction there are 1.9 million enterprises in Europe-16, employing on average 5 persons. The sector is SME dominant. Labour productivity is the same in SMEs as in LSEs. Exports in construction are negligible.

Wholesale trade

Wholesale trade includes 1.6 million enterprises and the average firm size is 5 employees. Within wholesale trade, average firm size varies between 9 in wholesale distribution, and 2 for agents. Within wholesale trade, SMEs labour productivity does not differ much from LSEs. The wholesale trade exports 10% of its total turnover.

Retail distribution

Retail distribution can be regarded as highly micro-firm dominated. On average the 3.5 million retail enterprises employ 3 persons. Also, in this sector SMEs to some extent outperform large enterprises with respect to labour productivity. Exports are not relevant to this sector.

Transport and communications

Transport and communications is dominated by LSEs. The average firm size of these 0.9 million enterprises is 8, which is above the overall average. However, large differences within the sector exist. For example, Railways, Sea and Air Transport, Transport Related Services, and Communications can be considered to be LSE dominant. In the sector, average firm size ranges between 3 (Inland Water Transport) and 1,000 (Railways). Travel Agents, Other Inland Transport, and Inland Water Transport are SME-dominated.

In general, SMEs in transport and communications have a higher labour productivity than LSEs, but here too, substantial variation between sectors exist. The propensity to export does not differ much from the average of all enterprises. However, large differences between subsectors exist. For Sea and Air Transport, and Services to Transport especially, exports constitute a large part of total turnover.

Producer services

Producer services include 1.9 million enterprises, and the average enterprise size equals the overall average of 6 employees. However, differences between activities within producer services are substantial. Banking, Finance and Insurance, and Research and Development, have an average firm size of about 100, while in the remaining sectors average enterprise size varies between 2 and 5. Generally speaking, SMEs labour productivity is above the sectoral average. The propensity to export is rather small, because many services from this sector require face-to-face contact. Internationalisation in this sector often follows the route of direct foreign investment.

Personal services

The 3.2 million enterprises in personal services are dominated by micro enterprises. The largest subsectors are Hotels and Catering and Services to General Public. The first is dominated by micro firms and the latter by small firms. The other subsectors, Repair and Other Personal Services, are dominated by micro firms. The average firm size varies between 3 and 5 employees. SMEs and LSEs do not differ much with respect to their labour productivity. The propensity to export is negligible.

Table 1.3 Size-class structure of sectors of industry, Europe-16, 1990

	Enterprises (1,000)	Average enterprise size	Size-class dominance*	SMEs relative labour productivity**	Share of exports in turnover
All enterprises	16,348	6	SME	92	13
Extraction	158	29	LSE	74	14
- Energy	24	77	LSE	102	8
• Extraction of coal	0	924	LSE	163	6
• Extraction of gas and oil	7	40	LSE	186	16
• Public utilities	16	73	LSE	54	2
- Production of metals	14	75	LSE	93	28
- Production of other minerals	120	14	SME	91	19
• Extraction of other minerals	96	10	SME	98	27
• Manuf. non-metall. products	24	16	SME	89	18
Manufacturing	1,844	16	SME	83	26
- Manuf. of chemical products	89	39	LSE	80	30
• Chemical industry	36	56	LSE	80	31
• Rubber, plastics	53	26	SME	94	25
- Production of metal articles	254	13	SME	82	19
- Mechanical engineering	131	25	SME	88	40
- Electr., instr. engineering	120	35	LSE	86	35
• Manuf. office machinery	7	51	LSE	60	48
• Electrical engineering	76	43	LSE	91	32
• Instrument engineering	37	15	SME	88	35
- Manufact. means of transport	38	75	LSE	72	38
• Motor vehicles	20	95	LSE	64	40
• Other means of transport	18	52	LSE	92	33
- Food/drink/tobacco industry	249	14	SME	84	14
- Textile, leather, clothing	367	11	SME	99	27
• Textile industry	109	15	SME	99	30
• Leather, leather goods	39	6	SME	99	29
• Footwear, clothing	218	10	SME	99	24
- Other manuf. industries	597	9	SME	91	12
• Timber industry	329	6	SME	98	12
• Paper & printing	191	14	SME	93	12
• Other industry	77	6	SME	96	36

Table 1.3 Size-class structure of sectors of industry, Europe-16, 1990 (continued)

	Enterprises (1,000)	Average enterprise size	Size-class dominance*	SMEs relative labour productivity**	Share of exports in turnover
Construction	1,945	5	SME	100	1
Wholesale trade	1,575	5	SME	95	9
- Wholesale distribution	780	9	SME	94	10
- Dealing scrap and waste	34	5	SME	97	1
- Agents	761	2	Micro	104	10
Retail distribution	3,656	4	Micro	105	0
Transport, communication	946	8	LSE	93	14
- Railways	1	996	LSE	185	6
- Other inland transport	759	4	SME	95	8
- Inland water transport	12	3	Micro	101	5
- Sea, air transport	8	71	LSE	152	59
• Sea transport	5	31	LSE	133	81
• Air transport	3	145	LSE	140	47
- Services to transport	159	8	SME	100	20
• Transport related services	84	4	LSE	82	17
• Travel agents	75	12	SME	106	20
- Communication	6	376	LSE	192	3
Producer services	1,899	6	LSE	110	7
- Banking, insurance etc.	1,538	91	LSE	160	6
• Banking, finance	24	90	LSE	114	8
• Insurance	8	94	LSE	341	3
- Business services	1,506	5	SME	98	8
- Renting of movables	87	4	Micro	117	1
- Letting of real estate	258	2	Micro	108	0
- Research and development***	7	98	LSE	141	n.a.
Personal services	3,168	4	Micro	98	1
- Hotels, catering	1,441	3	Micro	103	1
- Repair	568	3	Micro	100	1
- Services to general public***	1,166	5	SME	102	n.a.
- Other personal services	862	4	Micro	95	n.a.

* A sector is micro-, SME- or LSE-dominant if either micro-enterprises, SMEs (in restricted sense: 10-499 employees) or LSEs have the largest share in total employment of the sector.

** Calculated as labour productivity in SMEs as % of total labour productivity in that sector.

*** Export data not available.

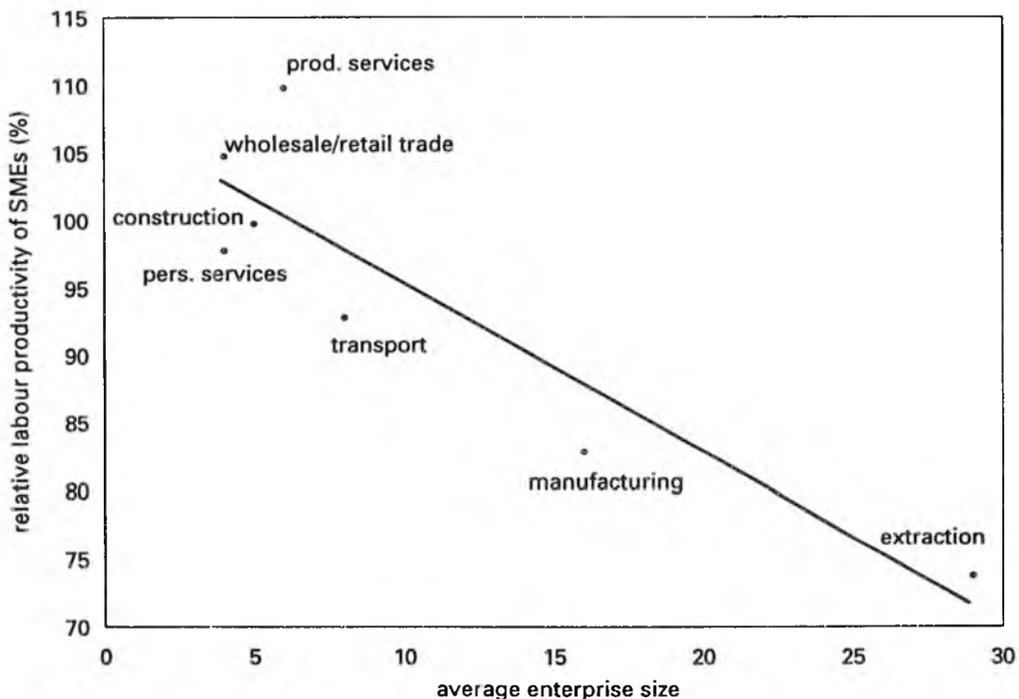
Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat.

General patterns

In general, firms in extraction, manufacturing, and parts of transport and producer services, can be considered as LSE dominated. Construction, trade, and services mainly consist of SME- and micro-dominated industries. There seems to be a positive relationship between the capital intensity of production and the average scale of enterprise, which can be explained by the fact that higher capital intensity gives rise to increasing economies of scale and also to entry barriers.

Furthermore, a negative correlation between relative labour productivity of SMEs and average enterprise size appears from the data (Figure 1.1). Thus, in sectors in which firm size is smaller than the overall average of 6, labour productivity in SMEs is generally greater than the same in LSEs. However, this correlation can not be observed at the level of branches within sectors and therefore requires further investigation, taking into account the differences between micro, small, and medium sized enterprises, within SMEs. From this and the hypothesised relationship between average enterprise size and capital intensity it follows that the relative labour productivity of SMEs is related to the nature of the production process. Also, it can be concluded that the distribution of SMEs and LSEs across sectors of industry is partly governed by economic efficiency: SMEs and LSEs dominate those sectors in which they generally have highest labour productivity.

Figure 1.1 The relationship between average firm size in an industry and the relative labour productivity of SMEs



Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat.

Regional variation

It was mentioned before that the average firm size differs significantly between EU-12 and EFTA-4. Table 1.4 shows that this can be observed for sectors of industry as well. In all sectors the average enterprise-size in EFTA-4 is higher than in EU-12. Even the size-class dominance differs in some sectors. For example, in EU-12 personal services are dominated by micro firms, but in EFTA-4 by small and medium-sized enterprises.

On the whole, the SMEs relative labour productivity does not differ significantly between EU-12 and EFTA-4. In most sectors of industry differences between these groups of countries are small. The main exception, however, is in extraction, where SMEs in the EU-12 have a higher productivity than in the EFTA-4 countries. In transport and communications this can also be observed to a lesser extent. The opposite is true in retail distribution and in personal services, where SMEs in the EU-12 have a somewhat higher relative productivity.

Table 1.4 Size-class structure by sector of industry in EU-12 and EFTA-4, 1990

Sector	Area	Enterprises	Size class		SMEs relative labour productivity**
		(x 1,000)	Average firm size	dominance*	
Extraction	EU-12	150	28	LSE	71
	EFTA-4	8	43	LSE	102
Manufacturing	EU-12	1,745	16	SME	83
	EFTA-4	99	23	SME	85
Construction	EU-12	1,894	5	SME	100
	EFTA-4	51	14	SME	101
Wholesale trade	EU-12	1,514	5	SME	95
	EFTA-4	61	9	SME	93
Retail distribution	EU-12	3,528	3	Micro	105
	EFTA-4	129	6	Micro	91
Transport/comm.	EU-12	910	8	LSE	92
	EFTA-4	36	19	LSE	102
Producer services	EU-12	1,830	6	LSE	110
	EFTA-4	60	10	SME	108
Personal services	EU-12	3,053	4	Micro	99
	EFTA-4	116	6	SME	92
All sectors	EU-12	15,782	6	SME	91
	EFTA-4	566	12	SME	93

* A sector is micro-, SME- or LSE-dominant if either micro-enterprises, SMEs (in restricted sense: 10-499 employees) or LSEs have the largest share in total employment of the sector.

** Calculated as labour productivity in SMEs as % of total labour productivity in that sector.

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat.

1.3 DEVELOPMENT OF ENTERPRISES IN EUROPE-16 DURING 1988-1995¹

This section presents estimated developments for non-primary private enterprise in Europe-16 during 1988 -1995. First, section 1.3.1 provides a general overview of the development of the SME-sector and the LSE-sector in the European economy, paying attention to the development of real value added, and turnover, employment, labour productivity, and profitability. An analysis of the factors determining the size-class pattern of economic development at the Europe-16 level is also presented. Section 1.3.2 then discusses the differences between countries regarding the size-class pattern of real value added growth and employment development, and section 1.3.3 pays attention to sectoral aspects. Finally, section 1.3.4 presents estimations with respect to the growth of the number of enterprises.

1.3.1 The size-class pattern of macro economic development in Europe-16

Development of the SME-sector

Table 1.5 presents data on the development of the SME-sector of the European economy during the 1988-1995 period.

1988-1990

During 1988-1990, SMEs benefited from the favourable macro economic conditions, resulting in average value added growth rates of 3,5% annually. Micro firms in particular stand out with average real value added growth of about 5%. Foreign demand contributed greatly to the favourable performance of SMEs: exports grew at an annual rate of 8% (Table 1.6).

Labour productivity grew only slightly at 1% a year. Thus, employment in the SME-sector increased at an average rate of 2,5%; reflecting differences in real value added growth, the employment increase was greatest in micro firms, and smallest amongst medium-sized enterprises.

¹ It should be noted, that this section refers to NACE-divisions 1-8 only. Thus, personal services only include hotels and catering, and repair of consumer goods and cars, while research and development is excluded from producer services. Developments between 1988 and 1990 are estimated using statistical information, amongst others Eurostat/DG XXIII: Enterprises in Europe, Second and Third Report, and European Economy, Supplement A, vol. 11/12, November 1994. For more recent years, use has been made of the SME in Europe Accounting Scheme. All this is further explained in Appendix 1 to this chapter.
For survey results regarding employers' expectations about current economic developments, see Eurochambres: European Economic Survey (January 1995).

Table 1.5 Development of real value added and employment in SMEs, Europe-16, 1988-1995

	1988-1990	1990-1993	1993-1995	1988-1995
<i>Real value added</i>				
SMEs	3.5	0.5	3	2
- Micro	5.25	0.5	3.25	2.5
- Small	2.5	0.5	3	2
- Medium	2.25	0.5	3	2
<i>Employment</i>				
SMEs	2.5	-1	-0.25	0.25
- Micro	3.75	-0.5	-0.25	0.75
- Small	1.75	-1	-0.25	0
- Medium	1.25	-1.75	0	-0.5

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

1990 -1993¹

During 1990-1993, the European economy fell into recession, with decelerating demand growth and even an absolute decline in investment. This had a great impact on the SME-sector, growth of real value added decelerating to no more than an estimated 0.5% annually. From Table 1.6 it can be concluded that the decrease in real investment contributed most to the deceleration in the SME-sector; SMEs in construction were especially hit. Also, with respect to exports, retarded growth rates can be observed.

During the recession, labour productivity increased to a limited extent: 1.5% annually during 1990-1993 against an average 1% rate during 1988-1990. As a result, job loss in the SME-sector was limited to an annual average of 1%.

1993 -1995

In 1994 the international economy recovered faster than expected. Value added growth accelerated to about 2% a year. Exports especially, and subsequently also investments contributed to this; the contribution of consumption demand to the accelerating growth rates has been less impressive. In 1995, further strengthening of the recovery is expected, with consumption demand increasing its contribution to growth.

SMEs labour productivity was increased, as a lagged result of labour hoarding during the early stages of the recession. As a result, SMEs' employment decreased in 1994 despite increasing growth rates in production. This occurred particularly in micro and small firms. Only in medium-sized enterprises, in which productivity grew already quite significantly

¹ As compared with the Second Annual Report, estimated growth rates for SMEs (as well as for LSEs) have been revised downwards. The latest data available for this periods show developments to be worse than previously assumed. Also, the incorporation of the EFTA-4 countries, which have experienced very unfavourable economic development during the early nineties, leads to downwards revisions.

during the recession, is labour productivity growth now relatively limited. Employment in medium-sized enterprises is expected to stabilise in 1994 and 1995.

Table 1.6 Real turnover in SMEs by demand category, Europe-16, 1988-1995

	1988-1990	1990-1993	1993-1995	1988-1995
Average annual growth in %				
Real turnover	4.25	0.25	3	2.25
- Consumption goods	3.75	0	1.25	1.5
- Investment goods	5.25	-3.5	2.5	0.75
- Intermediary goods	4	0.5	3.5	2.25
- Total domestic sales	4	0	2.5	1.75
- Exports	8	3.5	7.75	6

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

Developments in the LSE-sector

The main results regarding the development of the LSE-sector of the European economy during this period can be found in Table 1.7.

1988 -1990

Between 1988 and 1990 value added growth in LSEs was 2,5%. Exports in particular contributed to this. Domestic sales grew by less than 2% a year, and exports - which make up quite a large share of LSEs total sales - grew at an annual rate of 7%. Labour productivity grew by slightly less than 2% a year; and employment growth amounted to 0.75% annually between 1988 and 1990.

1990 -1993

LSEs were strongly hit by the recession, real value added growth falling back to, on average, less than 1% a year. Developments in both domestic and export markets contributed to this. Domestic sales, especially of investment goods, actually decreased, while the growth rate of exports fell back to about 3%. Labour productivity accelerated to about 2.5% a year under the influence of the recession, as the necessity to cut costs increased. Employment in LSEs is estimated to have decreased by over 1.5% a year.

1993 -1995

The LSE-sector also began to recover in 1994, with real value added growth at over 3% on average. Especially the recovery of export growth contributed to this, with export sales growing at an annual rate of 7.5% - which is even further than during the 1988 - 1990 period. Labour productivity accelerated a little further. Therefore, during 1994 and 1995 employment in the LSE-sector is growing at no more than an annual rate of 0.25%.

Table 1.7 Development of real value added, real turnover and employment in LSEs, Europe-16, 1988-1995

	1988-1990	1990-1993	1993-1995	1988-1995
Average annual growth in %				
Value added	2.5	0.75	3.25	2
Real turnover	3	0.5	3.75	2
Employment	0.75	-1.75	0.25	-0.5

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

Factors determining growth

In this paragraph further analysis of the factors behind value added growth in the SME-sector and the LSE-sector will be presented. By using the 'SME in Europe Accounting Scheme' it is possible to investigate how actual macro-economic developments have affected value added growth in the period 1988-1995. Therefore, the estimates try to explain actual growth rates in each size-class.

Value-added growth largely depends on demand factors. In the period 1988-1995 about one third of real value added growth in micro and small enterprises can be attributed to the development of domestic demand (consumption demand and investment demand). For medium-sized and large firms this figure is about one fifth (see Table 1.8). Within domestic demand, consumption demand is by far the most important factor determining SME value added. For all size-classes foreign demand strongly influenced value added growth.

The contributions of macro-economic demand categories do not coincide with the share of particular goods in turnover. For example, the share of exports in SMEs turnover is estimated to be approximately 10%, while in the past few years export demand directly and indirectly contributed to almost half of total value added growth. This can partly be explained by the high growth rates of exports. Exports of SMEs grew by 6% annually, while domestic sales grew by only 1,75%. Another reason is that SMEs benefit from LSEs exports by way of intermediate deliveries of goods and services. This demonstrates that there is a considerable indirect relationship between export growth and SME value added growth¹.

This means that many SMEs, and even micro firms, are actually intensely involved in international competition, even though indirectly. Therefore policy measures aiming at improving the international competitiveness of enterprises may also benefit SMEs that are not directly involved in exports.

¹ Note that, conversely, LSEs experience positive effects from supplying products sold by SMEs in retail trade and from providing goods and services to SMEs.

Table 1.8 Factors underlying real value added growth by size-class, Europe-16, 1988-1995

	SME				LSE	Total
	Micro	Small	Medium-sized	Total		
Compound growth rates in %						
Total growth	18.5	14	14	15.5	15.75	15.5
of which due to:						
- Consumption demand*	5	3.5	2	3.75	2	3
- Investment demand	1	1.5	1	1.25	0.75	1
- Foreign demand**	8.5	11.5	13.5	11	15.5	12.75
- Other factors***	2.5	-3	-2.5	-1	-2.5	-1.5

* Private and government consumption.

** Including intra Europe-16 trade.

*** Calculated as a residual.

Source: Preliminary estimate with 'SMEs in Europe Accounting Scheme' (NACE 1-8).

Labour productivity and profitability

Employment growth is linked to real value added growth by labour productivity. As has been shown above, the development of labour productivity has been different in SMEs as compared to LSEs. Partly because of its importance for job creation, the development of labour productivity deserves further attention.

Labour productivity is also one of the determinants of real unit labour costs. In macro economic analysis, the labour share in net national income is often taken as an indicator of profitability. Even though no adequate data on profitability is available at the size-class level, indications of the development of profitability can be provided by looking at real unit labour costs.

Labour productivity

During the 1988-1995 period, labour productivity in Europe-16 has on average increased at 2% annually (Table 1.9). Furthermore, it appears that labour productivity increased at an accelerating pace. Even during the recession labour productivity increased, which was a result of the increased international competition that forced enterprises to increase efficiency. In the period 1994-1995 labour productivity growth increases further. The strong productivity growth occurred despite the fact that during the 1990s, many countries followed policies of wage moderation to combat rising unemployment.

The increase in productivity may be explained by a number of factors¹. First, the export-led recovery is highly concentrated in industries with low labour intensities. Second, the intensified level of competition forces enterprises to cut labour costs and therefore enterprises are very cautious with respect to hiring new employees. However, note that shortly after the recession, increasing production can partly be obtained by utilising overcapacity that arised during the recession; this might especially hold for SMEs. It is expected that growth of labour productivity may fall back after 1995 and employment will rise moderately.

¹ EC, European Economy, 10.

Over the whole period labour productivity for Europe-16 increased on average by over 2%, but the increase was smallest in SMEs. During the 1988 -1990 period, labour productivity growth in SMEs was significantly lower than that for LSEs. However, during the recovery in 1994 and 1995 labour productivity is increasing by about 3% annually in both SMEs and LSEs.

Because LSEs are more orientated towards international markets, they suffered most during the early stages of the recession from the increased international competition. However, since SMEs are strongly related to LSEs as suppliers, they are affected by the increasing competition as well, but with some delay. Moreover, SMEs are becoming increasingly export-oriented. During 1993 -1995, labour productivity in SMEs grew slightly faster than in the LSE-sector. LSEs normally are faster than SMEs in adjusting their stock of labour to changes in demand for goods and services.

Table 1.9 Labour productivity and real unit labour costs in private non-primary enterprises Europe-16, 1988-1995

	1988-1990	1990-1993	1993-1995	1988-1995
Average annual change in %				
<i>Labour productivity*</i>				
SME	1	1.5	3.5	2
LSE	1.75	2.5	3	2.5
Total	1.25	1.75	3.25	2
<i>Real unit labour costs**</i>				
SME	0.5	-0.5	-2.5	-0.75
LSE	2	-0.5	-1.5	0
Total	1	-0.5	-2	-0.5

* Value added (in constant prices) per occupied person.

** Calculated as real labour costs minus growth in labour productivity.

Source: EIM Small Business Research and Consultancy based on data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

Profitability

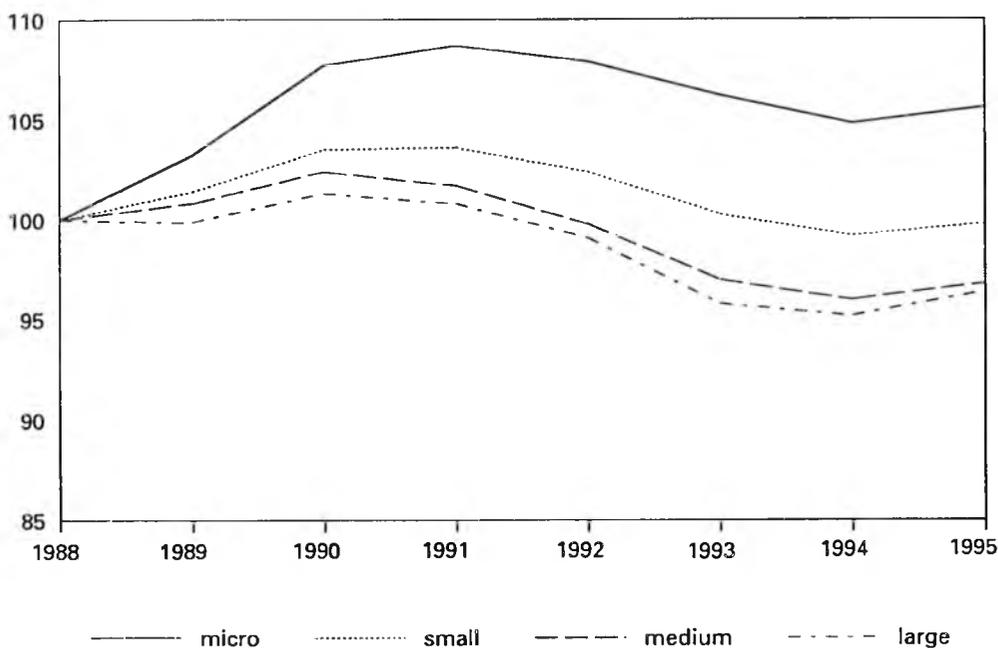
In macro economic analysis, the share of labour costs in domestic product is often taken as an indicator of profitability. At the size-class level, no adequate data on this is available. However, the development of real unit labour costs indicates how the share of labour costs has evolved over time. Therefore, this section provides an analysis of the development of real unit labour costs in both SMEs and LSEs.

The considerable increase in labour productivity together with marginal growth of real labour costs due to wage moderation resulted in a fall of real unit labour costs during both the recession period and the period of economic recovery (Table 1.9). Decreasing real unit labour costs indicate a general improvement in profitability for both SMEs and LSEs. In the period 1994-1995 micro enterprises achieved the highest reduction in their real unit labour costs.

Net job creation¹

Figure 1.2 depicts the development of employment during the 1988-1995 period. During 1988-1990, employment increased in all size bands. During the 1990-1993 recession, employment decreased steadily in both medium-sized and large enterprises. In small firms employment was stable in 1991, and decreased subsequently. The decrease in employment started in LSEs and medium sized enterprises². After a time lag employment also fell in small and micro enterprise. From 1994 job losses almost ceased. Recovery is now expected to occur initially in LSEs³, with smaller enterprises showing a more limited acceleration of employment growth during the early stages of the recovery.

Figure 1.2 Development of employment in micro, small, medium and large enterprises, Europe-16, 1988-1995, index 1988=100



Source: EIM Small Business Research and Consultancy based on data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

¹ Currently, a debate is going on about the 'real' significance of SMEs with respect to employment growth. This debate is extensively discussed in chapter 3 of this report. Tentative estimates using the 'SME in Europe Accounting Scheme', taking into account possible crossing of size-class by enterprises, suggest that although criticisms of the significance of the contribution of SMEs to employment growth are correct from a theoretical point of view, and perhaps also with respects to developments in manufacturing in the United States, they are of little significance to the analysis presented here regarding Europe-16.

² It is possible that this was partly a result of firms crossing size-class boundaries downward, which in itself seems not implausible in this stage of the business cycle. Again, the tentative calculations with the 'SME in Europe Accounting Scheme' suggest that this has not been a very significant phenomenon.

³ Here again, crossing size-class boundaries by enterprises might have played a role, but that does not seem to be very significant.

In previous recessions it has been shown that LSEs are more flexible than are SMEs in adjusting their stock of labour to production changes, partly as a result of the existence of threshold labour in the latter group of enterprises. Thus, SMEs are more successful in keeping jobs during the recession, but employment recovery starts in larger firms. It is to be expected that in the years to come, the growth difference between SMEs and LSEs with respect to employment will decrease (also see Figure 1.2).

1.3.2 The size-class pattern of macro economic development by country

Table 1.10 presents the main indicators of the development of the SME-sector and the LSE-sector by country during 1988-1995.

Real value added

Real value added growth in SMEs has been lowest in Finland, the United Kingdom, Belgium and Greece. For all these countries, macro-economic circumstances have played an important role in this. Particularly growth of domestic demand and investment activities stagnated, which had a negative impact on domestic oriented sectors, such as retail trade, personal services, and construction. Highest growth rates occurred in Ireland, Luxembourg, Germany, Portugal and Denmark. In these countries domestic demand developed relatively favourably.

In the LSE sector lowest growth rates occurred in Denmark, Sweden, Norway, Greece, and the United Kingdom. Highest growth rates were achieved in Ireland, Spain and Germany. In these countries the successful performance of LSEs was mainly led by favourable growth rates in exports.

Employment

As can be seen from Figure 1.3, in the longer run a definite relationship between employment growth and the development of real value added exists in the SME-sector. Differences between countries with respect to employment growth in both size-classes reflect those regarding real value added. The main exception is Ireland where real value added in SMEs grew at over 7% annually, with only a slight increase in employment. Therefore, in this country the greatest part of output growth was achieved by increasing labour productivity. Differences between countries regarding LSEs employment growth also reflect differences in value added growth.

Table 1.10 Real value added and employment by country, Europe-16, 1988-1995 (average annual change in %)

	Value added*		Employment	
	SMEs	LSEs	SMEs	LSEs
Belgium	1.25	1.5	0.5	-0.5
Denmark	2.75	0.5	1	-4.5
France	2	1.75	0.25	-1
Germany**	3	3.5	1.5	0.25
Greece	1.25	1	1.25	0.25
Ireland	7.25	6.5	0.25	2.75
Italy	1.75	2	-0.75	-2
Luxembourg	3.25	2	2.25	1.5
Netherlands	2.5	2.5	1.5	1
Portugal	3	1.25	1.25	-1.25
Spain	2	4.25	0	2.25
United Kingdom	1	1	-0.5	-1
EU-12	2	2.25	0.25	-0.5
Austria	2.25	1.5	1.25	1
Finland	0.75	1.75	-2	-2.5
Norway	1.75	1	-1.25	-0.5
Sweden	1.25	1	-1.5	-1.75
EFTA-4	1.5	1.25	-0.5	-1
Europe-16	2	2	0.25	-0.5

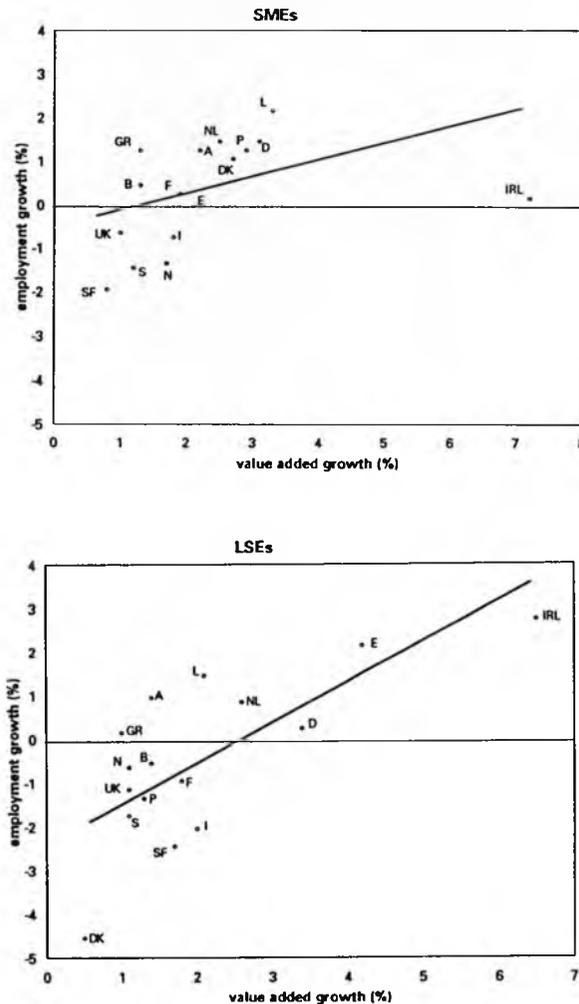
* In constant prices.

** Excluding the New German Länder.

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

Figure 1.3

Development of real value added and labour productivity by country, 1988 -1995, average annual growth rate



1.3.3 Sectoral and size-class patterns of economic development in Europe-16

Characteristics of growth patterns

It has been demonstrated above that real growth in value added has been equal in SMEs and LSEs over the 1988-1995 period. Can this also be observed at the sectoral level? Table 1.11 provides this information for EU-12, EFTA-4, and Europe-16.

Europe-16

Real value added growth has been highest in transport and communications, extraction, and manufacturing. These sectors - which are all strongly export oriented - have benefited from the increasing international specialisation, which gave rise to a strong increase

in exports relative to domestic demand. Retail trade and personal services have experienced less growth because of the relatively weak development of consumption demand. Growth was lowest in construction, mainly because of the weak development of investments (also see chapter 6).

At the sectoral level it appears that only in manufacturing, did real value added grow faster in LSEs than in SMEs. In the other sectors, however, value added growth was highest in SMEs. Thus, from a sectoral point of view, the fact that total value-added growth has been the same in SMEs and LSEs can be explained by the fact that:

SMEs have achieved the highest value-added growth in all sectors but one. This has had a positive impact on the relative growth of SMEs.

The fact that growth has been highest in manufacturing, extraction and transport and communications, which are generally LSE-dominated sectors, has had a negative impact on the relative growth of SMEs. This effect is reinforced by the fact that within manufacturing, growth has been highest in LSEs.

Regarding employment, results are even more diverse. First of all can be shown that sectoral results in employment are only to a limited extent related to production growth. Especially in sectors where labour productivity has grown only slightly - producer services is the main example - employment growth has been highest. Also, extraction, wholesale trade, and construction combined small increases in labour productivity with relatively large increases in employment. On the other hand manufacturing, which experienced the highest production growth, has had the largest employment decline. Personal services and retail both experienced above average productivity growth and employment decline.

LSE productivity growth has been greatest in manufacturing, retail trade, and transport and communications. SMEs experienced above average productivity growth in extraction and manufacturing. In construction and wholesale trade, no significant differences between SMEs and LSEs exists. It is striking that labour productivity growth in SME producer services was negligible. The modest increase in value added and the relatively high employment growth might be due to two trends in producer services. First, in most countries the birth rate in producer services has been very high during the last few years, which resulted in a strong increase in micro enterprises in this sector. This led to a substantial increase in employment, but initially to only a small increase in value added growth. Another reason might be the increase in the number of part time jobs. For example, in the Netherlands amongst SMEs in producer services, the number of part time jobs has increased greatly. This can partly explain the substantial increase in employment, while value added increased only modestly. Presumably there is a more general trend, because several governments have tried to stimulate part time jobs in order to reduce unemployment and such a measure well suited to producer services.

In five out of eight sectors, employment growth has been greatest for SMEs, the exceptions being extraction, construction, and personal services.

Regional variations

Real value added grew faster in EU-12 than in the EFTA-4 countries. The sectoral pattern of value added growth, however, does not show great differences between these

groups of countries. In both EU-12 and EFTA-4, growth has been greatest in extraction, manufacturing, and transport and communications, and lowest in retail, personal services, and especially construction. With the exception of manufacturing, growth has been greatest in SMEs.

Though total labour productivity has grown at almost the same rate in both EU-12 and EFTA-4, this does not hold for individual sectors. In manufacturing, construction, retail trade, and personal services, labour productivity growth in EU-12 was significantly higher than in EFTA-4. Only in transport and communications, and producer services, did the EFTA-4 significantly outperformed the EU-12 in labour productivity.

With respect to employment, the sectoral growth pattern of EU-12 and EFTA-4 differ considerably. The low employment growth of transport and communications and producer services in EFTA-4 is particularly striking. This is a result of stronger productivity growth in EFTA-4 in these sectors.

Growth differences between SMEs and LSEs were equal in all country groups in four out of eight sectors. The other sectors display differences between country groups. In Transport and communications and producer services SMEs generated highest employment growth in EU-12, while in these sectors LSEs experienced highest employment growth in EFTA-4. In personal services and construction LSEs had the highest employment growth in EU-12, but SMEs had the highest employment growth in EFTA-4.

General patterns

Orientation towards exports is an important determinant of value added growth. The part of value added growth which could be attributed to growth in foreign demand varied between a little less than 50% for micro firms to almost 100% for LSEs. It also appears that sectors which were at the outset strongly oriented towards exports experienced, on average, higher growth rates. This general pattern holds for SMEs and LSEs.

Furthermore, the tendency towards cost reduction seems to have played a significant role in the explanation of sectoral growth differences. Sectors experiencing an increase in unit labour costs - which worsened competitiveness - generally also had relatively low value added growth rates. However, careful analysis of the data reveals that this holds most strongly for LSEs. For SMEs the impact of nominal unit labour costs on value added growth is much weaker. Additionally, a weak positive impact of real unit labour costs is revealed by the data, giving rise to the hypothesis that at least some SMEs have increased price competitiveness by reducing profitability, as measured by real unit labour costs.

Table 1.11 Development of real value added and employment by sector and size-class, EU-12, EFTA-4, and Europe-16, 1988-1995

		Real value added			Employment		
		SMEs	LSEs	Total	SMEs	LSEs	Total
% per annum.							
Extraction	EU-12	2.5	2.2	2.3	0.4	1.0	0.7
	EFTA-4	3.0	2.5	2.7	0.3	1.9	1.3
	Europe-16	2.5	2.2	2.3	0.4	1.0	0.8
Manufacturing	EU-12	2.7	3.0	2.8	-0.8	-1.2	-1.0
	EFTA-4	2.4	2.5	2.4	-0.5	-1.1	-0.8
	Europe-16	2.6	3.0	2.8	-0.8	-1.2	-1.0
Construction	EU-12	1.2	-0.1	1.1	0.4	2.0	0.4
	EFTA-4	-0.6	-1.1	-0.7	-0.5	-2.1	-0.2
	Europe-16	1.1	-0.3	0.9	0.3	0.5	0.3
Wholesale trade	EU-12	2.3	1.2	2.2	1.1	0.0	1.0
	EFTA-4	1.7	-0.7	1.2	0.1	-1.5	-0.2
	Europe-16	2.3	1.0	2.1	0.9	-0.4	0.8
Retail trade	EU-12	1.7	-0.4	1.6	0.0	-2.2	-0.3
	EFTA-4	-0.3	-1.6	-0.4	-0.5	-1.3	-0.5
	Europe-16	1.6	0.3	1.6	0.0	-2.1	-0.3
Transportation communication	EU-12	2.6	2.1	2.4	2.0	-0.7	0.4
	EFTA-4	2.0	-0.4	1.3	-1.9	-2.0	-2.0
	Europe-16	2.5	1.8	2.3	1.5	-0.8	0.2
Producer services	EU-12	1.8	1.6	1.7	2.1	0.7	1.6
	EFTA-4	1.1	1.2	1.1	-1.0	0.3	-0.4
	Europe-16	1.7	1.5	1.7	1.9	0.7	1.5
Personal services	EU-12	1.9	0.7	1.8	-0.2	2.5	-0.1
	EFTA-4	-0.1	-2.0	-0.6	-0.2	-1.9	-0.6
	Europe-16	1.8	0.2	1.6	-0.2	0.4	-0.2
All sectors	EU-12	2.1	2.2	2.2	0.3	-0.5	0.1
	EFTA-4	1.5	1.3	1.4	-0.5	-0.9	-0.6
	Europe-16	2.1	2.1	2.1	0.2	-0.5	0.0

Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat and European Economy, Vol. A, no 11/12, November 1994.

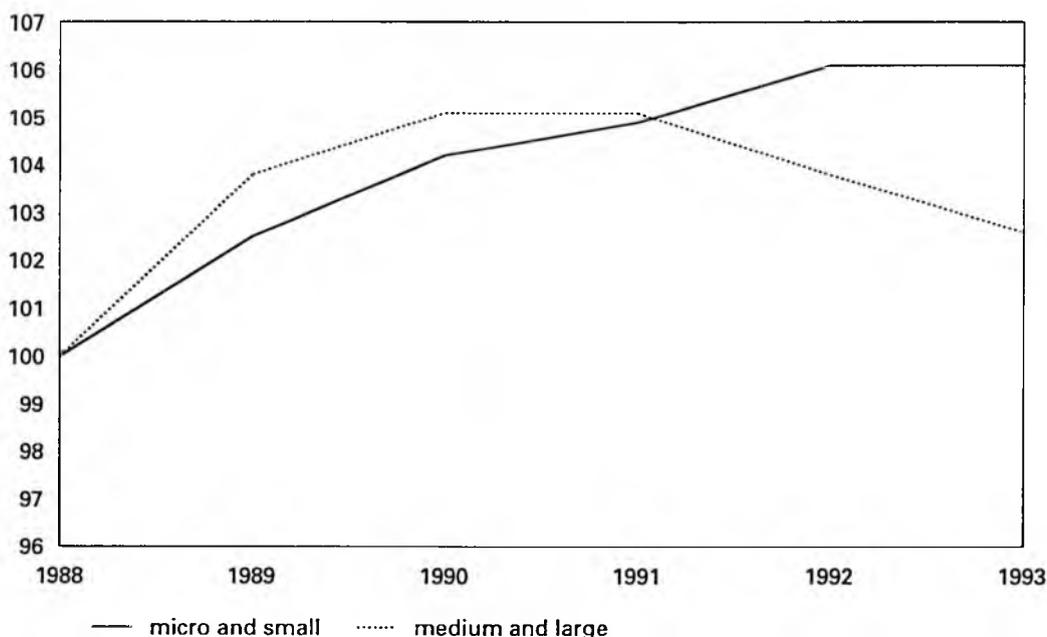
1.3.4 Number of enterprises

During the period 1988-1990 the number of enterprises increased strongly. The most expanding sectors were wholesale trade, transport and communications, and producer

services¹. During the recession 1990-1993 the increase in the number of micro and small firms slowed down. The number of medium-sized and large firms, however, decreased in absolute terms.

The unfavourable economic conditions during the recession had a negative impact on the number of enterprises. On the one hand the conditions became relatively unattractive to start a new firm and, on the other, increased competition led to an increase in death rate of enterprises. However, it must be stressed that the demography of enterprises shows differences between countries. In some countries, for example the Netherlands, the recession did not result in a slowdown of the birth rate, but actually led to an increase in the birth rate. This might be explained by the hypothesis that the decrease in employment led to an increase in initiatives to start new enterprises.

Figure 1.4 Index for estimated number of enterprises by size class, Europe-16, 1988-1993 (1988=100)



Source: EIM Small Business Research and Consultancy on the basis of data from Eurostat, European Economy, Vol. A., no. 11/12, November 1994, and OECD, Labour Force Statistics, 1972-1992.

¹ See also Eurostat, Enterprises in Europe, Third Report, part 4: Demography of enterprises; OECD, Labour Force Statistics 1972-1992.

APPENDICES TO CHAPTER 1

This Appendix pertains to the major statistical database used by the Observatory project. One of the cornerstones of the statistical information used in the Observatory is 'Enterprises in Europe'¹. This publication contains harmonised information for each of the 16 Countries about the number of firms, employment, turnover and value added, by sector (2-digit NACE classification).

In some respects, however, this publication does not provide all the information required for a comprehensive picture of the enterprise sector in each country, disaggregated by size-class. First, in some countries the data was incomplete, and estimates had to be generated. These will be described in section 2 of this Appendix. Second, Enterprises in Europe mostly relates to the situation in 1990, but this data is not easily compared with published data for earlier years. Therefore, it is not possible to use Enterprises in Europe to describe developments. To solve this problem, additional estimates had to be made on the basis of the available statistical information with respect to developments between 1988 and 1990. These additional estimates are described in section 3.

In order to estimate developments in recent years (1990-1995), an accounting scheme² has been developed which calculates turnover, value added, employment, and the number of enterprises by sector and size-class, in each country. This accounting scheme will be discussed in section 4 of this Appendix.

1 DEFINITIONS

All the data presented in this report relating to SMEs is based on non-primary private enterprise. This means that all enterprises belonging to the state are not included in the analysis, as are those enterprises in agriculture, hunting, forestry and fishing. Throughout much of the report, the sectors of industry which comprise non-primary private enterprise are classified as follows (using the NACE-1970 nomenclature):

- extraction (including energy and metal processing; NACE 1, 21 - 24);
- manufacturing (NACE 25, 26, 3, 4);
- construction (NACE 5);
- wholesale trade (NACE 61 - 63);
- retail distribution (NACE 64, 65);
- transport and communications (NACE 7);
- producer services (NACE 8, 94);
- personal services (NACE 66, 67, 91 - 83, 95 - 99).

In some cases, an almost full disaggregation using the second digit NACE classification (NACE-classes) is presented.

There is no unique, formal definition of what constitutes an SME, since no clear analytical threshold for this concept exists. For example, firms are sometimes classified according to their balance sheet, or LSEs are simply defined as the largest x% firms in the sector with SMEs being the remaining firms in the sector. In this report, the number of employees is

¹ Enterprises in Europe - Third Report. Prepared by Eurostat and DG XXIII (1994).

² SEAS: SME in Europe Accounting Scheme.

used to classify firms by size-class. The appropriate size-class classification of firms depends on the particular goal of the analysis. Therefore, disaggregation into multiple size-bands is desirable. 'Enterprises in Europe', which provides the main body of data used in this report, provides the opportunity to distinguish 9 size-classes for all countries:

- micro firms (0 - 9 employees), which can be further subdivided into those employing 0 (the self-employed) or 1 - 9 employees;
- small firms, which employ 10 - 99 people. Size-classes distinguished within this group are 10 -19, 20 - 49, and 50 - 99 employees.
- medium-sized firms, employing 100 - 499 people. Here, the further disaggregation into size-classes is possible between 100 - 199, 200 - 249, and 250 - 499 employees;
- large firms which employ 500 employees or more.

2 A COMPREHENSIVE DATABASE OF EUROPEAN ENTERPRISES, 1990

For each country, 'Enterprises in Europe' provides a fairly detailed picture of the economy, disaggregated by sector and size-class in 1990. However, to provide a comprehensive database by country, sector, and size-class, a number of additional estimates had to be made. These estimates were made at a fairly low level of aggregation, i.e.:

- by 56 2-digit NACE classes (also see Appendix 2 to this chapter);
- 9 size-classes, as outlined below in section 2 of this Appendix.

However, in the Observatory report data is normally presented at a much higher level of aggregation.

Four groups of problems arose in constructing this database:

- first, for some sectors - and in the case of Luxembourg and Spain, for the whole economy - data on turnover was missing;
- second, for some countries, data on enterprises, employment, and turnover only covered part of the economy - usually energy, extraction, and manufacturing;
- third, in some cases only the number of employees was provided, and not total employment;
- lastly, in a number of cases, Enterprises in Europe had combined sectors and/or size classes (because of lack of data or for confidentiality reasons).

How these problems were resolved will be the matter for discussion in this section.

Additional estimation of missing data on the number of enterprises and employment

The estimation of missing data, or the further disaggregation of available data (in sectors and/or size-classes which were combined in 'Enterprises in Europe') has basically been done by merging existing statistical data with expert knowledge from the partners in the ENSR, and further supplemented by other estimates. It was first checked with the partners in the ENSR if any additional information on the number of firms and/or employment by sector and size-class was available from national sources. This source was used for the first-round of estimates. Second, data from the Labour Force Survey, and the OECD Employment Outlook, have been used as a benchmark for sectoral employment. Finally, using appropriate ratios (firm size, the distribution of firms over size-classes, etc.) from countries that are assumed to be comparable, the last gaps were filled.

Of course, at all stages consistency-checks with Enterprises in Europe have been performed.

Additional estimation of missing data on turnover and value added

Missing data on turnover and value added was basically estimated the same way as those on enterprises and employment. The estimation started with the investigations of the ENSR-partners as to what information on turnover by sector and size-class was available. However, in many cases no data on (sectoral) turnover are available¹ and so sectoral output data (from national accounts) had to be used, assuming that the turnover/output ratio does not differ greatly between Member States. In those cases in which no size-class distribution of the sectoral turnover or the value added was available, assumptions regarding (the apparent) labour productivity had to be made.

Again, at each stage consistency-checks with Enterprises in Europe have been performed.

3 ESTIMATING DEVELOPMENTS 1988-1990

The data in 'Enterprises in Europe' for 1988 and 1990 is not fully comparable. This is a result of the introduction of new sources of information by Eurostat and thus of improved measurement methods. The introduction of new sources of information has particularly affected the number of firms counted, especially the number of smaller enterprises being influenced by the introduction of new sources. The comparability of average firm size and turnover per employee does not seem to be strongly influenced by the introduction of new sources of data. This follows from the fact that these ratios might in both 1988 and 1990 be regarded as estimates from a large sample of the total population of firms, disaggregated by sector and size-class².

It appears that the difference in the number of firms between 1988 and 1990, presented in 'Enterprises in Europe', does not coincide with the development of the number of self-employed, as registered by the Labour Force Survey (LFS)³. For example, from 'Enterprises in Europe' a lower number of firms in 1990 (compared with 1988) were recorded for Denmark and Portugal, while the number of entrepreneurs in these countries actually increased quite significantly. On the other hand, 'Enterprises in Europe' records a much larger number of enterprises in Italy and Spain in 1990 as compared to 1988, while at the same time the number of businessmen in these countries increased by significantly less than in the EU as a whole.

Since the LFS is conducted on a regular, comparable basis, it can be combined with data from 'Enterprises in Europe' to estimate the development of the number of firms by sector and by size-class in those countries for which 'Enterprises in Europe' has changed its basic source of information. Generally, it is assumed that the smaller firms are the more

¹ Sectoral data on value added can be obtained directly from the National Accounts.

² Note that in the second report of 'Enterprises in Europe', relating to 1988, a less detailed size-class disaggregation has been used. Thus, the estimate of developments between 1988 and 1990 was based on the size-class distribution of firms used in that report.

³ For EFTA-4 countries, OECD's Labour Force Statistics have been used.

appropriate to estimate growth in the number of firms by the development of self-employment. Larger firms are presumably better observed by 'Enterprises in Europe' than are smaller firms.

As has been noted already, it is assumed that the development of the average firm size can indeed be taken directly from 'Enterprises in Europe'. Using estimates for the development of the number of firms, changes in employment by sector, and by size-class, can be calculated. Note, however, that the sectoral developments in employment have been checked against employment change data presented in the LFS.

Finally, the development of turnover and value added follows from estimated employment change and the assumption that 'Enterprises in Europe' provides an unbiased estimate of turnover and value added per employee.

4 ESTIMATION OF DEVELOPMENTS 1990-1995

Since statistical information only provides data on developments by size-class between 1988 and 1990, additional tools are needed to analyse changes in the most recent years. The instrument used is called the 'SEAS: the SME in Europe Accounting Scheme'. This accounting scheme is designed:

- to link development of turnover and value added by sector and size-class to macro-economic developments;
- to derive the development of employment by sector and size-class from turnover developments and from wages and prices;
- to estimate changes in the number of firms by sector and size-class from turnover development and the general economic climate.

These calculations have been performed for all the countries. So, the Accounting Scheme in fact consists of 16 independent country models.

This section provides a description of the SEAS. First, SEAS itself will be discussed, then the way it is applied.

Estimation of development of real turnover

The development of turnover by size-class in SEAS is derived in three steps:

- first, macro-economic demand indicators are transformed into final demand by sector and macro-economic categories;
- secondly, by means of a multisectoral input-output model, output of intermediate goods and services by sector, and thus total output, is calculated;
- finally, for each sales category turnover by sector and size-class was derived.

Thus, the first step in SEAS is the calculation of the sectoral development of sales for each final demand category. Three categories of final demand are distinguished:

- consumption goods. Sales of consumption goods and services are calculated as follows. First, macro-economic consumption demand is broken down into goods categories. For each country, at least two goods categories are distinguished, *i.e.* food and non-food. This breakdown is performed using long term revealed demand elasticities. Information on the share of these goods categories in total sales of consumption goods by sector makes it possible to calculate potential sales of each sector. Finally, an elasticity between potential sales and actual sales - which is usually smaller than

one due to import penetration - enables the system to calculate the actual output of consumption goods.

- investment goods. Basically, the procedure is the same as with consumption goods. However, the distribution over equipment and buildings is exogenous. Furthermore, the elasticity between potential and actual sales is usually lower than for consumption goods.
- exports. Export growth as published by the Commission¹ is used as the explanatory variable, and directly linked to sales abroad by means of a constant elasticity for each sector. On average, this elasticity is equal to one.

Output of intermediate goods and services is modelled by means of an input-output model for each country. With sales of intermediate goods and services, import penetration is allowed for as well. So, potential sales of intermediate goods is modelled by using the traditional Leontief matrix.

Stockbuilding - which is part of gross production as well - is directly linked to the growth of sales (total sales, that is, inclusive of sales of intermediate goods and services).

At this stage, sales by sector and sales category is known. Using this information, turnover growth by sector, size-class and sales category can be calculated². For each sector and sales-category, it is assumed that:

- on average, turnover growth equals growth of sales³
- smaller firms are more vulnerable to import penetration than larger firms. Since the difference between actual and potential sales in the sectoral submodel described above is a result of import penetration, in case actual sales grows less than potential sales, this will have most serious drawbacks in smaller firms. Of course, the converse holds as well. Note, however, that these effects are very small.

All calculations are performed for second-digit NACE-70 classes.

Base-year information on turnover by sector, size-class and macro economic category

Data on turnover by sector, size-class, and macro-economic sales category are not directly available, and thus have to be estimated. Basically, the following procedure has been applied. For each country, from input-output tables and national accounts, the distribution of output by macro-economic category and sector is known. The following macro-economic categories are distinguished:

- consumption goods and services;
- investment goods and services;
- intermediary goods and services
- exports.

Turnover includes, next to output, the value of purchased goods. It has been assumed that the ratio between turnover and output is the same within each size-class within a

¹ European Economy - Supplement A. no 11/12, 1994.

² This is done for all sectors distinguished in SEAS except for those in NACE-9. So, the sectoral sub-model of SEAS covers the whole economy (thus including agriculture, non-market services and government, while the size-class submodel only covers NACE-classes 1 - 8.

³ Note that turnover includes sales as well as the purchased value of merchandise.

sector of industry. So, total turnover can be assigned to each sales category for each size-class according to the sectoral distribution of sales to goods categories.

This procedure provides a first-round estimate of the distribution of sales. For a number of countries, the distribution of turnover between exports and domestic sales is known. This information has been used to adjust the first round estimates.

Estimation of the development of real value added

The development of real value added is arrived at in two steps:

- first, it is assumed that in each size-class in a sector, real value added growth is equal to the corresponding sectoral average
- secondly, differences between size-classes, and the corresponding sectoral average, are introduced by making this difference equal to the equivalent difference in real turnover growth.

Employment

The development of turnover and value added was basically modelled in a top-down way: starting from macro-economic demand indicators, first sales by sector, and sales category were calculated, and subsequently, sales by size-class was derived from that. Employment however, was modelled in a bottom-up manner. This is because there are essential differences in how small and large firms hire and fire their employees.

First, because of the existence of threshold labour, lack of information, etc., SMEs are assumed to be relatively slow in reacting to production changes. Secondly, because of the large share of labour in total costs in SMEs, the wage elasticity of employment in SMEs is larger than that in LSEs. Finally, autonomous labour saving technological progress is slower in SMEs than in LSEs.

Employment growth by sector and size class is a function of:

- real value added growth. Here, using a lagged adjustment of actual to desired employment, it is assumed that SMEs react more slowly on demand shocks than do LSEs;
- the real wage rate (exogenous; taken from macro-economic data);
- a (negative) constant term, reflecting autonomous technological progress.

Number of enterprises

The growth of the number of enterprises also is calculated in a bottom-up fashion. This too has to do with general differences between firms of different size-classes regarding their growth in number; e.g. start-ups are very important with respect to the growth in the number of micro firms, while it is not important regarding the development of the number of large firms.

Factors determining the growth of the number of firms can be subdivided into:

- factors determining the 'demand for entrepreneurship', especially sales growth. An increase in sales-volume makes it attractive to start an enterprise;
- factors determining the 'supply for entrepreneurship':
 - population growth;
 - unemployment;

Obviously, other things being equal, population growth increases the potential number of entrepreneurs. An increase in unemployment might well lead to an increase in start-ups.

Prices

Prices of sales and turnover are calculated by taking into account all relevant costs for enterprises, that is:

- costs of intermediate consumption (both produced domestically and abroad);
- costs of labour.

This is compared with the development of macro economic prices, such as the consumption price index and the export price index. Adjustments are made to make sales-prices consistent with the latter set of macro economic deflators.

The price of value added is calculated in the sectoral models according to the definition of value added. The deflator of value added by size-class is estimated the same way as real value added growth by size-class and sector.

Applying SEAS

Basically, SEAS can be run using only its exogenous variables - macro-economic consumption growth, investment growth, export markets, real wages, population growth and unemployment in each country - as inputs. However, the system has been benchmarked by updating it with statistical information whenever possible. So, information on the export performance of sectors of industry from Industrial Trends¹ - have been used to calibrate export sales. Also, data from the LFS on employment and the number of self-employed, are used to calibrate the development of employment and the number of firms, respectively. Furthermore, information on GDP development from the European Economy² has been used to calibrate domestic output in each country and each respective year; also, Enterprises in Europe and OECD's Labour Force Statistics have been used in estimating the growth of the number of enterprises. By so doing, the business cycle in each country is taken into account as well. With respect to employment, information from the European Economy has been taken into account to estimate employment developments in broad sectors³.

So, the design and use of SEAS has been such that knowledge about the way the economy functions, as well as statistical information about actual economic development have been integrated such that an estimate of SMEs development between 1990 and 1992 could be provided for each Member State.

¹ Eurostat: Industrial Trends - monthly statistics (various issues)

² European Economy, Supplement A, 11/12, 1994.

³ European Economy provides data on total employment, but also on employment in manufacturing for recent years, for which no LFS is available yet.

Appendix 2 Definition of industries

Regarding private non-primary enterprise, the following sectors and industries are distinguished in this chapter¹:

- extraction, subdivided into:
 - energy (NACE 1):
 - extraction of coal (NACE 11, 12)
 - extraction of gas and oil (including oil refining; NACE 13, 14)
 - public utilities (including nuclear fuels industry; NACE 15 -17)
 - production of metals (NACE 21, 22)
 - production of other minerals (NACE 23, 24):
 - extraction of other minerals (NACE 23)
 - manufacture of non-metallic products (NACE 24)
- manufacturing, subdivided into:
 - manufacturing of chemical products (NACE 25, 26, 48):
 - chemical industry (NACE 25, 26)
 - processing of rubber and plastics (NACE 48)
 - manufacture of metal articles (NACE 31)
 - mechanical engineering (NACE 32)
 - electrical and instrument engineering (NACE 33, 34, 37)
 - manufacture of office machinery (NACE 33)
 - electrical engineering (NACE 34)
 - instrument engineering (NACE 37)
 - manufacture of means of transport (NACE 35, 36):
 - manufacture of motor vehicles (NACE 35)
 - manufacture of other means of transport (NACE 36)
 - food, drink, tobacco (NACE 41/42);
 - textile, leather, clothing (NACE 43 -45):
 - textile industry (NACE 43)
 - manufacture of leather and leather goods (NACE 44)
 - manufacture of footwear and clothing (NACE 45)
 - other manufacturing industries (NACE 46, 47, 49)
 - timber industry (NACE 46)
 - paper industry, printing, publishing (NACE 47)
 - other manufacturing (NACE 49)
- construction (NACE 5);
- wholesale trade (NACE 61-63), subdivided into:
 - wholesale distribution (NACE 61)
 - dealing in scrap and waste (NACE 62)
 - agents (NACE 63)
- retail distribution (NACE 64, 65);
- transport and communication, subdivided into:
 - railways (NACE 71)
 - other land transport (NACE 72)
 - inland water transport (NACE 73);
 - sea and air transport (NACE 74, 75):

¹ Sectoral codes used refer to the NACE-1970 nomenclature.

- sea transport (NACE 74);
 - air transport (NACE 75);
- services to transport (NACE 76, 77):
 - transport related services (NACE 76)
 - travel agents (NACE 77)
- communication (NACE 79)
- producer services, subdivided into:
 - banking, finance and insurance (NACE 81, 82):
 - banking and finance (NACE 81)
 - insurance (NACE 82)
 - activities auxiliary to banking (NACE 83)
 - renting of movables (NACE 84)
 - letting of real estate (NACE 95)
 - research and development (NACE 94; for this sector, no data are available regarding exports and the development between 1988 and 1995)
- personal services, subdivided into:
 - hotels and catering (NACE 66);
 - repair of consumer goods and cars (NACE 67);
 - services to the general public (NACE 92, 93, 95, 96; for this sector, no data are available regarding the development between 1988 and 1995);
 - other personal services (NACE 97-99; for this sector, no data are available regarding exports and the development between 1988 and 1995).

2 BUSINESS DYNAMICS AND ENTREPRENEURSHIP

Co-ordinated by Swedish National Board for Industrial and Technical Development (NUTEK)

MAIN POINTS

- There has been a decline in the number of the birth of new enterprises in many countries. A partial recovery could be seen during 1993.
- Several countries experienced a larger number of deregistered than registered enterprises during the last two years.
- The median value of the number of the birth of new enterprises per 1,000 inhabitants has decreased between 1988 and 1993.
- Relatively speaking, few enterprises are registered within manufacturing and construction sectors while many new enterprises are registered in the service sector.
- New enterprises enjoy high survival rates. Almost seven out of ten survive their first three years of trading.
- Self-employment has decreased by 0.8% in EU Member Countries from 1990 to 1992. The change in self-employment varies a great deal between countries: in Germany self-employment has increased by 21.1% while in Portugal it has decreased by 10.2%. In Sweden the decrease has been even bigger, 19.2%, which is partly due to a start-up boom in 1990 and the subsequent recession.
- The majority of enterprises are not growth oriented. The main objective of these enterprises is to provide the founder with a livelihood. There is, though, a small but important group of enterprises with potential and ability to grow.
- In recent years (the risk of) unemployment has been an increasingly important motive for starting an enterprise.
- Choice of business and good preparation before starting are equally important as factors behind success as managerial experience, motivation and education.
- Lack of capital (collateral) is the most severe obstacle to starting and expanding a business, although this may be symptomatic of other problems within an enterprise.

2.1 INTRODUCTION

This chapter endeavours to answer questions about new enterprises and their significance in generating jobs and promoting industrial and commercial renewal. The issues include what happens to new enterprises in their early years - how many new enterprises survive, and how many will generate jobs, and the motivation and drive of those who start new businesses¹.

In the chapter existing registration statistics are discussed first, together with statistics on genuinely new enterprises. Dynamic issues such as survival, growth, and employment follow. The second part of the chapter deals with the obstacles and opportunities faced by new enterprises, and the motivation and drive behind the establishment of a new enterprise.

2.2 REGISTRATION TRENDS IN NEW ENTERPRISES

An outline of recent trends in different countries can be seen in Table 2.1. The table assumes that there were no serious changes in the registration criteria within individual countries over the period assessed (the 1988 to 1993 period, with 1988 the index year).

The differences between new registrations and genuinely new enterprises is illustrated using data from Statistics Sweden. In 1993 the total number of officially new registrations in Sweden was 67,500. According to Statistics Sweden, a number of these enterprises were take-overs in the agriculture, fisheries, and real estate sectors, furthermore, many were known to have been existing enterprises that merely changed their legal form. When these categories are subtracted from the total number of registrations 44,700 registrations remain.

From the 44,700 remaining registrations a stratified sample was drawn and a survey was conducted to find the number of genuinely new enterprises by excluding changes of ownership and restructured companies. The sample was drawn so that the results could be estimated with a 90% confidence interval, and the survey indicated that there were 18,190 (+/- 3%) genuinely new enterprises. This is only about 40% of the 44,700 registrations that remained after the first filtering exercise.

It is important to note that Table 2.1 does not show the actual level of registrations and start-ups for each country since 1988 but is based on an index. This means that there may have been rapid development from a low base in certain countries, and rapid decline in others.

¹ Most countries do not distinguish between the number of newly-registered enterprises and the number of genuinely new enterprises. Genuinely new enterprises are those that have not previously existed, while new registrations show all enterprises that registered (usually for tax purposes) over a given period, and this will include existing businesses that have changed their legal form.

Figures for genuinely new enterprises exist for Denmark, France, Germany, Norway and Sweden. The percentage of genuinely new enterprises as a proportion of all new registrations is 65% in France, 70% in Germany, and around 40% in Sweden. National data sources also differ in this context as the VAT threshold which determines whether or not an enterprise has to register varies from country to country. Differences such as these are mentioned in notes to the tables.

Table 2.1 Indexed registrations of enterprises by country, 1988-1993

	1988	1989	1990	1991	1992	1993	%-change
Belgium	100	100	95	93	97	n.a.	-3
Denmark	100	117	117	143	131	n.a.	+31
France	100	101	99	91	90	90	-10
Germany 1	100	103	114	120	122	125	+25
Germany 2	n.a.	n.a.	100	110	102	101	+1
Greece	100	84	70	62	69	76	-24
Ireland	100	99	98	n.a.	n.a.	n.a.	-2
Italy	100	95	94	114	103	97	-3
Luxembourg	100	130	137	140	149	159	+59
Netherlands	100	109	112	121	135	n.a.	+35
Portugal	100	112	125	119	146	141	+41
Spain	n.a.	100	99	107	118	n.a.	+18
United Kingdom	100	109	109	91	75	67	-33
Austria	100	115	83	79	91	102	+2
Finland	100	108	95	88	92	96	-4
Norway	100	n.a.	76	n.a.	52	n.a.	-48
Sweden	100	99	117	101	84	94	-6
Europe-16							
median value	100	103	99	107	99.5	99	-1

Germany 1 refers to former Western Germany, and Germany 2 to Germany since re-unification.

Sources:	Austria	Regional databank of the IFG, Vienna.
	Belgium	National Institute for Statistics.
	Denmark	Danish Statistical Bureau.
	Finland	Statistics Finland, Business Register.
	France	INSEE, fichier SIRENE, 1994 in ANCE.
	Germany	IfM in Bonn.
	Greece	National Statistical Services Greece.
	Ireland	Census of Industrial Production 1987-1990.
	Luxembourg	Trade Register.
	Norway	Central Bureau of Statistics.
	Portugal	INE-Monetary and Financial Statistics.
	Spain	Industrial Record Office and IKEI:s Elaboration.
	Sweden	Statistics Sweden.
	the United Kingdom	Business Start-Up Estimates, National Westminster Bank
	Italy	Movimprese Data Bank.
	the Netherlands	Van der Hoeven, W.H.M. and W.H.J. Verhoeven, Creatie en teloorgang van arbeidsplaatsen, EIM Small Business Research and Consultancy, 1994.

During the past five years, the number of new enterprises, has increased in Denmark, Germany (excluding the new 'Bundesländer'), Luxembourg, the Netherlands, Portugal, and Spain¹. In a number of countries: Austria, Belgium, Finland, Germany (as a whole),

¹ Apparently Denmark, the Netherlands, Portugal and Spain show an increase from a relatively low level in 1988. For Luxembourg there are only figures for certain sectors, for Germany one can expect that the re-union has had an impact on the figures.

Ireland (for three years), and Italy, the changes have been very small, while there has been a decline in others: Greece, France, and the United Kingdom. The median value for all 16 countries shows little change over the period. Many countries experienced a decrease in the early 1990s and an increase in 1993; the number of new enterprises appears to fluctuate with the state of the economy.

Evidence supporting this theory is found in the difference between the number of registrations and deregistrations which has decreased significantly in recent years in the countries which provided this information. Finland, Italy, Norway, and the United Kingdom, all show more deregistrations than registrations during the last year for which data was available, however, Belgium has consistently shown a relatively small surplus, while Germany has a large but shrinking surplus. Finland experienced a large number of bankruptcies, about 35% of all closures in 1992.

In order to assess the significance of the above trends, it is important to consider the initial levels of registrations. One way of doing this is to examine the number of new enterprises per 1,000 inhabitants. Another way is to examine the number of new enterprises per 1,000 enterprises. In Table 2.2, these values have been calculated for 1988 and 1993.

Table 2.2 New registrations per 1,000 inhabitants, 1988 and 1993, per 1000 enterprises 1993

	New registrations/1,000 inhabitants		New registrations/1,000 enterprises
	1988	1993	1993
Belgium	5.7	5.4 *	131 **
Denmark	2.5	3.3 *	139
France	5.4	4.7	118
Germany***	5.4	6.2	168 **
Italy	5.2	4.8	71 **
Netherlands	2.5	3.3 *	118 **
Portugal	1.5	2.1	115 **
Spain	2.8	3.3 *	52 **
United Kingdom	4.3	3.3 *	72 **
Austria	n.a.	2.9	120
Finland	4.1	3.9	161
Norway	6.6	3.4	n.a.
Sweden	4.8	4.6	110
Europe-13 median	4.3	3.4	

* 1992.

** 1990.

*** 1988 excl. new 'Länder', 1993 incl. new 'Länder'.

Source: See Table 2.1, the figures for France have been recalculated.

The table shows that the median rate of registration decreased between 1988 and 1993. Most countries experienced relatively little change; and Norway alone shows a significant decline during this period. Relatively high registration rates were found in Belgium and

Germany, and to a lesser extent in France, Italy, and Sweden. The Netherlands, Portugal, Spain and the United Kingdom show lower rates of registration. The Danish and Norwegian numbers are based on genuinely new enterprises and are therefore lower by definition.

There are significant differences in the number of new registrations per 1,000 enterprises between countries, partly due to differences in the total number of enterprises in each country. Countries like Spain, the United Kingdom, and Italy, show relatively low rates of registration, whilst the opposite is true of Denmark, France, Germany, and the Netherlands.

There are also differences in new registrations by sector. In general, a large proportion of all the new registrations took place in the service sector, while manufacturing and construction were less important. Table 2.3 gives the figures for the most recent year for which data was available.

Table 2.3 Newly-registered enterprises as a percentage of the total number of enterprises in 1992 or 1993

	Manufacturing		Construction		Services	
	new	total	new	total	new	total
Belgium-92	6.3	12.3	11.2	12.3	81.9	75.4
Denmark-92	8.1	29.5	6.6	9.0	85.3	61.5
France	8.7	12.1	12.2	14.3	79.1	73.6
Luxembourg-89	3.1	6.2	6.2	7.4	90.7	86.4
Netherlands-92	6.5	27.1	5.3	9.9	88.2	63.0
Portugal	13.4	24.2	9.0	11.2	77.6	64.6
Spain-92	11.9	25.7	22.0	10.8	66.1	63.5
United Kingdom-92	10.1	11.0	11.9	16.3	78.0	72.7
Finland-92	29.8	36.4	20.2	23.8	50.0	39.8
Norway-92	9.7	10.3	14.3	15.6	78.0	74.7
Sweden	7.4	10.4	11.5	11.7	81.1	77.9
Median value	9.7	12.3	11.5	11.7	79.1	72.7

Finland's figures include only VAT-registered firms; France's figures include only genuinely new firms.

Sources: Belgium NIS: (National Institute for Statistics): *VAT files*.
Denmark The Danish Statistical Bureau.
France INSEE, *fichier SIRENE* in ANCE.
Luxembourg STATEC: *CEPS/INSTEAD*; Chambre des Métiers - Luxembourg.
The Netherlands Hoeven, van der, W.H.M. and W.H.J. Verhoeven: *Creëte en teloorgang van arbeidsplaatsen (Creation and loss of employment)*, EIM Small Business Research and Consultancy, June 1994.
Portugal INE - *Monetary and Financial Statistics*.
Spain Ministry of Labour: *Openings of Establishments*; Industrial Record Office.
The United Kingdom DTI: *Statistical Bulletin, November 1993*.
Finland Statistics Finland: *Business Register*.
Norway Central Bureau of Statistics, Norway.
Sweden Statistics Sweden: *New firms in Sweden 1992 and 1993*.

Table 2.3 includes data for eleven countries. Generally the results show a low frequency of enterprise establishment in the manufacturing sector and a high frequency of establishment in the service sector. This probably indicates a continuing restructuring of national economies through growth in the service sector, but it is important to note that some of the increases will be spin-offs from existing enterprises.

France is one country for which it is possible to assess the size of genuinely new enterprises. In three cases out of four, these enterprises had no wage-earner. Only about seven per cent of the genuinely new enterprises had at least three wage earners in 1993. They were also relatively smaller, in terms of the number of wage earners, in 1993 to those established in 1988¹.

There are two ways of assessing the significance of new enterprises. The first is to look at the surplus, that is the difference between newly-registered enterprises and enterprise closures. It is, for example, quite possible for a low level of newly-registered enterprises to be highly significant if the number of closures rate is still lower. Since there do not exist adequate data at present, this method is not pursued in this chapter.

The second way is to analyse the survival rate among newly-registered enterprises: a large number of registrations is of little significance if the survival rate is low. It is more difficult to estimate survival as this requires monitoring of newly-registered enterprises throughout their existence, but studies have been conducted in many countries (see Table 2.4).

Table 2.4 has compiled the results from several interim studies, and differences in the survival rates may be partially explained by differences in the sectors and periods covered, especially considering the impact of the recession. However, despite these caveats, the median shows that almost nine out of ten newly-started enterprises survive for one year, seven out of ten survive for at least three years, and more than half are still operating after five years. Denmark, Germany, Ireland, and Sweden show relatively higher survival rates.

In such analysis closures or contractions can be explained in many ways, but one explanation of the generally high rate of survival rate may be that many of these enterprises were started as a hobby; hence the likelihood of business 'failure', and subsequent closure, is less than would be the case amongst conventional businesses.

¹ INSEE, fichier SIRENE in ANCE.

Table 2.4 Survival among newly-registered or newly-established enterprises, per cent

	Percentage of enterprises surviving after			Starting year
	1 year	3 years	5 years	
Belgium	84	n.a.	n.a.	1990
Denmark	n.a.	69	58	1985
France	84	62	48	1987
Germany*	86	70	63	1985
Ireland	91	70	57	1986
Italy	87	66	54	1987
Luxembourg	76	56	45	1980
Netherlands	90	74	n.a.	1988
Portugal	76	56	47	1986/87
Spain	n.a.	70	n.a.	1986
United Kingdom	87	62	47	1980
Finland	91	63	55	Various studies
Norway	92	68	53	1980
Sweden	n.a.	70	59	1988
Median value	87	68	54	

* Refers to former West Germany.

Sources:	Belgium	Degardt, J. 1992.
	Denmark	Danish Statistical Bureau.
	Finland	Confederation of Finnish Entrepreneurs.
	France	INSEE and ANCE.
	Germany	IfM.
	Ireland	Department of Enterprise and Employment.
	Italy	INPS Data-Bank.
	Luxembourg	Chambre de Commerce.
	Portugal	MESS-Portuguese Enterprise's Demography.
	Spain	IKEI Survey.
	Norway	Statistical Bureau of Norway.
	Sweden	Statistics Sweden.
	The United Kingdom	Department for Trade and Industry.

2.3 SELF-EMPLOYMENT

Self-employment can be considered as an indicator of the degree of entrepreneurship. The term self-employment refers to people who provide themselves with work as entrepreneurs rather than seeking paid employment elsewhere. The Second Annual Report of the European Observatory distinguished between two definitions:

1. Persons who are leading a business which is not legally incorporated. These people have no salary but live from the profits of the enterprise. They have full personal liability for the conduct of the business.
2. Owner-managers who gain a share of the profits as well as a salary from an incorporated business. This type of entrepreneur only runs a risk equal to his share of the paid-up capital in the business.

People in the first category are clearly self-employed, but there is some debate about those in the second since the individual does not only live off the profits but also receives a salary. In some countries only the first category are considered to be self-employed (France, the Netherlands, and the United Kingdom), whilst in others (Belgium, Denmark,

Germany, Ireland, Luxembourg, Portugal and Spain), the owner-managers of incorporated businesses are also included.

Table 2.5 shows the number of persons working in their own business, professional practice or enterprise.

Table 2.5 Self-employed and employers, 1990-92 (x 1,000)

	Self employment 1990	Self employment 1991	Self employment 1992	Change in % 1990-92	Self employment/ labour force 1992
Belgium ^a	583	555	568	-2.6	14.1
Denmark ^a	252	238	233	-7.5	8.0
France ^a	2813	2781	2757	-2	11.2
Germany ^a	2592	2688	3140	21.1	8.1
Greece ^a	1293	1279	1301	0.1	32.6
Ireland ^a	256	244	257	0.1	19.0
Italy ^a	5151	5230	5386	4.6	23.2
Luxembourg ^a	15	15	15	0	8.9
Netherlands ^a	620	628	671	8.2	9.6
Portugal ^a	1200	1276	1077	-10.2	22.9
Spain ^a	2616	2568	2631	0.1	17.4
United Kingdom ^a	3560	3402	3211	-9.8	11.3
EU 12 ^a	20951	20903	21249	-0.8	13.8
Austria ^b	150	151	152	1.3	n.a.
Finland	n.a.	n.a.	n.a.	n.a.	n.a.
Norway ^c	184	n.a.	177	-3.8	n.a.
Sweden ^d	379	326	305	-19.2	6.8

Sources: a. Eurostat, European Labour Force Survey. (Self-employed defined as persons who work in their own business, profession practice or firms. Figures include agriculture).
 b. Statistisches Handbuch der Österreichischen Sozialversicherung, 1994.
 c. Statistical Bureau of Norway, 1994.
 d. Statistics Sweden, Regional Labour Statistics, 1990-92.

During the 1990-92 period, self-employment in the EU as a whole decreased by 0.8%, but there was according to the latest information at Eurostat, considerable variation between countries. In Germany self-employment increased by 21.1% while in Portugal it declined by 10.2% and in Sweden by 19.2%. The sharp decline in Sweden can be partly explained by a start-up boom in 1990 followed by the recession.

Of those who were self-employed in 1992, only 26% were women. The countries with the highest percentages of self-employed women were Portugal (40%) and Luxembourg (33%), and the countries with the lowest percentages of self-employed women were Ireland (14%), Denmark (18%) and Greece (20%).

2.4 JOBS GENERATED BY NEW ENTERPRISES

The term business dynamics refers not only to the number of start-ups and closures, but also to changes in job availability, structure, markets, production methods, and working procedures. These dynamics are influenced by a number of different factors, and it is not possible to discuss them all within this chapter. There is, moreover, a lack of representative and comparable data for the European countries, although research is being undertaken in several. One issue that is understandably receiving increased attention is employment. The dynamics of new enterprises with regard to employment are therefore discussed in this section (employment in SMEs, rather than in new enterprise, is discussed in greater detail in Chapter 3 Labour).

The expansion of new enterprises and SMEs is a complicated issue. Many factors may influence growth but it is difficult to measure growth in a comparable way. Many new enterprises and SMEs are not even interested in expansion as many entrepreneurs are content with a yield that they, and any employees, can live on. They are often particularly reluctant to lose control over their 'own' business, and expansion may threaten control.

There are, however, new enterprises and SMEs that do want to grow. Several studies have been conducted on rapidly expanding enterprises. One study estimates that 4% of the enterprises started today will account for half the employment of the surviving enterprises in ten years' time¹. However, it is important to see the limitations of studying growth by the number of employees alone. Another study² shows that whilst a rapid increase in the number of employees in SMEs is closely related to the expansion of the turnover of the enterprises, it is not strongly linked to increasing profitability.

There are no general statistics on employment growth, but ad hoc studies have been done. Some show growth and others a decline in total employment after five years: a Danish study³ found 24% growth in employment after five years, but a French study⁴ estimated a decline in employment of 26% over five years.

Many studies only follow enterprises which survive throughout the period of analysis, which naturally yields an average figure indicating growth. In Luxembourg, for example, a study⁵ of the craft sector showed a growth of 198% during the first five years, and a Swedish study⁶ shows employment growth of 52%.

¹ Storey, D.J. *Small Firms in Regional Economic Development*, Cambridge University Press, Cambridge, The United Kingdom, 1985.

² Storey, D.J. and S. Johnsson, *Job Generation and Labour Market Change*, Basingstoke, 1987.

³ The Danish Statistical Bureau, 1990.

⁴ ANCE, 1992.

⁵ Chambre des Métiers, 1984.

⁶ Statistics Sweden, 1993.

Table 2.6 Jobs gains and job losses (%)

	United Kingdom						
	Denmark	Finland	France	Germany	Italy	Sweden	United Kingdom
	83-89	86-91	84-92	83-90	84-92	85-92	85-91
Gross job gains	16.0	10.4	13.9	9.0	12.3	14.5	8.7
Openings	6.1	3.9	7.2	2.5	3.9	6.5	2.7
Expansions	9.9	6.5	6.7	6.5	8.4	8.0	6.0
Gross job losses	13.8	12.0	13.2	7.5	11.1	14.6	6.6
Closures	5.0	3.4	7.0	1.9	3.8	5.0	3.9
Contractions	8.8	8.7	6.3	5.6	7.3	9.6	2.7
Net employment change	2.2	-1.6	0.6	1.5	1.3	-0.1	2.1
Net entry (openings less closures)	1.1	0.5	0.2	0.5	0.2	1.5	-1.2
Net expansion (expansions less contractions)	1.1	-2.1	0.4	0.9	1.1	-1.6	3.4
Job turnover	29.8	22.4	27.1	16.5	23.4	29.1	15.3
Base period Employment (thousands)	1,447	1,308	12,778	16,350	8,381	2,306	16,744

Source: OECD, Employment Outlook July 1994, Paris, 1994.

Table 2.6 shows that the highest net change in employment was in Denmark (+2.2%), and the lowest net change was in Finland (-1.6%). Overall, new enterprises and expansions in existing enterprises generated only slightly more jobs than those that disappeared as a result of closure and contraction.

In almost all the countries studied except for France, expansion and contraction have a greater short-term impact on employment figures than new enterprise creation and closures.

Another important dynamic process underlies the net changes. Job turnover varies in the countries studied from 16.5% in Germany to 29.8% in Denmark. This means that between a third and every sixth job is changed during a year; a flexibility of the labour market that is of major importance today with rapid changes in society, but opinions differ as to whether or not this trend is wholly positive. In cases where more job opportunities are created in sectors that are internationally competitive and profitable, these changes are positive from the point of view of trade and industry, but in cases where the new jobs are created in less profitable sectors the competitiveness benefits are less even though the jobs are significant to the labour market.

2.5 ENTREPRENEURIAL BACKGROUND

Irrespective of his country, the typical entrepreneur is a man aged about 35 who has previously worked in a small, private enterprise, in a mid-management position, or as a skilled worker, and has an average educational background relative to the population as a whole.

This though is the 'average' entrepreneur. If we look at each country and the type of enterprise started, the picture becomes more complicated. In Belgium for instance, 81% of those who start high-tech enterprises have university qualifications. In Ireland, France, Germany, the Netherlands, and Sweden, a starter tends to be from amongst the better-educated sections of the population (see also chapter 12).

In Italy, 16% of enterprises are started after a period of unemployment, in Sweden, the corresponding figure is 29%, and in France 33%, but in Luxembourg only 0.6% of those who started enterprises in craft trades did so from unemployment.

In Germany, female starters are younger than their male counterparts, and preceding unemployment is three times more common among women entrepreneurs than amongst men.

The proportion of female starters averages 27% of the total. There are however, national differences as illustrated in Table 2.7.

Table 2.7 Female starters as a percentage of the total

Belgium	ca 30	Austria	38*
Denmark	26	Finland	33
France	25-30	Norway	30
Germany	26	Sweden	19
Italy	25**		
Luxembourg	15***		
Netherlands	ca 25		
Spain	ca 25		

* Special study of 306 enterprises.

** Leader of existing enterprises.

*** In crafts trade.

Sources: Belgium	<i>National Departement of Health and Social Security (RSVZ: Rijksdienst voor sociale verzekering der zelfstandigen), 1994.</i>
Denmark	The Danish Statistical Bureau: <i>New companies in 1991.</i>
France	ANCE - <i>data for 1991, 1993.</i>
Germany	Institut für Mittelstandsforschung, Bonn.
Italy	I.N.P.S.
Luxembourg	Chambre des Métiers, Luxembourg 1991.
The Netherlands	EIM Small Business Research and Consultancy.
Spain	EMAKUNDE: <i>Las Mujeres Empresarias: un valor en alza, 1994.</i>
Austria	Frank, H./Wanzenböck, H: <i>Insolvenzquoten und Entwicklungslinien von geförderten Unternehmensgründungen, Wien, 1994.</i>
Finland	Statistics Finland: <i>Business register.</i>
Norway	Agder Research, Kristiansand.
Sweden	Statistics Sweden, 1994.

The small percentage of female starters in Sweden can partially be explained by the fact that, relative to other countries, there is a high number of women who are employed in the public sector, which has, until recently, had a limited scope for breeding entrepreneurs and this has been a constraining factor.

Female entrepreneurs are mainly to be found in the catering, trading, and service sectors. Operations are usually limited in scope and involve low capital requirements, both at start-up and for expansion.

Only a very limited number of countries have provided information about the role of spouses. In Austria one study found that 27.8% of the founders employed their spouses when starting their enterprise. A study in Denmark found that the number of spouses employed was about 10%. Work in the Netherlands¹ showed that, in the Community of Ten in 1986, approximately thirteen million women were running their own independent businesses, or were working in their husband's business. It was found that two thirds of these women were co-enterprising spouses (8,185,000). This number is greater than the total number of women registered as employers, self-employed, or as a family workers, in the 12 Member States during the same year. The number of co-enterprising spouses is therefore far larger than official statistics indicate.

Case A

How many people consider starting their own enterprises?

In France, a study has been carried out to find out how many potential entrepreneurs are interested in starting a new enterprise. The findings show that out of a the total French population of 22 million in the 20 to 57 age bracket, 6 million have considered starting their own business, 3.5 million have a business project in progress, 650,000 are considering starting within a year, and 220,000 started a business in 1993. This means that about 27% of the population in this age group have considered becoming entrepreneurs at one time or another. However, only about 1% actually start a business during a given year. These results are similar to those found by studies in the USA² and Sweden³.

In the French study, 40% of those who have business projects in progress were in employment, whilst 60% were unemployed. Of those who actually started a company a smaller share (33%) were previously unemployed. Fifty-five per cent of those who had business projects were men (to 45% women), and of those who actually started a business, 70% were men.

Source: ANCE, IFOP Survey, November 1992.

2.6 MOTIVES AND DRIVING FORCES BEHIND BUSINESS START-UPS

It would seem that self-realisation, the will to be independent, and business ideas/opportunities (all pull motives) are, alongside the risk of unemployment (the main push factor) the most important motives for starting a new enterprise. During recent years, unemployment has become an increasingly important motive in many countries, including Denmark, Belgium and the Netherlands.

¹ Peters, M.L.A., Key Issues Regarding the Social Protection of Co-Enterprising Spouses in SMEs, paper for the European Conference on Women Entrepreneurs and Co-entrepreneurs in Family Business, EIM Small Business Research and Consultancy, Zoetermeer, 1994.

² Reynolds, Paul and S. White, Wisconsin's Entrepreneurial Climate Study, Marquette University, USA, 1993.

³ Lundström, A. and E-L Löwstedt, Having business ideas - creating new firms, Örebro, Sweden, 1994.

Table 2.8 Motives and driving forces behind the start of an enterprise

	Self- realisation	Business opportunity	The will to be independent	(Risk of) unemployment	Belief in higher income	Entrepreneurial environment
Belgium	X (1)	X	X	X (1)		
Denmark	2	1	2	3	4	
France	X		X			X
Germany (West)	1	3	2	X	3	
Greece	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ireland		X				X
Italy	1	1 (2)		2	2	
Luxembourg	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Netherlands	X	1	X	2	X	X
Portugal	1	2	3			
Spain	1	2	1			
United Kingdom				X		
Austria	1	X	2		3	X
Finland	X	X	X	X		
Norway	2	3	1			
Sweden	3	4	2	1	5	

Figures in the table indicate order of importance, where 1 = most important, 4 = least important.

'X' indicates that the factor is mentioned, but not its order of importance.

Sources: Belgium	Bragard, I., Donckels, R., Michel, P., Demarcke, M-P and Dupont, B.: <i>De nieuwe ondernemer (The New Entrepreneur)</i> , Brussels, Liège, Intercollegiate Center for Management Science, 1987.
Denmark	National Institute of Social Research and Danish Technological Institute: <i>The Enterprise Allowance Scheme, 1992</i> .
France	ANCE: <i>IFOP survey</i> , November 1992.
Germany	Institut für Mittelstandsforschung, Bonn.
Ireland	Donoghue, F.: <i>Entrepreneurship - a literature review</i> , Policy Research Centre, Dublin, 1994.
Italy	ENSR: <i>The European Observatory for SME: First Annual Report</i> , p. 158, p. 160.
The Netherlands	EIM Small Business Research and Consultancy: <i>Creatie en teloorgang van arbeidsplaatsen, 1994</i> .
Portugal	IAPMEI: <i>The New Entrepreneur</i> .
Spain	Veciana, J. M.: <i>Características del empresario en España; Papeles de Economía</i> , No 39, 1989.
The United Kingdom	Storey, D.: <i>Understanding the Small Business Sector</i> , Routledge, London, 1994.
Austria	Institut für Gewerbe- und Handwerksforschung, Vienna 1995.
Finland	Tervonen, Hannu and Niittykangas, Hannu: <i>Työttömyydestä ä yrittäjäyteen?</i> , Työpoliittinen Aikakauskirja 2/1993.
Norway	Sletten, J.: <i>Fra etableringsopplæring till bedrift? FOU-rapport 142</i> , Agder Research Foundation, Kristiansand (Norway), 1993.
Sweden	Statistics Sweden, 1994.

The reason for starting a business may have different implications despite the same general motives being given. For instance, amongst men, the will to be independent usually means that they want to be their own boss, whilst amongst women, it is more often a matter of financial independence.

2.7 FACTORS BEHIND SUCCESS

Table 2.9 lists the entrepreneur-related factors that have been stated as being most important to business start-ups and expansion. A propensity to take risks is also given as a factor for success, but a less important one.

Table 2.9 Success factors

	Management experience/Commercial know-how	Positive motivation/strong confidence	Educational	Ability to adapt to changes	Network/active board/use of consultants	Strategic insight	Well planned start	Entrepreneurial background
Belgium	X	X	X		X		X	X
Denmark	X		X		X			
France		X		X	X	X	X	X
Germany	X		X		X		X	X
Ireland				X		X		
Netherlands	X			X			X	
Spain		X		X		X		
United Kingdom	X	X	X					
Austria	X			X	X		X	X
Finland	X	X			X			
Norway	X							X
Sweden	X	X	X					

'X' indicates that the factor is mentioned, but not its order of importance.

Sources: Belgium	Donckels, R.: <i>De startersgids (Startersguide) Brussels</i> , Roularta Books, CERA, 1992.
Denmark	Andersen, Ib et al.: <i>Success criteria for entrepreneurs</i> , The Danish for Development of Industry and Trade, 1992.
France	ANCE.
Germany	Institut für Mittelstandsforschung, Bonn.
Ireland	Donoghue, F.: <i>Entrepreneurship - a literature review</i> , Policy Research Centre, Dublin, 1994.
The Netherlands	ING Bank: <i>Starten op z'n best (Starting the best way)</i> , Amsterdam, 1993. Koster, E. and Pruis, M.N.: <i>Onderzoek naar de succes- en faalfactoren van startende ondernemers</i> , Hogeschool van Amsterdam, 1992.
Spain	Veciana, J.M., <i>Características del empresario en Espana</i> , Papeles de Economica No 39.
The United Kingdom	Storey, D.: <i>Understanding the Small Business Sector</i> , Routledge, London, 1994.
Austria	Institut für Gewerbe- und Handwerksforschung, Vienna 1995.
Finland	Delphi 26.9.1994.
Norway	Agder Research, Kristiansand, 1993.
Sweden	NUTEK.

Findings from Danish studies reveal that the higher survival rate in enterprises started by people with a solid educational background are more a reflection of the choice of the business and thorough preparation rather than of the entrepreneur's actual educational

level. However, the choice of business and the state of preparation may themselves reflect a good education¹.

In a newly published book from the United Kingdom², eighteen different studies of success factors are compared. According to this book some factors appear to be more significant than others. It should be borne in mind, however, that information is incomplete, since no study has included all the (15) variables.

Motivation appears to be 'of some importance'. Furthermore, 'individuals with higher levels of education are more likely to be found in rapidly growing enterprises, as are those with some prior managerial experience'. Another result seems to indicate that 'rapidly growing enterprises are more likely to be founded by groups, rather than by a single individual'.

The most important negative factor was unemployment push. Four studies (of a total of 8 that included the factor) found a negative link: an enterprises started by an unemployed person was likely to under-perform (in terms of growth) those started by former employees. However, four other studies found no such link.

These patterns, positive or negative, are not very strong; 'what the entrepreneur has done prior to establishing the business seems to exert only a modest influence upon the success of the business'.

It should also be borne in mind that there may be considerable variation between the different commercial and industrial sectors, and within the sectors themselves.

2.8 OBSTACLES AND BARRIERS TO START-UP AND EXPANSION

The studies of obstacles to business start-up and expansion in different countries almost always mention a lack of capital as the most important factor. This is followed by, in declining order: inadequate demand, lack of entrepreneurial insight, social fees and taxes, and shortcomings in marketing ability.

Other factors mentioned include a lack of will or courage, (excessively) long lead times for product development, poor financial skills, and inflexible labour laws.

However, average figures do not provide a really coherent picture. New enterprises and SMEs are highly heterogeneous in terms of sector, development phase, and potential, so the most important obstacles to start up and expansion may differ widely.

This is illustrated by a British study. Entrepreneurs in small but stable or declining enterprises stated that inadequate demand was the single most important obstacle, whilst entrepreneurs in rapidly growing enterprises place this factor fifth. A lack of capital was the greatest obstacle in the latter group, a factor that entrepreneurs in stable or declining enterprises rank fourth.

Similar findings emerged from a Portuguese study. Entrepreneurs in newly-started enterprises stated a lack of demand as the third most important obstacle, while those in older

¹ See chapter 12 for a deeper discussion about the relationship between education and entrepreneurship.

² Storey, D.J. *Understanding the Small Business Sector*, London 1994.

enterprises rank this factor in eighth place. Both categories, however, ranked a shortage of capital first.

It should be borne in mind that shortage of capital and difficulties in attracting external capital may in many cases be the result of other problems in the company. Financiers may have judged the business idea to be too weak or the marketing inadequate.

Table 2.10 Obstacles to start and expansion

	Lack of collateral/capital	Lack of demand	Inadequate business skills	Social fees/taxes	Inadequate marketing skills	Uncertain market trends	Major financial risk
Belgium	1	3	X		X		X
Denmark	1		X		3	X	2
France	2			1		5	1
Germany	1	X		3			
Ireland	X						
Italy	2	1	3				
Netherlands	1	X	2		3		
Portugal	1	3		X			
Spain	X	X	X	X	X		
United Kingdom	X	X			X		
Austria	1	X	X		X		X
Finland	1		X	X		2	
Norway	X		X				
Sweden	X				X		

Figures in the table indicate order of importance, where 1 = most important, 5 = least important.

'X' indicates that the factor is mentioned, but not its order of importance.

Sources: Belgium	Moyson, F. Seghers, N. and Vuerings, R.: <i>Zin voor ondernemerschap: empirisch onderzoek bij studenten Toegepaste Economische Wetenschappen</i> , Leuven, 1985.
Denmark	Jakobsen, L.: <i>The Need by New Innovative Companies to Receive Advice - Experiences From the Start-up Scheme 1994</i> . Jakobsen, L.: <i>Innovative Entrepreneurs - Experiences from the Scholarship Scheme</i> , 1994.
France	ANCE.
Germany	Institut für Mittelstandsforschung, Bonn.
Ireland	<i>Task Force on Small Business (March 1994)</i> , The Stationary Office, Dublin, 1994.
Italy	ENSR: <i>The European Observatory for SMEs: First Annual Report</i> , p.158, 1993.
The Netherlands	ING Bank: <i>Starten op z'n best (Starting the best way)</i> , Amsterdam, 1993. Koster, E. and Pruis, M.N.: <i>Onderzoek naar de succes- en faalfactoren van startende ondernemers</i> , Hogeschool van Amsterdam, 1992.
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Spain	Rojo Torrecilla, E. and Vidal Martinez, I.: <i>Mercado de trabajo y política de fomento del empleo autónomo</i> , Información Española No 729, 1994.
The United Kingdom	Storey, D.: <i>Understanding the Small Business Sector</i> , Routledge, London, 1994.
Austria	Institut für Gewerbe- und Handwerksforschung, Vienna 1995.
Finland	OECD: <i>Globalisation of Economic Activities and Small and Medium Sized Enterprises' Development</i> , Helsinki School of Economics, 1994.
Norway	Sletten, J.: <i>Fra etableringsopplærning til bedrift? FOU-rapport 142</i> , Agder Research Foundation, Kristiansand (Norway), 1993.
Sweden	NUTEK.

3 LABOUR

Co-ordinated by SME Centre, Warwick University

MAIN POINTS

- Despite valid methodological criticism of studies alleging a dominant role for small enterprises in the job generation process, implying that the job creation prowess of SMEs is overstated, prevailing evidence shows that SMEs still outperform LSEs with regard to job creation.
- Although knowledge of job creation by enterprise size remains relevant, increasingly important in this respect are the interrelationships between SMEs and LSEs.
- Over the last 30 years the growth of small enterprises, together with the growth of part-time and temporary jobs, flexible working, low pay, poor conditions and so on, can be partly understood in terms of strategies of large scale enterprises to cope with growing uncertainty in global markets.
- Involuntary part-time and temporary working, inversely correlated with job quality, is shown to be of significance in the Union. Part-time working and temporary working, for example, each constitutes 5%-10% of male and female jobs. Also, both are growing in importance.
- Part-time and temporary work is more frequent in women's employment and is concentrated in smaller enterprises in the service sectors. There is also probably a trade-cycle component in its variation over time.
- Normal working hours have been reduced by 1-2 hours a week in the Union in the last decade. The biggest difference in working hours, however, is between employees and the self-employed. The latter have been on the increase in most Union countries.
- Education levels of the workforce increase with enterprise size. However, they are lower for the self employed than for workers in micro enterprises.
- Health and Safety of the workforce increases with enterprise size, along with wages and fringe benefits offered to workers.

3.1 INTRODUCTION

This chapter focuses on enterprise level performance aspects of labour issues and builds on the material in the chapter 'Employment creation and human capital' of the Second Annual Report. It is concerned primarily with themes that are micro-economic, enterprise-level and internal to the enterprise. Both the internal labour markets of enterprises, and the nature, quantity and quality of jobs generated by enterprises of different sizes are described and analysed. The chapter largely ignores broader issues relating to the labour market in particular sectors (assigned to chapter 8: Labour Market), except where these are essential to the interpretation of the material presented. It also ignores issues relating to the even wider macro-economic picture of the Union's country-wide labour markets

(assigned to chapter 6: Macro-economic Developments). Finally, it also bypasses issues that relate to other 'labour' aspects of the micro-economic environment, such as the legal framework (see chapter 13) or the education system (see chapter 12), except insofar as these have an identifiable enterprise size dimension.

In the latest Employment Outlook¹ the OECD paid attention to the job creation potential of SMEs. The general message of the OECD was that on account of severe methodological problems the job creation potential of SMEs might have been overstated. In addition, it was stated, SMEs might not be 'independent' motors of employment growth, since the functioning of SMEs and LSEs in everyday life is heavily interwoven. The OECD concluded that enterprise size per se is not critical for job creation and that in general it is much more fruitful at analysing the synergy of small, medium and large scale production.

The present chapter will assess this critique. The structure of the chapter is as follows. In section 1 (and in appendix 1 to this chapter in more detail) the delicate issue of job generation by SMEs will be dealt with. Methodological problems concerning the measurement of job creation by SMEs will be discussed and also attention will be focused on strategies of large scale enterprises to withdraw to core business and outsource non-core activities, which might further distort the picture of independent job creation by SMEs.

Section 2 of this chapter is closely linked to the latter issue. Relationships between LSEs and SMEs are increasing, at least partly due to policies of LSEs to deal with increasing uncertainties. Currently lean production, subcontracting, outsourcing and strategic alliances are the key management concepts in LSEs. In this context LSEs seem to make use of relative flexible labour relations in SMEs, which are said to work to the detriment of job quality in SMEs. Therefore in section 2 job quality and changing labour relations in SMEs will be dealt with.

3.2 JOB CREATION IN SMEs

3.2.1 Introduction

The growing role of small enterprises has been a theme of the 1980s and continues to be central to policy discussion in the 1990s. However, the premises of this assumption have recently been questioned. The criticisms levelled at both job generation studies and their interpretation are of sufficient academic weight to merit detailed discussion and evaluation. If correct, they would impugn the validity of the conclusions reached in the Observatory reports and other studies, together with the policy implications deduced from them.

3.2.2 Methodological problems

Recently the OECD², among others,³ has questioned the job creation prowess of SMEs. Mainly on basis of an examination of manufacturing employment change in the United

¹ OECD Employment Outlook, OECD, July 1994, Paris, p. 121-127.

² See Chapter 3 of OECD (1994), Employment Outlook, Paris.

³ Davis, S.J., J. Haltiwanger and S. Schuh (1993), 'Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts', BNER.

States, it has been stated that the contribution of small enterprises to employment creation has been substantially over-emphasised.

Three major criticisms of job generation studies have been raised and are briefly discussed in this section. A more detailed discussion is to be found in the appendix to this chapter.

Misinterpretation of the data

It has been pointed out that, even with no statistical flaws in the analysis, and perfect data, if small enterprises were to figure as the major sources of new jobs in an economy, this would not, of itself, provide any policy insights. It certainly would not justify government intervention either to increase or reduce support for the small business sector, it has been argued¹. Policy requires knowing not merely where the new jobs are created but also how and why they are created there. For example it has been argued that rather than the small enterprises themselves generating the jobs, it is the uncertainty-reducing and cost-reducing strategies of large enterprises that have been primarily responsible for the growth of the small enterprise sector.

Problems with the analysis of cross section employment data by enterprises size

It has correctly been argued that, when analysing cross section data on the change of the distribution of employment by enterprise size, an observed increase in the contribution to employment of small enterprises between two periods of time does not necessarily mean small enterprises have been contributing to job creation. Any apparent increase in the importance of small enterprises could be exclusively because large enterprises become smaller, rather than because small enterprises grow larger.

Problems with the analysis of longitudinal data of individual enterprises

The use of longitudinal data on individual enterprises eliminates the problems arising from the crossing of boundaries by growing SMEs or downsizing LSEs. In this case it is however also possible to step in methodological pitfalls. For example, in instances where there is no overall change in the employment of an enterprise, but where there are fluctuations over time about the enterprise's mean size (e.g. due to macro-economic events), it is possible to conclude that there is a statistical relationship between size and growth, where in reality there is none, a statistical phenomenon which is described as the 'regression to the mean fallacy'. Indeed, much studies stepped into this fallacy, and incorrectly overstated employment growth in SMEs relative to LSEs.

These methodological problems are relevant and need careful attention. To do this, the current report of the European Observatory for SMEs develops a method, by which it is possible to make unequivocal statements on the job creation prowess of SMEs. Specifically, this means that SMEs still play a major role in job creation in the EU-12 and that at the same time it is necessary to pay attention to the interrelationships between SMEs and LSEs, as a means of a better understanding of employment developments in SMEs.

¹ Also see: Harrison, B. (1994), 'Lean and Mean', New York.

The latter point is precisely the reason for the subject of the remaining part of this chapter, being the role of SMEs in the growing flexibilisation of production and its relation to job quality in SMEs.

3.3 SME JOB QUALITY - THE DARK SIDE OF FLEXIBLE PRODUCTION?

The last two decades have seen a major structural change away from full-time, male dominated, permanent, 'inflexible' work towards part-time, female dominated, temporary and flexible work. There is also substantial evidence of a widening wage gap between white collar and blue collar workers, and a reduction in fringe benefits, health insurance and so on. These trends are in particular observed in the US and are by some observers deemed 'the dark side of flexible production'¹.

These trends are illustrated by temporary and part-time working in the US in the last two decades. The growth rate of temporary employment has clearly been considerable, being no less than three times that of total employment over the period 1982-90. Similarly, the growth of part-time employment (particularly involuntary part-time employment) has also outstripped that of total employment over the two decades 1970-90. Regarding subcontracting other observers² have described the recent extent of the phenomenon in Japanese manufacturing. The culmination of the trend in the late 80s is striking: in some industries as much as 80% of enterprises play the role of subcontractors, usually to large dominant, enterprises.

These increasingly international trends can be traced in part, it is argued, to large enterprises' response to uncertainty. The primary driving force behind the changes is large enterprises' quest for flexibility to mitigate this uncertainty.

Below evidence will be used to assess the extent to which the developments have a counterpart in the European Union. The next sections therefore detail the theory of flexible production and its implications for small enterprises.

3.3.1 Flexible production in the union and job quality in SMEs

From the foregoing discussion, if flexible production plays a role in the EU it will do so via part-time, temporary, flexible working, particularly involuntary part time working³, and through other measures of decline in job 'quality'. Parameters of quality analysed below include: the extent of (involuntary) part-time working by sector and gender, the age distribution of the workforce by employed and unemployed, education levels of the workforce, sick leave, accident rates, part-time and temporary working, and so on. Also examined is how far identified trends are explicable within the framework of flexible production. Finally, assessed is the extent to which small enterprises are instrumental in the process.

¹ Harrison, B. (1994).

² Cressy, Robert C., Nick Clay, Marc Cowling and Stephen Creigh-Tyte, Medium sized enterprises: an international perspective, report for the National Westminster Bank of Great Britain.

³ Involuntary part-time working is defined as a shorter hours *imposed* by the enterprise on the worker, rather than (as is the case with voluntary working) by *mutual agreement* with the employer. It clearly implies a degree of monopsony power in the labour market.

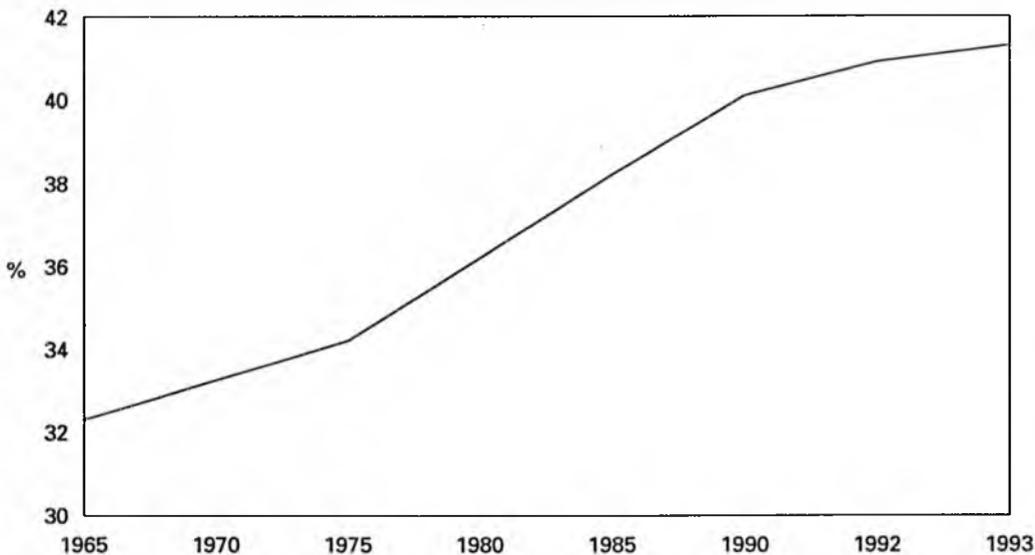
Trends in the Union labour market

A number of changes in the European labour market in the last three decades have profoundly shaped its current appearance. In order to interpret the material that follows, a brief overview of these changes is needed¹.

1. A very substantial increase in the participation of women in the labour force, accompanied by a decline in the participation of men;
2. A significant increase in women's share of jobs;
3. A significant trade-off is apparent in the employment of women and men;
4. A sectoral shift in employment from manufacturing to services;
5. An apparent increase in the importance of SMEs;
6. An increase in part-time and temporary jobs;
7. A reduction of the working week of EU workers of 1-2 hours;
8. A marked trend towards downsizing and production outsourcing or subcontracting (both nationally and internationally) amongst larger enterprises;
9. An increase in the unemployment rate in the EU both over time and relative to countries such as the US and Japan.

Figure 3.1 and 3.2 illustrate the changing roles of women and men.

Figure 3.1 Female employment as a percentage of total employment in the EU, 1965-1993

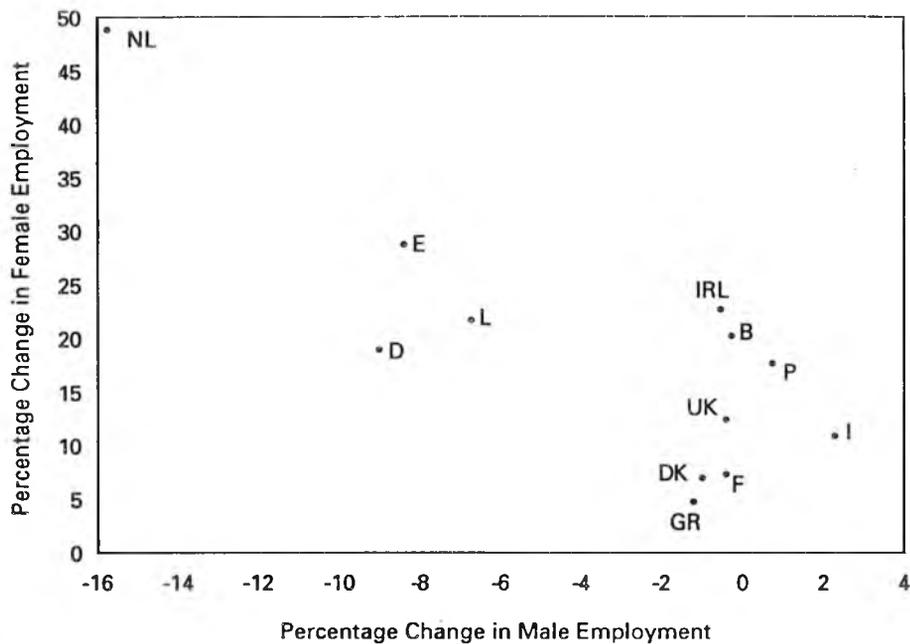


Source: European Commission, Employment in Europe 1994.

¹ The data are largely taken from DG V: Employment in Europe, European Commission, Brussels, 1994.

Figure 3.2

Percentage change in male and female employment in the EU 1985-1992



Source: European Commission, Employment in Europe 1994.

The following sub-sections detail some of these changes and relate them to the role of SMEs.

Full-time and Part-time Working

There are two measures of the importance of part-time work available: the Gender Share of Part-Time jobs (GSPT) which shows the proportion of part-time jobs that are occupied by a particular sex e.g. men; and the Part-Time Likelihood (PTL) which shows the chances that a female (resp. male) will occupy a part-time (rather than full-time) job¹. The former measure therefore shows the gender composition of jobs or how job quality is shared between the sexes, whilst the latter measures the job quality of a specific gender, e.g. females.

Trends in the Part-Time Likelihood (PTL)

Table 3.1 shows the trend in the part-time likelihood for the EU-10² and EU-12.

¹ Whilst gender shares sum to 1 (or 100) the PTLs do not.

² EU-10 is EU-12 excluding Greece and Portugal.

Table 3.1 Part-time likelihood of EU workers, 1983-91

	Males		Females		Married women	
	EU-12	EU-10	EU-12	EU-10	EU-12	EU-10
1983	-	2.3	-	27.8	-	36.7
1984	-	-	-	-	-	-
1985	-	3.0	-	29.4	-	38.3
1986	-	-	-	-	-	-
1987	3.4	3.7	28.6	30.2	37.2	39.1
1988	3.6	3.9	28.8	30.6	37.5	39.5
1989	3.4	3.8	28.9	30.8	37.1	39.4
1990	3.5	3.9	29.3	31.4	37.4	39.7
1991	3.8	4.1	29.5	31.7	37.6	40.0

Source: Eurostat, 1993.

An upward trend can indeed be observed in the Union PTL over the period, but a number of factors must be taken into account in interpreting this data.

Firstly, the proportion of EU jobs that are part-time is small (4% of male jobs and 30% of female jobs in 1991) and the rise is much less on average than has occurred in, for example, the United States. Secondly, there is a sectoral component to the trends - services are more likely to use part-time workers than manufacturing - and there is, as noted above, a trend towards services as in the States. Thirdly, there is a gender component (women are more likely to work part-time than men). Fourthly, there is considerable inter-country variation in the levels and trends in part-time working (in some countries, e.g., Greece and Spain, there has even been a decrease in part-time working)¹.

Having said this, a clear message from Table 3.1 is the tendency for both male and female jobs to become more part-time. The proportion of female jobs that are part-time in the EU-10 increased from 27.8% in 1981 to 31.7% in 1991, whereas those of males increased from 2.3% to 4.1% over the same period. In some countries, however, (e.g. the Netherlands, Denmark, the United Kingdom) this trend was more dramatic. Whilst in others (e.g. Spain and Greece) the trend was even reversed.

Although the overall trend is not dramatic², it is clear that taking the criterion of job quality to be whether the job is full or part-time, the evidence shows that for both women and men job quality has declined over the period³.

¹ There is additionally a problem of comparing statistics across countries because of difference in definition (there is much less variation in hours worked than in the proportion of jobs that are part-time. This problem does not of course affect the interpretation of trends over time.

² Also it must be noted that the two series do not start from the same base, female jobs being some 12 times more likely to be part-time at the start of the period than those of men.

³ Although (lack of) job quality is strictly associated with involuntary rather than voluntary part-time working, the two are positively correlated in the data from Harrison and other sources.

Trends in the Gender Share of Part-Time jobs (GSPT)

The trends in GSPT in the Union are less clear-cut than those for PTL noted above. The general conclusion is that over the last five years the GSPT for men has increased and that for women decreased. Thus, females have not only been increasing their share of jobs but also increased their share of full-time jobs. However, the trends are less marked here than for PTL, and whilst in Denmark, Germany, the Netherlands, Portugal and the United Kingdom the upward trend in men's share of part-time jobs is striking, the trend in other Member States is more ambiguous. Indeed, in Greece, the trend is in the opposite direction.

Variation of the GSPT share with enterprise size

In some Union countries there is a clear enterprise size dimension to the GSPT which reflects sectoral differences. Firstly, in the Netherlands there is a great variation in part-time working across sectors, being as high as 75% in personal services and as low as 4% in others - construction). In some sectors small enterprises are more dependent on part-time working (manufacturing, construction, wholesale, hotels and catering), whilst in others (retail and personal services), the reverse is true, and large enterprises have a higher part-time density. In yet other sectors (transport, banks and finance), there is a U-shaped relationship between part-time frequency and size. Secondly, in Denmark, also, there is considerable sectoral variation in part-time working. However, here a distinct tendency for the part-time frequency to fall with enterprise size can be observed. Thus, in Denmark, small enterprises are typically associated with part-time working and large enterprises with full-time working.

Preference towards part-time work

The thesis that trends towards flexible production can be discerned and that these trends have implications for job quality in SMEs relies on an assumption that much of the increase in part-time work is involuntary. Evidence from the Union suggests a more unambiguous state of affairs. In Finland, for example, preferences towards part-time work, on the part of those employed full-time, increased from 14% in 1989 to 18% in 1991. Thus the preference for most full-time workers was not to alter status. However, this is inconclusive evidence the hypothesis should be tested on a sample of individuals currently employed as part-time workers. The Norwegian evidence throws some light on this. In Norway, evidence shows that the involuntary fraction of part-time jobs has increased by some 50% over the period 1989-93. One in six part-time Norwegian workers is now employed on an involuntary basis.

Length of the working week

One of the questions that arises in explaining the absorption of the growing labour force alluded to above is how far new jobs have been created by reducing productivity growth and the length of the working week. In this subsection the latter issue is addressed.

Changes to the average hours worked in the Union 1983-92

Average weekly hours worked in the EU have declined by about 4%, or an hour and a half a week, over the period 1983-92. Two explanations have been put forward to account for this phenomenon. Firstly, a shift towards services and away from manufacturing and agriculture has occurred; less hours are normally worked in services than in the other two sectors. Secondly, there has been (as noted above) an increase in the employment of women; they work shorter hours than men¹.

Differences in working time between self-employed and employees

The main difference in working time in the Union (and its major competitors) is not between sectors (agriculture apart), or between women and men, but between the self employed and employees: a large proportion of the relatively high numbers of people working long hours in the Union are the self-employed. For example, 51% of self employed men in industry and services and 32% of self employed women usually worked 48 hours/week or more in 1992. This, however, varies among Member States. For men for example, it is about 40% in Spain rising to 75% in Belgium.

Self-employed individuals have been growing in importance over the last two decades,² so that these figures are assuming greater significance.

Enterprise size dimension

Three countries are able to offer data on the enterprise size dimension of the working week, namely, the Netherlands, Spain and the United Kingdom. The Netherlands data is most detailed and covers size, sector and gender dimensions. From Table 3.2 below we can see that the sectors with the highest proportion of part-time workers are personal services(74%), hotels and catering (54%) and retail (49%), which are also the sectors with the lowest hours worked. In those sectors, hours worked fall with the part-time share which in turn varies with the gender-share of women. This is because women have a very high share of the jobs in those sectors, reaching almost three quarters of jobs in personal services. Their tendency to work part-time is therefore reflected in the lower working hours of these sectors. In hotels and catering, however, women appear to be employed more in a full-time capacity than in other sectors.

The sectors with the lowest proportion of part-time jobs are construction (4%), manufacturing (7%), and wholesale (12%). In these sectors there is a strong decline in the part-time share with enterprise size, and, construction apart, an associated decline in female gender-share. Hours worked tend to increase with size of enterprise in these sectors for similar reasons to those discussed above for the part-time-dominated sectors.

¹ In this case, it is not clear whether the increase is due to the employment of women *per se* or to the *nature of the jobs*: a higher proportion of jobs created were part-time, and there has been a significant reduction in full-time working hours. Thus there may be a demand *and* supply component operating to bring these changes about. Estimates from Eurostat in fact suggest that: 30% of the change is due directly to structural changes (sectoral shifts) - especially in Italy, the United Kingdom and Ireland (almost all the change), but also in Spain and Portugal (half the change) and 10% is due to the increased employment of women (especially in Belgium and the Netherlands).

² OECD, 1994.

Aggregate data for Norway shows that across all enterprises and sectors the part-time share decreases with enterprise size. Thus smaller enterprises in Norway have a higher density of part-time workers. As in the Netherlands, the part-time share is highest in the personal services, hotels and catering and lowest in construction and manufacturing sectors, reaching its nadir in the extractive and energy industries.¹ The same positive correlation is found in Norway between part-time share and the gender-share of females across sectors and hours worked that characterise the Dutch data. However, the aggregate gender-share of females seems to be approximately constant with enterprise size at some 45% of the workforce. This differs from the Netherlands, where the aggregate gender-share is U-shaped with size, so that smaller and larger enterprises have a high female density with intermediate enterprises showing smaller representation of women.

Interestingly, in one of the few instances of information on involuntary part-time working, the Norwegian data shows that the percentage of part-time workers who are involuntarily working on a part-time basis has increased quite dramatically by some 50% in the period 1989 to 1993. Still, it affects only a minority of part-timers with only one in six part-time workers currently in the involuntarily employed category.

In the United Kingdom² female employees in small enterprises were 50% more likely to work part-time (less than 20 hours/week) than males. The United Kingdom males, although much less likely than females to work part-time, had twice the likelihood of doing so if they were located in a small rather than a large enterprise.

¹ It is not possible to include the Norwegian data in Table 3.2 due to different sectoral definitions.

² Hughes, P., 'The economic contribution of small enterprises', Employment Department, the United Kingdom (unpublished), 1989, quoted in Storey (1994), 'Understanding the Small Business Sector', Routledge, London.

Table 3.2 Part-time share, hours worked and gender share by sector, the Netherlands, 1990 and 1992

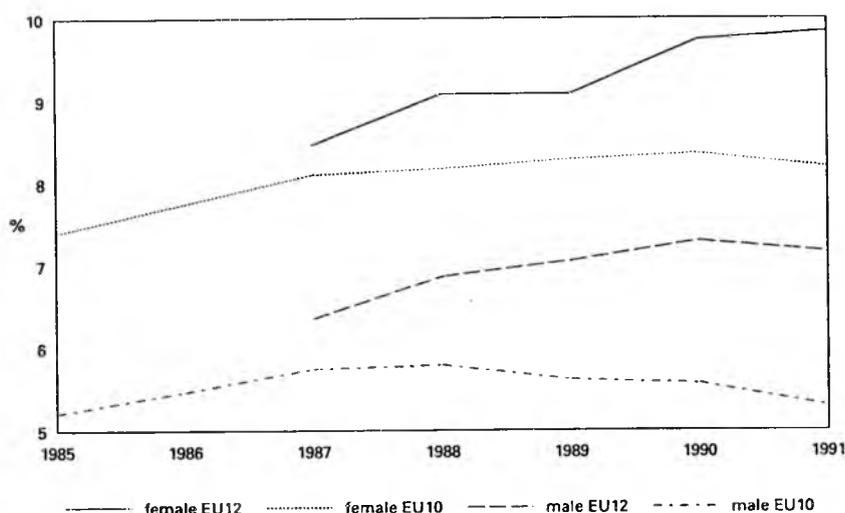
	Part-time share of jobs, 1990 (%)		Female share of jobs, 1992 (%)		Hours worked/week, 1992	
	<i>Highest</i>	<i>Change with enterprise size</i>	<i>Highest</i>	<i>Changes with enterprise size</i>	<i>Lowest</i>	<i>Changes with enterprise size</i>
Personal services	74	increase	57	U-shaped	22.3	decrease
Hotels and catering	54	decrease	51	U-shaped	24.2	increase
Retail	49	increase	58	U-shaped	27.1	decrease
	<i>Lowest</i>	<i>Changes with enterprise size</i>	<i>Lowest</i>	<i>Changes with enterprise size</i>	<i>Highest</i>	<i>Change with enterprise size</i>
Construction	4	decrease	4	increase	38.8	increase
Manufacturing	7	decrease	19	decrease	37.6	increase
Wholesale	12	decrease	25	decrease	36.9	none

Source: EIM Small Business Research and Consultancy 1994.

Temporary working in the Union

Temporary working, defined as working on a contract with shorter than standard duration, directly affects a significant proportion of the Union workforce, namely 10% of females and 7% of males in 1991 (Figure 3.3). Temporary working has, moreover, been increasing in the Union (EU-12) in absolute and proportional terms over the five years 1987-91. Examining the available data, temporary working will be shown to have geographical/developmental, enterprise size, sectoral and gender components.

Figure 3.3 Temporary employment as a percentage of total employment in the EU 1985-1991



Source: Eurostat, Labour Force Survey, 1992.

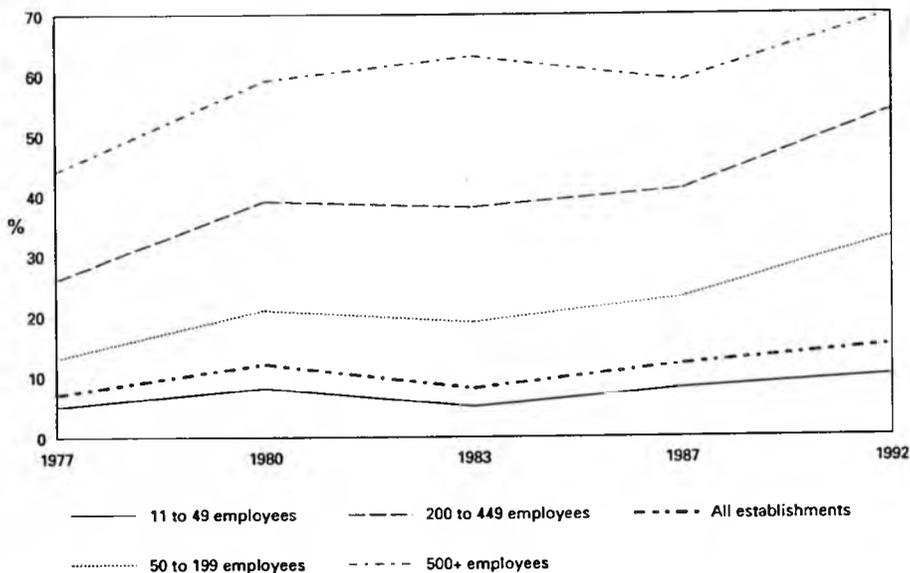
Geographical and developmental dimensions

Temporary working for men currently (1991) has greatest importance in Spain (22% of contracts, 28% of female), Denmark (10% resp. 12%), and Portugal (9% resp. 10%), and least importance in Luxembourg (1% resp. 4%), Belgium (2% resp. 7%) and Italy (3% resp. 6%). It has increased fastest in France where in 1983 about 3% of both male and female contracts were temporary, rising to 7% and 10% respectively in 1991. In some countries, the proportion of temporary contracts has declined significantly in relative terms whilst increasing in absolute terms. In Portugal, for example, the proportion of contracts that were non-permanent decreased over the period 1988-93 from 19% to 10%, a development following from the new freedom of Portuguese trade unions in the wake of the country's transition to democracy. Temporary contracts, an indicator of job quality, may thus have a developmental dimension, unrelated to flexibility-trends. It is apparent that such working also has a gender dimension, with women significantly more likely to be placed on short-term contracts than men.

Enterprise size dimension

In France (Figure 3.4 and 3.5), a general upward trend in temporary working contracts is evident, rising from about 1% of all employment contracts in 1977 to some 4% in 1992. Enterprises with 50-200 employees have the highest temporary employment ratio through 1980-92, rising from almost 4% to 5% of contracts. Looking at the proportion of enterprises that resort to temporary contracts, rather than the proportion of workers covered by them, we find that in France larger enterprises are more likely to resort to such temporary arrangements. In fact here also the trend is increasing over time, with below half in 1977 to almost three quarters of enterprises doing so in 1992. In conclusion, there is some evidence that a large enterprise is more likely to resort to some kind of temporary contract amongst its staff; but, given that a small enterprise resorts to temporary contracts, it will have a greater proportion of its staff covered by them.

Figure 3.4 Percentage of French establishments using temporary workers, 1977-1992

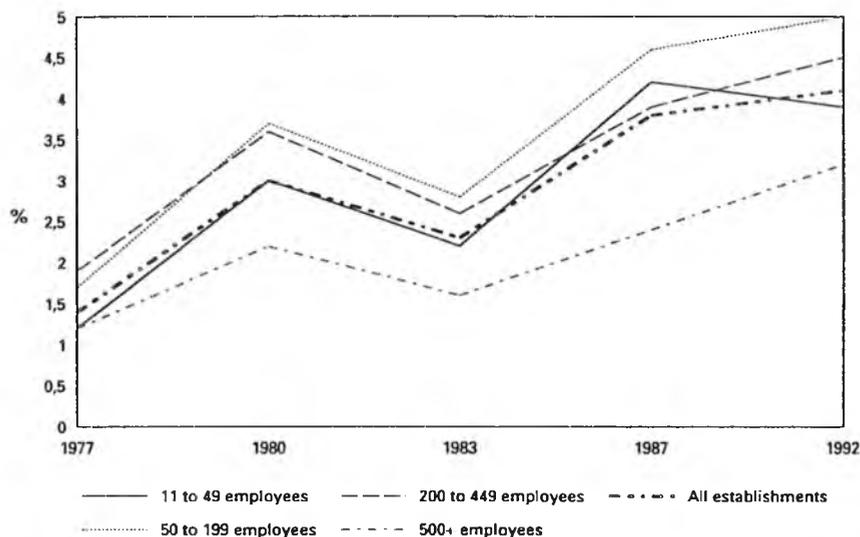


Source: MTEFP, DARES, ACEMO.

Sector dimension

Data from Sweden show that 10% of workers are employed on short-term contracts in 1992. This is a small increase over 1990. There is significant sectoral variation, with the highest representation in non-specified and other services. Some sectors have shown very significant increases over the period, e.g. agriculture.

Figure 3.5 Percentage of temporary workers in French industry by establishment size, 1977-1992



Source: MTEFP, DARES, ACEMO.

Age distribution of the workforce

The age distribution of the Union's workforce reflects the basic demographics of the Member States. An older population on average can be expected to have an older workforce. Similarly, the school leaving and retirement ages will be expected to influence the age distribution of the workforce at the extreme ends. A higher school leaving age and a later retirement age both lead to an older workforce, other things being equal. Whilst most countries have a workforce median age in the 24-49 bracket, some states have as many as three out of four workers in this range (as in Finland and Denmark) and typically two thirds of the countries' workers are in this category. In some countries only one in twenty workers are young (14-24), as in Denmark, whilst in others (namely the Netherlands) the proportion rises to almost one third¹.

Sector dimension

Some sectors are more likely to employ young workers than others, due to the lack of training required for these occupations, the correspondingly low wages and the high rate of turnover. Thus in the Netherlands, which at 20% has an above average proportion of young people (16-26 years) in the working population, the retail, hotels and catering sectors have about one half of their workforce young². Personal services is close behind with almost one third of workers young. Dutch transport, manufacturing, wholesale and construction sectors by contrast employ less a quarter of their workers from this age group, preferring to employ people throughout the full age range. This pattern reflects

¹ Danish Technological Institute (DTI) 1994; EIM Small Business Research and Consultancy 1994.

² EIM Small Business Research and Consultancy 1994.

both sector turnover, skills required, gender and turnover effects. Workers in Dutch manufacturing, in starkest contrast with those in the retail industry, require more out-of-house education and training (implying later entry into the workforce), have a lower job turnover (their higher levels of enterprise-specific capital bonding them more strongly to the enterprise), and are less likely to be female (so less frequently part-time or temporary workers).

In the Netherlands there have also been dramatic changes in the workforce over time. In the five years 1988-1992 the percentage of workers in Dutch manufacturing in the 35-45 age range fell from 40% to 25%, whereas the proportion in the 16-26 age group rose from under 10% to over 20%.

Enterprise size dimension

In Sweden, with a workforce of some 2.5 million people, the working group of prime age (35-49 years) is dominant at all enterprise sizes, constituting about one third to two fifths of the workforce. At 40% of the workforce, micro enterprises have a slightly higher than average proportion in this category. As we move up the enterprise size ladder the proportion of prime age workers falls to 35% and then rises gradually until 500+ employees is reached, where 38% of the workforce are in the prime age group. Small enterprises (10-99 employees) on the other hand have the highest density of young workers (16-25 years), employing one in five of this age group. This reflects the fact that small enterprises offer less skilled vacancies and pay correspondingly lower wages; younger workers are more willing to accept such conditions, given their relatively high rates of unemployment. In Sweden, also, older workers (60-74 years) never reach more than 6% of the workforce at any enterprise size. The proportion of such workers is effectively independent of enterprise size.

In the Netherlands, the SME-dominated sectors of retail, hotels & catering and personal services, as we have seen, have a high proportion of younger workers. This suggests that in the Netherlands also, there is a tendency for young workers to be more concentrated in smaller enterprises, though the sector and gender dimensions may well be the determining factors rather than enterprise size as such.

Educational levels of the workforce

The aggregate statistics of education in the Union are described in Chapter 12 of this Report. This section concentrates on describing the enterprise size dimension of education. That is, the question is answered whether smaller enterprises have more or less educated workers than large, and whether the education level of the self-employed differs from that of employees.

Data on the educational levels of the workforce by size of enterprise is available for only four countries, namely, Denmark, the Netherlands, Sweden and the United Kingdom. From the Swedish data (Table 3.3) a unique insight into the relative educational levels of the self-employed and employees can be gained. The figures show that the self-employed are less educated than the workers in the smallest (micro) enterprises. They also show, in common with the Danish and Dutch data, that large enterprises have a more educated workforce than small and that the level of education increases continu-

ously with enterprise size¹. The Danish data indicate, moreover, that skilled vocational training in the workforce rises with enterprise size, as was indicated in the Second Annual Report.

Table 3.3 Educational level of the workforce (self-employed and employees) by company size, Sweden, 1992

Educational level	Enterprise size (employees)							Total
	Self employed	0-9	10-49	50-99	100-199	200- Unknown		
9-year compulsory school	21,804 11%	167,242 26%	234,857 24%	108,955 25%	92,181 25%	195,035 21%	96,718 30%	1,016,791 25%
Upper secondary school (two years or less)	92,817 45%	239,755 37%	360,974 37%	152,983 35%	125,345 34%	322,800 35%	135,022 42%	1,429,696 13%
Upper secondary school (two years or more)	45,794 22%	95,170 15%	125,864 13%	55,799 13%	48,631 13%	125,382 13%	37,438 12%	534,078 13%
University training (less than three years)	22,105 11%	86,099 13%	126,992 13%	50,792 11%	45,080 12%	153,224 16%	30,472 9%	514,764 13%
University training (three years or more)	18,864 9%	53,429 8%	109,422 11%	72,697 16%	53,714 15%	114,816 12%	20,600 6%	443,542 11%
Postgraduate qualifications	793 0%	1,576 0%	3,009 0%	2,538 1%	2,798 1%	12,921 1%	933 0%	24,568 1%
Info. not available	2,842 1%	5,711 1%	5,348 1%	2,340 1%	2,100 1%	5,016 1%	3,905 1%	27,262 1%
Total	305,019	648,982	966,466	446,104	369,849	929,194	325,088	3,990,702
Percentage share	8%	16%	24%	11%	9%	23%	8%	100%

Source: SCB, Regional Labour Statistics, 1992.

¹ In Sweden, unlike the Netherlands, there seems to be some tailing in education levels after 100 employees is reached.

In Sweden the self-employed have a greater chance of upper secondary education than the typical employee of both smaller and larger companies. On the other hand, whilst the self employed are more likely to be educated to basic level they are less likely to be educated to a higher level than employees in enterprises of all sizes, except micro. Only 9% of the self-employed have degrees, compared with as high as 16% of certain smaller enterprises (50-99 employees). Thus in the United Kingdom, where detailed enterprise size data are not available, studies of Chartered accountancy intakes in the 1980s showed quite clearly the preference of top university graduates for the large (then 'top six') accountancy enterprises and an unwillingness to consider employment in the smaller enterprises of the profession. This attitude was a function of a familiar range of job quality parameters: salary, status, promotion prospects, travel opportunities, and so on.¹ Finally, in Denmark, although in the smallest enterprises (1-4 employees) about half of the workforce had no formal education, in the largest enterprises (500+ employees) this proportion fell to about one third.

In conclusion, whilst it is in general dangerous to generalise from the information on the Northern countries in the Union to the rest, it seems plausible in view of the international 'corporate culture' of the largest enterprises in all countries to assume that the variation of educational characteristics with enterprise size are broadly representative of the Union as a whole. In summary, larger enterprises tend to employ more an educated, and therefore productive, workforce than smaller ones. From the Second Annual Report we saw that wages of workers in such enterprises tend to reflect this pattern, with larger enterprises paying more.

Fringe benefits

American evidence² indicates clearly that larger enterprises not only pay their workers more but also offer them greater fringe benefits, defined as benefits over and above the salary or wage of the worker, reflecting their superior productivity and long-run value to the enterprise. Available evidence shows that the same holds for the Union.

Information for the United Kingdom service sector indicates that the incidence of pension schemes and health insurance both rise with the scale of enterprise. Thus, only 6% of workers receive a pension from an enterprise of less than 5 employees, whereas 2/3 do so in an enterprise of over 20 employees. Almost the same proportions apply to health insurance provision. Sick pay, whilst much more common in enterprises of all sizes, follows a similar pattern but with a less marked trend. Thus 2/3 of the smallest enterprises offer sick pay, whereas 9/10 of the largest do so.³

¹ Cressy, Robert, 'Are Chartered Enterprises Picking the Right Candidates?', unpublished paper, City University, London, 1989.

² Brown, C., J. Hamilton and J. Medoff, *Employees large and small*, Harvard University Press, Cambridge, Mass., USA, 1990.

³ Curran, James, J. Kitching, B. Abbott, and V. Mills (1993), 'Employment and employment relations in the United Kingdom small service sector enterprise - a report', ESRC Centre for Research on Small Service Sector Enterprises, Kingston Business School.

Health of the workforce

Data from only one country is available for the analysis of health and enterprise size, namely for Denmark. This data indicates that the incidence of enterprise level health and safety organisations increases steadily with enterprise size. Thus, larger enterprises are more likely to have formalised procedures to deal with issues of health in the workplace. This reflects the familiar economies of scale present in the larger organisation. Smaller enterprises do not have the resources to devote to these issues and workers in them are less likely to be organised to raise issues with management.

Accident rates at work

The United Kingdom data for manufacturing industry (Table 3.4), indicates that rates per 100,000 employees decline steadily with enterprise size after the 1-19 employee size range. The highest rate occurs in the size band 20-49 employees, and the lowest in the band 1-19. The very largest enterprises (100-+ employees) have a rate of some 115 per 100,000 employees. Thus there is prima facie evidence that accident rates decrease with scale of enterprise. However, these statistics should be interpreted with caution, since they do not cover the service industry sector.

Belgian data¹ for 1989 moreover indicate a rather different picture, with accident rates actually rising from 35/1000 in micro enterprises with 0-4 employees to a peak of 64/1000 in enterprises with 50-99 employees and thereafter falling to the mid-forties in large enterprises (500 and more employees). Thus the aggregate statistics indicate no clear trend with size to safety at work in Belgian industry. Once again, there may be sectoral influences operating here which explain the pattern.

Table 3.4 Employee major injury rates by size of establishment in manufacturing industry, UK, 1988-90

Size of establishment	Rates per 100,000 employees	
	1988-89	
1-19	63.7	
20-49	161.1	
50-99	156.0	
100-199	139.8	
200-499	135.4	
500-999	135.4	
1,000+	115.1	

Source: Thomas (1991)².

In Spain available evidence indicates that 63% of accidents occurred in establishments with less than 50 employees. Also, the incident rate is twice as high amongst women as men and increases with worker age³ Thus enterprises with an older workforce can be expected to have higher accident rates than those with younger. There is also, as might

¹ Due to different definitions figures from the United Kingdom and Belgium are not comparable.

² Thomas, 'Safety in smaller manufacturing establishments', *Employment Gazette*, January, 1991, 20-25.

³ IKEI, Background Document, 1994.

be anticipated, an important sectoral dimension to the problem: rates are highest amongst Spanish industry and construction sectors and lowest in the primary and service sectors. Since a high proportion of small enterprises are located in the latter, the overall statistics clearly reflect these sectoral features.

Appendix to Chapter 3

Appendix 1 The current debate on job creation by enterprise size

1 METHODOLOGICAL PROBLEMS

Recent papers by Davis, Haltiwanger and Schuh¹ (henceforth Davis et al.) examining manufacturing employment change in the United States 1972-1988, and the book by Bennett Harrison (1994)² have brought into question the contribution of small enterprises to employment creation, arguing that this has been substantially over-emphasised, particularly by politicians. Significantly, the Davis et al. position has been endorsed by the OECD³.

Three major criticisms of job generation studies are levelled by the above authors and are discussed here in order of importance.

1.1 Misinterpretation of the data

Both Harrison and Davis et al. are critical of naive interpretations by politicians of job generation data. Both point out that, even with no statistical flaws in the analysis, and perfect data, if small enterprises were to figure as the major sources of new jobs in an economy, this would not, of itself, provide any policy insights. It certainly would not justify government intervention either to increase or reduce support for the small business sector. Policy requires knowing not merely where the new jobs are created but also how and why they are created there.

Harrison argues that rather than the small enterprises themselves generating the jobs, it is the uncertainty-reducing and cost-reducing strategies of large enterprises that have been primarily responsible for the growth of the small enterprise sector. Furthermore, this growth has resulted in growing inequality in society with poorly paid, unskilled, part-time, temporary, unhealthy and dangerous work being created as a result.

These arguments are well-documented and persuasive. The authors also correctly point to the tendency of commentators and policy-makers to draw unwarranted inferences from the data. Nonetheless, whilst a tendency to reiterate the 'small is beautiful' motto is unwarranted, the Harrison argument, especially in a European context, places too much emphasis on demand side of the labour market and too little on supply side, as has been discussed in this chapter.

1.2 The size distribution fallacy

Davis et al. demonstrate that an increase in the contribution to employment of small enterprises between two periods of time does not necessarily mean small enterprises have been contributing to job creation. Any apparent increase in the importance of small en-

¹ Davis, S.J., J. Haltiwanger and S. Schuh (1993), 'Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts', BNER.

² Harrison, B. (1994), 'Lean and Mean', New York.

³ See Chapter 3 of OECD (1994), Employment Outlook, Paris.

terprises could be exclusively because large enterprises become smaller, rather than because small enterprises grow larger. This criticism rightly points to the need for longitudinal data sets, which track individual enterprises through time. However, the advantage of such datasets is well known, and indeed Birch, the father of job generation studies, used this as the justification for constructing his first longitudinal data set some 16 years ago (Birch, 1979¹). Finally, the use of this type of data itself introduces potential for bias, since longitudinal datasets ignore the birth and death process altogether. Thus they should always be supplemented by other data.

1.3 Regression to the mean

In instances where there is no overall change in the employment of an enterprise, but where there are fluctuations over time about the enterprise's mean size (e.g. due to macro-economic events), it is possible to conclude that there is a statistical relationship between size and growth ('small is beautiful'), where in reality there is none. This is described as the 'regression to the mean fallacy'. The use of Starting year weightings for employment size² then leads to an exaggeration of the job creation performance of small enterprises and an underestimation of the job creation performance of large enterprises. It is argued by Davis et al. that, to overcome this problem, it is more appropriate to normalise employment change by long-run average, rather than starting year, employment size.

The implication of the argument is that, if the bulk of job creation in small enterprises takes place amongst a comparatively small number of businesses which start small and become large (which is almost certainly the case), then use of an average year as the basis for the calculation would mean that such jobs would be more likely to be classified to the large, rather than to the small, enterprise sector, reducing the 'contribution' of small enterprises to job creation. This criticism by Davis et al. has the most force. However, its quantitative significance needs to be evaluated.

1.4 Summary and conclusion from the theoretical debate

The methodological problems put forward by the OECD and Davis et al. are relevant and need careful attention. The problems caused by the size distribution fallacy show that it is perilous to draw conclusions on the examination of the cross-section distribution of employment by enterprise size, although there exist estimation methods which can overcome most of the problems (see section 2 of this appendix). It should also be emphasised that the size distribution fallacy does not per se 'benefit' SMEs. The direction of the bias is in fact statistically accidental.

Problems caused by the regression to the mean fallacy show that it is not correct to use Starting year employment as a starting point, since this 'benefits' SMEs, as the use Final year as a starting point would 'benefit' LSEs. Therefore it is necessary, as Davis et al. have suggested, to use the average employment as starting point.

¹ Birch, D. (1979), 'The Job Generation Process', MIT Programme on Neighbourhood and Regional Change, Cambridge, Mass.

² The *Starting* year of the period 1985-1995 is defined as the first year of the period, i.e. 1985. The *Final* year is 1995.

A predominantly theoretical discussion cannot solve the problem regarding the question of whether small or large is beautiful in relation to job creation. The empirical results of Davis et al. are far too meagre to draw final conclusions concerning the job creation prowess of small, medium or large, since they only present results of US manufacturing. Which size is the most beautiful has to be decided by empirical evidence.

2 JOB CREATION IN SMEs - SOME EMPIRICAL FINDINGS

This section reports some of the recent studies of European and North American job generation that have attempted to address the issues raised by Davis et al. and discussed in the previous section. These studies show that Davis et al. have exaggerated their statements and that empirical knowledge thus far points to the fact that SMEs still are the major source of new jobs.

2.1 Some recent studies

Davidsson¹ argues that the extent of shifts between size classes is easily overestimated. In Davis et al.'s example two out of the three enterprises crossed the size boundary from being small to large, whereas in his Swedish data less than two out of one hundred enterprises appear to cross size boundaries. Thus it is argued that although the size distribution fallacy may have theoretical significance, empirically it might be virtually irrelevant.

Davidsson's study is a general response to the criticisms of Davis et al. but also provides some facts from the Swedish experience to cast light on the quantitative importance of their thesis on real data. They refer to several recent Swedish studies for empirical evidence. These studies cover deaths, births, expansions and contractions amongst Swedish commercial establishments in the period 1985-9. The small enterprise analysis is based on the notion of a simple, i.e. independent, single-establishment enterprises. They also distinguish branches i.e. units other than headquarters in multi-establishment enterprises, and tops, i.e. headquarters of multi-establishment enterprises. Enterprises can switch between these categories and such changes are ascribed to the category of establishment at the beginning of a twelve-month period.

The chief findings of Davidsson are as follows. Firstly, formation of growth of simples accounted for 63% of net job generation, roughly twice their share of the employment base. Secondly, in conformity with the Second Annual Report of the Observatory, 2/3 of the job growth is due to expansion and one third to births. Thirdly, only 16% of simples experienced any growth at all during an individual year, implying that most growth comes from a small fraction of fast growing enterprises. Fourthly, net job creation for small enterprises was greatest in business services, a finding consistent with the results for other countries (e.g. the United Kingdom). Davidsson argues that whilst this would seem to provide some support for the Harrison hypothesis of outsourcing by large enterprises creating small enterprise employment, in fact most of the growth occurred in industries where the hypothesis is implausible. In conclusion, the results of this study are highly

¹ Davidsson, P. (1994), 'Small Enterprises as Job Creators - Myth or Fact?', paper presented at the RENT VII Workshop, Tampere, Finland, 24-25 November, 1994.

encouraging for the role of small enterprises in the job generation process, and the care with which it is conducted is exemplary.

In a study on Canadian manufacturing data Baldwin and Picot¹ have not been able to draw the same conclusions as Davis et al., although they performed the same types of analyses. Over the 1970-90 period using both the Starting year weightings, the Final year weightings and multi period weightings they find the highest measures of job creation by small enterprises are obtained from Starting period weightings, and the lowest rates of job creation by small enterprises from Final year weightings. However, irrespective of the weightings system chosen, smaller enterprises are net job creators and larger enterprises make the weakest or most strongly negative contribution. Thus the results for Canada are very different from those for the United States.

It is argued by Berney and Phillips² that Davis et al. exclude from their study the potentially most fecund of all businesses, namely those between 1-4 employees. (This introduces bias of another kind.³)

A study by Blanchflower and Burgess, 1994 uses a panel of some 2,000 small enterprises in the United Kingdom covering three dates 1980, 1984 and 1990. The sectors covered are manufacturing and services, both private and public sector establishments. The dataset is not ideal for the analysis of job generation of small enterprises since like Davis et al. (and unlike Davidsson) it ignores the smallest enterprises, here those less than 25 employees. They indicate firstly that most jobs are not created in fast-growing plants (less than half are created in enterprises growing/declining at more than 20% p.a.). Secondly, the net job creation rate declines with enterprise starting size, being in 1980 17% (versus employment share of 15%) for enterprises between 25 and 49 employees, and falling steadily to -9% (versus 23%) for enterprises of over 999 employees. The same pattern is observed for 1990 with corresponding figures of 17% (versus 19%) and 11% (versus 15%). Thus, on a United Kingdom panel dataset the result that smaller enterprises are more 'fecund' than large seems to be supported once more.⁴

2.2 Handling the size distribution fallacy in cross section data sets

Since in the Annual Reports of the European Observatory for SMEs cross-section data on the distribution of employment by enterprise size of Eurostat are used, EIM Small Business Research and Consultancy⁵ undertook a longitudinal study of a sample of 1,146 Dutch businesses in the period 1987 to 1992 to examine the implications of the

¹ Baldwin, J. and G. Picot (1994), 'Employment Generation by Small Producers in the Canadian Manufacturing Sector', *Small Business Economics* (forthcoming).

² Berney, R.E. and B.D. Phillips (1994), 'Small Business and Job Creation: An Update', U.S. Small Business Administration, Washington D.C.

³ Recall that in the Second Annual Report it was shown that 1/3 of new jobs were generated by net births of businesses. These would mainly fall into the smallest size category.

⁴ It is however not perfectly clear whether Blanchflower and Burgess have been able to avoid in stepping into the regression to the mean fallacy. If they have'nt, the fact that they ignored the smallest enterprises, by which they understate job creation in SMEs, might well compensate for this, so that their conclusion might remain valid.

⁵ Van der Hoeven, Kleijweg and Visser, Job Creation in SMEs: an assessment of the importance of size distribution and regression fallacies, EIM Small Business Research and Consultancy, Zoetermeer, December, 1994.

various methodological pitfalls and the Davis et al. critique in particular and to establish whether adjustments could be made to existing measures of job generation to render them immune to methodological criticism, in particular the size distribution fallacy.

The dataset they used is very well suited to analysing the consequences of different methods of analysis.¹ In Table 3.5 the major findings of their effort to show the implications of the various analysis techniques and their respective fallacies are summarised.

Five different methods of analysis were carried out:

1. an examination of the changes in the cross-section distribution of employment by enterprise size;
2. longitudinal analysis of the job creation behaviour of individual enterprises, using the starting year as the Base year of the computations;
3. longitudinal analysis of the job creation behaviour of individual enterprises, using the Current year as the Base year of the computations;
4. longitudinal analysis of the job creation behaviour of individual enterprises, using average enterprise size as the basis for the computations;
5. an examination of the changes in the cross-section distribution of employment by enterprise size and making a correction for the net crossing of the size boundary by assuming a constant stock of the large scale enterprises over time in the computations of employment developments by size class.

As has been made clear by Davis et al., method 4, using longitudinal data on individual enterprises and using average employment as the Base year for the computations is the most satisfactory method of assessing job creation by enterprise size. The adequacy of the results from the other methods can be assessed by comparing them to this method.

As can be seen, straightforward analysis of the size class distribution of employment (see Row 1 in the table) is not adequate: in this case job creation of SMEs is understated substantially in this specific sample, because of the growth of a substantial number of SMEs into the LSE-class.

Table 3.5 Empirical illustration of methodological fallacies and solutions

	SME		LSE		Share SMEs in total net job creation
	absolute growth	% growth	absolute growth	% growth	
Size class distribution	172	7,6	345	9,1	33,3
Base year 1987	544	23,9	-27	-0,7	105,2
Base year 1992	227	10,0	289	7,7	44,0
Average enterprise size	410	18,0	106	2,8	79,5
Corrected size class distribution	402	17,7	115	3,0	77,8

Source: Van der Hoeven, Kleijweg and Visser, EIM Small Business Research and Consultancy, 1994.

¹ Since the dataset is not random, no straightforward conclusions may be drawn regarding the relative importance of the different size classes concerning job generation.

In Row 2 and 3 the results are summarised for longitudinal analysis of individual enterprises using the starting and the final year as the Base year of the computations respectively. In Row 2 one sees the regression to the mean fallacy at work, which overstates job creation in SMEs because the initial year is the Base year. In Row 3 one sees the regression to the mean fallacy working at the opposite direction, understating job creation in SMEs.

Finally, a plausible correction on the size class distribution analysis is developed (see Row 5), assuming that the net change in the number of enterprises in the largest size class is caused by transitions of enterprises, for which must and can be corrected by assigning the boundary value as the work force. As can be seen in the table, this solution leads to results which approximate the theoretically most adequate method in Row 4. Therefore, this solution has been used as a check on the results of the analyses in chapter 1 of this report.

4 REGIONAL DISPARITIES

Co-ordinated by Instituto Vasco de Estudios e Investigación (IKEI)

MAIN POINTS

- This chapter shows that SMEs and especially micro enterprises are currently playing a significant and dynamic role in the European regions as far as employment is concerned, particularly in comparison to LSEs. However, this chapter also shows that the SMEs' role in employment is subject to strong regional variations within countries (with varying shares of employment in SMEs, varying job creation capabilities, and varying attitudes to self-employment). Due to these variations, the regional analysis provides support for policy measures specifically designed for particular regions.
- The share of employment in SMEs shows strong and significant regional variations within countries. Objective 1 regions seem to be relatively heavily dependent on SME for employment, whilst the Objective 2 regions generally have a lower dependence on SMEs for employment than their countries as a whole.
- Regional dependence on SMEs for industrial employment in the EU's internal border regions often varies dramatically either side of a border. In contrast, there are no significant differences in the regional dependence on SMEs for industrial employment between border and non-border regions within countries. There is no consistent pattern of higher or lower dependence on SMEs for industrial employment in the central regions of EU countries.
- From a dynamic perspective, SMEs in most of the Objective 1, 2 and 5b regions have either increased their aggregate manufacturing employment or declined less rapidly than the LSEs in the region. Micro enterprises have generally shown the best comparative behaviour in relation to the creation and maintenance of manufacturing employment.

continued

continued

- Despite this positive view, SMEs in the Objective 1 regions still have important barriers to their fully benefiting from the creation of the Internal Market and thereby fulfilling their potential in employment creation. These barriers are basically associated with the supporting 'milieu' and their own resources and capabilities. Therefore recent EU initiatives such as the 'Community Initiative in Support to SMEs' and the 'Integrated Programme in favour of SMEs and the Craft Sector' may be useful instruments for to assist SMEs with the exploitation of the positive dynamics associated with the Internal Market, and thereby helping to tackle Europe's unemployment problem.
- A spatial process of decentralisation in manufacturing employment can be observed in several countries. Job losses have been greater in the capital regions, other large cities, and in old manufacturing areas, whereas smaller towns and peripheral areas have gained an increased share of manufacturing jobs or suffered smaller job losses than in the country as a whole.
- The attitude to 'Entrepreneurship' is not equally distributed amongst the regions. Generally it seems to be higher in traditionally SME-dominated regions that are currently undergoing a period of industrial expansion, whereas 'Entrepreneurship' is lower in the older industrial regions that were dependent on now declining industries. Most of these areas are included in the Objective 2 regions. A qualitatively differentiated spatial pattern of localisation of new firms can also be identified, at least in some countries.

4.1 INTRODUCTION

Unemployment reduction is presently one of the most pressing problems for public authorities. Previous Observatory reports have demonstrated the increasing importance of SMEs in employment creation at national level. This national perspective may however conceal important differences at regional level: the 'death' of a small firm in a declining industrial region may be perfectly compensated at a national level by the 'birth' of another firm in an expanding region, but the social, economic and political impact of these employment flows, may be very different from a regional perspective.

A regional perspective is justified as it generates a more accurate picture about the real role SMEs are playing in employment change as regions are the places in which firms develop, where individuals live, and where political decisions, often taken at a national basis, are implemented. Therefore, analysis from a regional perspective provides an approach that identifies geographical inequalities which regional policies may be designed to address.

This chapter builds on the regional chapters presented in the two previous Observatory reports. Those chapters provide a general overview of the role that SMEs are playing at the regional level and especially in the EU's problem regions; notably the Objective 1 regions. This chapter is concerned with analysing industrial SMEs' employment creation

capabilities in the European regions, particularly in the regions badly affected by unemployment: the EU Objective 1, 2 and 5b regions¹.

The chapter is divided in three sections. Section 4.2.1 will deal with the share of the total industrial employment in SMEs at the regional level. Industrial employment change by firm size is studied in section 4.2.2, and self-employment will be examined in section 4.2.3.

The regional classification employed in this chapter is the NUTS-II² level, with the exceptions of Denmark, where the NUTS-III level is used, and the United Kingdom, where the NUTS-I level is used. The NUTS II level is used because of difficulties obtaining data on industrial employment by firm size at a lower regional scale (NUTS-III level). This level of aggregation used may therefore conceal developments that have taken place within the Objective 2 and 5b regions as these are often defined at a lower scale than entire regions at the NUTS III level.

4.2 EMPLOYMENT CREATION BY SMEs IN THE EUROPEAN REGIONS

4.2.1 SMEs' share in employment at regional level

The importance of SMEs to total employment in all EU member countries has been well documented in previous Observatory reports. Generally speaking the employment share of SMEs in Southern European countries tends to be higher than SMEs share in Northern countries. However, and from a regional perspective there are some strong and significant variations within countries. The sectoral specialisation of regional economies in LSE or SME dominated sectors is the main explanatory factor for these regional variations.

For a set of nine EU member countries regional evidence of the share of industrial employment by enterprise size is available, this shows that wide differences exist within countries. Using the standard deviation as a measure of dispersion, SMEs share of industrial employment by region varies most in the Netherlands (0.126), followed by Finland (0.108), France (0.092), Spain (0.088), Portugal (0.085) and Norway (0.065) in descending order (see Table 4.1). When compared with the variation between Member States of the EU only Austria (0.058), the United Kingdom (0.045), and Belgium (0.040), have lower intra-national regional differences than the EU's inter-national variation (0.062). Table 4.1 also shows the extreme regional cases for the nine countries for which data was available.

The Objective 1 regions seem to have especially high SME employment shares, at least when compared to the other regions in their countries. This is true of Burgenland (Austria), Corse (France), Flevoland (the Netherlands), Galicia and Comunidad Valenciana (Spain) and Northern Ireland (the United Kingdom). Meanwhile, the Objective 2

¹ Objective 1 regions are regions with GDPs per capita below 75% of the EU average, Objective 2 regions are those particularly affected by industrial decline, and Objective 5b regions are those rural areas suffering from structural adjustment problems as a consequence of changes in agricultural activities.

² NUTS = Nomenclature of Territorial Units for Statistics as established by the Statistical Office of the EU. The NUTS is a three-level hierarchical classification. Each Member State is subdivided into a number of NUTS-I level regions, which are subdivided again in NUTS-II level regions. The smallest territorial units are the NUTS-III level regions.

regions seem to have a lower dependence on SMEs for employment than other regions in their countries. Examples include Antwerp and Limburg (Belgium), Franche-Comté and Auvergne (France), Limburg (the Netherlands), País Vasco (Spain), and the North of England and Wales (the United Kingdom). The Objective 5b regions do not display a consistent pattern as to their level of dependence on SME for employment.

The available and comparable data for regions that border other countries within the EU shows that the dependence of border regions on SMEs for employment can be very different either side of a border. Table 4.2 shows that significant differences can be found on across all borders but especially the Belgian-Dutch and Belgian-French borders. For example, the dependence on SME's for employment in the Belgian border regions of West (88.4%) and East Flanders (86.0%) is significantly higher than in the Dutch region of Zeeland (54.6%) across the border, this illustrates the presence of a 'border effect'¹. It is notable in contrast that significant differences cannot be found between the dependence on SMEs for employment between border and non-border regions within countries.

There is no consistent pattern to the level of dependence on SMEs for industrial employment in the capital regions² of EU countries. In Austria, France, the Netherlands, Portugal, and Spain the capital regions are characterised by a relatively low, but not significantly lower, dependence on SMEs for industrial employment. On the other hand, the dependence on SMEs for industrial employment is higher, relative to their national average, in the Danish, Swedish and British capital regions. In Belgium and Norway the share of employment in SMEs in the capital region is very similar to the national average.

Finally, some countries show marked geographical variations in their regional dependence on SMEs for industrial employment. A good example of this is the United Kingdom where a North-South divide can be found, with SMEs, and especially micro enterprises, assuming a greater importance in the southern regions than in the north.

¹ For a discussion of the 'border effect' see the First Annual Report of the European Observatory for SMEs, pp 255-259, 1993.

² Capital regions are defined as those regions containing the national capital.

Table 4.1 Share of Industrial Employment According to Firm Size in the European regions. Extreme Regional Examples within a Selection of Countries (NUTS II regions)

EU Countries	Standard Deviation*	Extreme regions within countries	
		SME dominated regions (1)	LSE-dominated regions (1)
Netherlands, 1992	0.126	Flevoland (100.0%) Utrecht (90.2%)	Zeeland (54.6%) Limburg (61.5%)
Finland, 1992**	0.108	Ahvenanmaa (100.0%) Itä-Suomi (91.4%)	Uusimaa (68.4%) Pohjois-Suomi (74.6%)
France, 1992**	0.092	Corse (100.0%) Limousin (84.0%)	Franche-Comté (57.4%) Auvergne (57.6)
Spain, 1991**	0.088	Baleares (100.0%) Galicia (94.3%)	Cantabria (64.9%) País Vasco (79.1%)
Portugal, 1992	0.085	Algarve (100.0%) Centro (90.3%)	Lisboa e Vale do Tajo (75.4%) Norte (80.6%)
Norway, 1992***	0.065	North East (93.0%) North (91.3%)	South (73.8%) West (81.3%)
Austria, 1993	0.058	Burgenland (95.1%) Tirol (86.7%)	Wien (74.7%) Vorarlberg (80.6%)
United Kingdom, 1991	0.045	Northern Ireland (78.5%) East Midlands (76.7%)	North (62.2%) Scotland (66.9%)
Belgium, 1992**	0.040	Luxembourg (92.8%) West-Flanders (88.4%)	Antwerp (77.6%) Limburg (82.7%)

* Standard deviation of the regional share of industrial employment in SMEs by country. The higher the deviation, the higher are the regional disparities within the country in terms of SMEs' employment shares.

** Data provided for industrial establishments.

*** There is as yet no official decision in Norway of which regional division corresponds to the NUTS-II level regions. For the purpose of this chapter the division of regions used has been obtained from the adding together the countries indicated in brackets: Capital region (Oslo, Akershus), North East (Hedmark, Oppland), South East (Østfold, Buskerud, Vestfold, Telemark), South (Aust-Agder, Vest-Agder, Rogaland), West (Hordaland, Sogn og Fjordane, Møre og Romsdal), Trøndelag (Sør-Trøndelag, Nord-Trøndelag), North (Nordland, Troms, Finnmark).

(1) SMEs employment share in brackets.

Source: National Databases.

Table 4.2 SMEs' Industrial employment shares in some of Europe's Internal border regions*

Bordering regions (NUTS-II level)	SMEs' industrial employment shares in the respective border regions
PORTUGAL/SPAIN	
Norte ==> Centro, Castilla y León	80.6% ==> 94.3%, 86.7%
Centro ==> Castilla y León, Extremadura	90.3% ==> 86.7%, (?)
Alentejo ==> Extremadura, Andalucía	84.8% ==> (?), 89.6%
Algarve ==> Andalucía	100% ==> 89.6%
SPAIN/FRANCE	
Basque Country, Navarre ==> Aquitaine	79.1%, 84.0% ==> 70.1%
Aragón ==> Aquitaine, Midi-Pyrénées	86.1% ==> 70.1%, 70.5%
Cataluña ==> Midi-Pyrénées, Languedoc-Roussillon	89.8% ==> 70.5%, 75.5%
FRANCE/BELGIUM	
Nord Pas de Calais ==> West Flanders, Hainaut	66.2% ==> 88.4%, 84.4%
Champagne-Ardenne ==> Hainaut, Namur, Luxembourg	76.9% ==> 84.4%, 88%, 92.8%
Lorraine ==> Luxembourg	64.8% ==> 92.8%
BELGIUM/NETHERLANDS	
West-Flanders, East-Flanders ==> Zeeland	88.4%, 86.0% ==> 54.6%
Antwerp ==> Noord-Brabant	77.6% ==> 66.9%
Limburg ==> Noord-Brabant, Limburg	82.7% ==> 66.9%, 61.5%
Liège ==> Limburg	86.0% ==> 61.5%
UNITED KINGDOM/BELGIUM/FRANCE	
South East ==> Nord Pas de Calais, West-Flanders	73.8% ==> 66.2%, 88.4%
NORWAY/FINLAND	
North ==> Pohjois-Suomi	91.3% ==> 74.7%

* Data refer to 1992, with the exception of Spain and the United Kingdom, whose data are for 1991.

Source: National Databases.

4.2.2 Industrial employment change 1988-1992

Most regions in Europe have suffered heavy losses in industrial employment between 1988 and 1992, the only exceptions being the Belgian regions and some Austrian, Danish, Dutch, French and Spanish regions. However, the available evidence also shows that this general decline in industrial employment has had a differential impact according to firm size. Employment decline has been more acute in LSEs than in SMEs, with micro enterprises performing best with regard to employment.

Concentrating on the EU's current Objective regions (Objective 1, 2 and 5b)¹, the evidence displayed in Table 4.2 for the period 1988-1992 confirms the general trend noted above: SMEs, especially micro firms, have generally played a very positive role in these

¹ The current Objective 1 and 5b regions will hold their special status between 1994 and 1999, whereas the Objective 2 regions will last between 1994 and 1996.

regions in terms of maintaining and creating industrial employment, at least in comparison to LSEs.

SMEs in most of the Objective regions have shown either an aggregate increase in employment or an aggregate decrease less acute than that experienced by LSEs (see Table 4.2). The only exceptions to this trend are: the Greek and Spanish Objective 1 regions of Ipeiros and Southern Aegean, Cantabria, Comunidad Valenciana and Extremadura; the Objective 2 and 5b regions of Centre (France) and Wales (the United Kingdom); and the Objective 5b Belgian region of Namur. No significant differences are apparent between the different groups of Objective regions.

As far as micro enterprises are concerned, in all the Danish and Dutch Objective regions, and in all of Belgium and France with the exception of Luxembourg and Centre respectively, micro firms have increased their employment by more than the regional growth average (for industrial employment, this can be either positive or negative), in contrast the LSEs performed below their regional averages. The same is also true of the Greek, Spanish and British Objective regions of Eastern Macedonia-Thrace, Thessaly, Ionian Islands, Continental Greece, Peloponnese and Krete, Andalucía, Baleares, Canarias, Castilla y León, Galicia, Navarra, Murcia, País Vasco and Rioja, Northern Ireland and East Anglia.

Even in those Objective regions where micro enterprises have reduced their aggregate industrial employment the evidence suggests that, in most of these regions, micro enterprises have declined less dramatically than the regional average. This is true for the British regions, with the exception of Wales, the French Centre region, and the remaining Greek regions (Centre, Central and Western Macedonia, Ipeiros, Western Greece, Attiki and the Aegean Islands). Only in the Spanish Objective regions have micro enterprises reduced their aggregate employment by more than the regional average.

This chapter shows that SMEs and especially micro enterprises are currently playing a significant and dynamic role in the European regions as far as employment is concerned, particularly in comparison to LSEs. However, this chapter also shows that the SMEs' role in employment is subject to strong regional variations within countries (with varying shares of employment in SMEs, varying job creation capabilities¹, and varying attitudes to self-employment). Due to these variations, the regional analysis provides support for policy measures specifically designed for particular regions.

Finally in this section, spatial process of national decentralisation in manufacturing employment can be observed in several countries. This trend shows job losses to have been greater in the capital regions, in the other large cities, and in the old manufacturing areas, whereas smaller towns and peripheral areas have benefited from an increase, or relatively smaller reductions, in manufacturing employment. Examples can be found in Norway, Austria, the Netherlands, and the United Kingdom, where industrial employment has decreased in the core/central regions of the Norwegian capital region, Wien, Noord- and Zuid-Holland, the South East of England and the Greater London area, and the Copenhagen area, but increased in other, often less developed regions such as the Norwegian South, Burgenland, Flevoland, East Anglia and Wales.

¹ For a further discussion on this topic see the First Annual Report of the European Observatory for SMEs and the EU Commission's Com (94/207/final) Integrated Programme in Favour of SMEs and the Craft Sector.

Table 4.3 Industrial employment change by firm size in the Objective regions

OBJECTIVE 1 REGIONS						
Austria	1-9	10-99	100-249	250-499	500+	Total
Burgenland	-1.1	3.7	-2.4	5.7	-0.5	1.6
Total Austria	-0.5	0.3	1.9	0.5	-2.0	0.0
Belgium (1988-1992)	1-9	10-99	100-199	200-499	500+	Total
Hainaut	1.7	2.9	1.9	2.0	-4.7	1.0
Total Belgium	1.7	2.9	1.6	2.0	-2.3	1.4
France (1988-1992)	-19	20-49	50-99	100-499	500+	Total
Corse	16.4	-6.2	n.a.	8.3	n.a.	-1.8
Nord Pas de Calais	6.4	1.6	0.6	-3.3	-4.3	-2.3
Total France Métropole	2.1	0.8	-0.9	-1.0	-3.6	-1.4
Greece (1988-1992)	20-49	50-99		100+		Total
Eastern Macedonia-Thrace	5.0	1.6		-3.7		-1.1
Central Macedonia	-1.9	-0.2		-2.6		-2.0
Western Macedonia	-7.7	3.3		-15.5		-12.1
Ipeiros	-1.2	-6.7		-1.5		-2.1
Thessaly	2.5	0.2		-5.1		-2.1
Ionian Islands	3.9	0.7		-23.0		-4.4
Western Greece	-1.2	0.6		-10.3		-6.8
Continental Greece	1.4	2.3		-7.5		-5.0
Attiki	-1.6	-1.6		-5.2		-3.7
Peloponnese	1.1	3.5		-3.8		-1.7
Northern Aegean	-0.1	-16.2		-28.1		-13.4
Southern Aegean	-1.9	-22.7		-1.5		-2.8
Krete	3.5	-2.3		-8.2		-0.6
Total Greece	-0.9	-0.4		-5.2		-3.3
Ireland (1988-1990)	0-9	10-99	100-199	200-499	500+	Total
Total Ireland	-5.1	1.5	5.3	5.2	-0.3	2.3
Netherlands (1988-1992)	1-19	20-99	100-199	200-499	500+	Total
Flevoland	5.0	5.1	n.a.	n.a.	n.a.	6.3
Total Netherlands	4.4	1.8	1.7	1.9	-2.7	0.6
Spain (1988-1991)	-19	20-49	50-99	100-499	500+	Total
Andalucia	2.2	5.5	5.2	-1.0	-8.0	0.9
Asturias	-1.8	7.2	13.8	-4.1	n.a.	0.8
Canarias	3.4	-3.2	1.1	-2.3	n.a.	0.3
Cantabria	-4.0	2.0	14.5	-9.2	3.0	-1.0
Castilla y León	1.8	4.9	5.3	-0.6	-1.0	1.5
Castilla-La Mancha	-0.6	0.9	1.9	7.4	n.a.	1.6
Ceuta y Melilla	-4.5	-8.6	n.a.	n.a.	n.a.	-5.9
Comunidad Valenciana	2.7	3.3	2.9	-0.2	9.4	2.8
Extremadura	-9.3	5.9	-1.8	7.7	n.a.	-3.4
Galicia	6.5	5.0	2.6	3.1	0.4	4.4
Murcia	2.2	-0.4	6.5	1.1	n.a.	1.9
Total Spain	0.8	4.2	2.7	-0.2	-2.8	0.9
United Kingdom (1988-1991)	1-9	10-99	100-199	200-499	500+	Total
North West	-1.9	-2.2	-3.9	-2.1	-12.5	-5.7
N. Ireland	3.3	-0.1	-0.8	1.2	-5.5	-0.9
Scotland	-0.4	-0.7	-2.4	-5.2	-3.8	-2.9
Total United Kingdom	-1.0	-1.9	-3.4	-4.0	-5.9	-3.7

Source: National Databanks.

OBJECTIVE 2 REGIONS						
	1-9	10-99	100-199	200-499	500+	Total
Belgium (1988-1992)						
Antwerpen	1.6	2.9	0.7	3.5	-1.1	1.5
Liège	0.7	3.0	-1.0	0.2	-5.2	0.3
Limburg	2.6	6.2	6.0	3.0	-6.2	2.3
Luxembourg	3.1	6.0	-0.8	10.9	8.6	4.9
Total Belgium	1.7	2.9	1.6	2.0	-2.3	1.4
Denmark (1986-1992)				100+		Total
Nordjyllands Amt	5.2	-1.4		-0.3		0.0
Storstroms Amt	6.5	-1.8		-4.0		-1.6
Total Denmark	5.0	-0.7		-1.3		-0.3
France (1988-1992)		20-49	50-99	100-499	500+	Total
Alsace	6.1	2.2	-1.3	0.5	0.7	0.6
Aquitaine	7.3	-0.4	-0.8	0.9	-2.7	-0.6
Auvergne	6.8	3.5	0.6	2.5	-5.1	-1.1
Basse Normandie	0.7	2.0	0.6	1.3	-0.2	0.8
Bourgogne	3.2	0.6	1.3	-1.5	-1.4	-0.8
Bretagne	6.0	3.9	-1.9	5.0	-2.0	1.4
Centre	-0.5	3.9	-0.1	-2.5	-0.1	-0.6
Champagne-Ardenne	3.6	0.3	-1.0	-0.2	-1.8	-0.6
Franche-Comté	5.5	2.9	-0.4	1.0	-2.4	-0.4
Haute-Normandie	3.1	1.1	-1.7	0.3	-3.3	-1.0
Languedoc-Roussillon	5.2	0.2	-3.4	-4.4	-3.1	-2.6
Lorraine	0.7	1.4	-0.6	-0.2	-2.8	-1.0
Midi-Pyrénées	6.5	0.0	-0.8	2.0	-3.3	-0.5
Nord Pas de Calais	6.4	1.6	0.6	-3.3	-4.3	-2.3
Pays de Loire	3.6	3.7	-1.2	-0.1	-1.9	-0.1
Picardie	12.2	1.5	-1.2	0.0	-4.3	-1.1
Poitou-Charentes	3.0	1.5	0.9	3.8	-6.7	0.4
Provence-Alpes Côte d'Azur	1.3	0.4	-1.2	-2.2	-4.4	-2.0
Rhône-Alpes	1.3	1.9	-0.3	-0.5	-2.7	-0.4
Total France Metropole	2.1	0.8	-0.9	-1.0	-3.6	-1.4
Netherlands (1988-1992)	1-19	20-99	100-199	200-499	500+	Total
Drenthe	4.3	3.5	-3.6	3.3	3.6	2.1
Gelderland	4.8	1.5	2.3	2.7	-3.2	1.4
Groningen	4.1	3.6	0.9	1.0	-2.3	1.1
Limburg	5.4	2.2	0.8	4.7	-1.6	1.0
Noord-Brabant	6.4	2.9	0.3	1.7	-3.7	0.0
Overijssel	5.4	0.5	n.a.	n.a.	-0.4	1.9
Total Netherlands	4.4	1.8	1.7	1.9	-2.7	0.6
Spain (1988-1991)		20-49	50-99	100-499	500+	Total
Aragón	0.1	5.9	0.5	-0.7	13.6	2.6
Baleares	3.0	-1.6	-6.5	-1.1	n.a.	0.4
Cataluña	-1.3	6.3	3.6	-2.3	-3.1	0.1
Madrid	-4.3	8.7	2.9	3.4	-2.7	1.3
Navarra	4.5	0.7	-3.5	5.1	-8.4	0.6
Pais Vasco	5.6	-1.8	-0.9	0.6	-8.4	-1.3
Rioja	0.4	5.2	-1.1	-10.1	n.a.	-0.6
Total Spain	0.8	4.2	2.7	-0.2	-2.8	0.9
United Kingdom (1988-1991)	1-9	10-99	100-199	200-499	500+	Total
East Midlands	-0.1	-1.9	-4.2	-5.2	-6.3	-4.0
North West	-1.9	-2.2	-3.9	-2.1	-12.5	-5.7
North	-0.3	0.6	-1.6	-2.2	-6.0	-3.0
Scotland	-0.4	-0.7	-2.4	-5.2	-3.8	-2.9
South-East	-3.4	-5.0	-8.1	-7.8	-8.3	-6.7
South-West	-2.0	-2.2	-3.8	-5.1	-3.4	-3.4
Wales	-1.8	-2.2	1.4	-4.1	-0.3	-1.5
West Midlands	-0.8	-2.7	-3.4	-4.4	-6.1	-4.1
Yorkshire & Humberside	-1.8	-1.8	-3.2	-4.8	-3.2	-3.1
Total United Kingdom	-1.0	-1.9	-3.4	-4.0	-5.9	-3.7

Source: National Databanks.

OBJECTIVE 5b REGIONS						
Belgium (1988-1992)	1-9	10-99	100-199	200-499	500+	Total
Luxembourg	3.1	6.0	-0.8	10.9	8.6	4.9
Namur	2.0	3.8	-0.7	-2.0	2.9	2.0
Oost Vlaanderen	1.6	2.7	3.6	2.5	-1.9	1.8
West Vlaanderen	1.8	2.7	2.0	1.0	-2.0	1.6
Total Belgium	1.7	2.9	1.6	2.0	-2.3	1.4
Denmark (1988-1992)	1-9	10-99	100+			Total
Arhus Amt	4.9	-0.2	-3.1			-0.7
Bornholms Amt	27.4	-2.9	n.a.			1.7
Fyns Amt	4.4	-0.1	-1.3			-0.1
Nordjyllands Amt	5.2	-1.4	-0.3			0.0
Ribe Amt	5.9	0.9	2.5			2.3
Ringkobing Amt	2.6	-1.4	3.5			0.9
Sonderjyllands Amt	4.5	-0.3	-0.1			0.3
Storstroms Amt	6.5	-1.8	-4.0			-1.6
Veje Amt	3.6	1.8	-0.9			0.7
Vestjaellands Amt	6.0	0.4	0.5			1.6
Viborg Amt	5.9	1.7	2.0			2.4
Total Denmark	5.0	-0.7	-1.3			-0.3
France (1988-1992)	-19	20-49	50-99	100-499	500+	Total
Alsace	6.1	2.2	-1.3	0.5	0.7	0.6
Aquitaine	7.3	-0.4	-0.8	0.9	-2.7	-0.6
Auvergne	6.8	3.5	0.6	2.5	-5.1	-1.1
Basse-Normandie	0.7	2.0	0.6	1.3	-0.2	0.8
Bourgogne	3.2	0.6	1.3	-1.5	-1.4	-0.8
Bretagne	6.0	3.9	-1.9	5.0	-2.0	1.4
Centre	-0.5	3.9	-0.1	-2.5	-0.1	-0.6
Champagne-Ardenne	3.6	0.3	-1.0	-0.2	-1.8	-0.6
Franche-Comté	5.5	2.9	-0.4	1.0	-2.4	-0.4
Haute-Normandie	3.1	1.1	-1.7	0.3	-3.3	-1.0
Languedoc-Roussillon	5.2	0.2	-3.4	-4.4	-3.1	-2.6
Limousin	2.2	0.6	-3.0	-0.2	-3.0	0.9
Lorraine	0.7	1.4	-0.6	-0.2	-2.8	-1.0
Midi-Pyrénées	6.5	0.0	-0.8	2.0	-3.3	-0.5
Pays de Loire	3.6	3.7	-1.2	-0.1	-1.9	-0.1
Poitou-Charentes	3.0	1.5	0.9	3.8	-6.7	0.4
Provence-Alpes Côte d'Azur	1.3	0.4	-1.2	-2.2	-4.4	-2.0
Rhône-Alpes	1.3	1.9	-0.3	-0.5	-2.7	-0.4
Total France Métropole	2.1	0.8	-0.9	-1.0	-3.6	-1.4
Netherlands (1988-1992)	1-19	20-99	100-199	200-499	500+	Total
Drenthe	4.3	3.5	-3.6	3.3	3.6	2.1
Friesland	4.5	1.8	3.3	-4.3	-4.5	0.4
Groningen	4.1	3.6	0.9	1.0	-2.3	1.1
Limburg	5.4	2.2	0.8	4.7	-1.6	1.0
Overijssel	5.4	0.5	n.a.	n.a.	-0.4	1.9
Zeeland	5.8	-0.7	19.7	-12.0	0.6	1.0
Total Netherlands	4.4	1.8	1.7	1.9	-2.7	0.6
Spain (1988-1991)	-19	20-49	50-99	100-499	500+	Total
Aragón	0.1	5.9	0.5	-0.7	13.6	2.6
Baleares	3.0	-1.6	-6.5	-1.1	n.a.	0.4
Cataluña	-1.3	6.3	3.6	-2.3	-3.1	0.1
Madrid	-4.3	8.7	2.9	3.4	-2.7	1.3
Navarra	4.5	0.7	-3.5	5.1	-8.4	0.6
País Vasco	5.6	-1.8	-0.9	0.6	-8.4	-1.3
Rioja	0.4	5.2	-1.1	-10.1	n.a.	-0.6
Total Spain	0.8	4.2	2.7	-0.2	-2.8	0.9
United Kingdom (1988-1991)	1-9	10-99	100-199	200-499	500+	Total
East Anglia	42.6	38.2	41.8	34.1	28.7	35.4
East Midlands	-0.1	-1.9	-4.2	-5.2	-6.3	-4.0
North West	-1.9	-2.2	-3.9	-2.1	-12.5	-5.7
North	-0.3	0.6	-1.6	-2.2	-6.0	-3.0
Scotland	-0.4	-0.7	-2.4	-5.2	-3.8	-2.9
South West	-2.0	-2.2	-3.8	-5.1	-3.4	-3.4
Wales	-1.8	-2.2	1.4	-4.1	-0.3	-1.5
West Midlands	-0.8	-2.7	-3.4	-4.4	-6.1	-4.1
Yorkshire & Humberside	-1.8	-1.8	-3.2	-4.8	-3.2	-3.1
Total United Kingdom	-1.0	-1.9	-3.4	-4.0	-5.9	-3.7

Source: National Databanks.

Some authors¹ claim that this process of spatial decentralisation has produced specific sectoral and regional distributions of employment, with the core regions of different countries specialising in new high tech or customer-oriented manufacturing, whilst the peripheral regions are more dependent on older and more labour intensive manufacturing.

4.2.3 Self-employment

Self-employment is often regarded as an indicator of 'entrepreneurship' as the self-employed have started a new business. Although international comparisons have to be taken with care (for a discussion on different definitions of 'self-employment', see chapter 2), it is possible to make inter-regional comparisons on a national basis. The available evidence for several countries shows distinct differences in rate of self-employment by region, with the largest disparities being found amongst the Norwegian, Spanish and the British regions. The Norwegian North-East shows a self-employment rate of 12.7%, whereas the capital region has a rate of just 6.8%. In Spain, regional self-employment rates vary between Galicia (35.8%) and Madrid (12.1%). In Britain, the self-employment rate in the South West of England (14.8%) is much higher than that in the North of England (8.4%).

Each country has its own particular geographical pattern of self-employment. For example, the United Kingdom has a North-South divide, with a higher propensity for self-employment in the metropolitan and semi-rural Southern regions, but by contrast other urban and central regions like Germany's Hamburg and Berlin city-regions, the Ile de France, the Italian metropolitan regions of Lazio and Lombardia, Madrid in Spain, and the Norwegian capital region, all have rates of self-employment below their national averages.

In general terms the rate of self-employed is higher in traditionally SME-oriented regions, which are now expanding economically, and which have not had a high dependence on basic and heavy industries in the recent past. Examples of such regions include Flanders in Belgium, the French Mediterranean regions of Languedoc-Roussillon and Provence Alpes-Côte d'Azur, Abruzzi-Molise or Emilia-Romagna in Italy, the northern regions of Norway (North Norway and Trøndelag) and East Anglia in the United Kingdom.

The existing evidence also shows that the regions with the lowest self-employment rates are the old industrialised regions formerly dominated by now declining industries (Coal Extraction, Iron and Steel, Shipbuilding, Textile industry). Examples of these regions include Hainaut, Limburg or Liège in Belgium, the Basque Country in Spain, the North and North-West of England, Yorkshire and Humberside, and Scotland in the United Kingdom, and Germany's Saarland and Nordrhein-Westfalia. These two German regions have the lowest rates of industrial self-employment in Germany. Several reasons have been proposed to explain the lack of 'entrepreneurship' in these regions. Amongst them the most important are the lack of a tradition of self-employment, with most existing employment

¹ Isaksen, A., Spatial Division of Labour in Norway: Dynamic Centre, Traditional Periphery, *Norsk geogr. Tidsskr*, Vol 44:50-53, 1990. The study, with data for the period 1976-1985, only included independent, single-unit enterprises with less than 20 employees.

being waged or salaried, and the old-fashioned or outdated nature of the workforce's qualification¹.

The uneven geographical pattern of the 'attitude' to self-employment is apparent in qualitative as well as quantitative terms. Although the available evidence is limited, several studies carried out in Denmark² and Norway³ show a qualitative differential in the spatial distribution of new firm formation. The employment created in new and expanding small firms in the national capital regions is more likely to be in customer-oriented and high-tech enterprises, relative to the rest of the country. This also means that there will probably be an uneven concentration of highly skilled well paid new jobs in the national core regions. However, this trend is not entirely clear and requires further research.

Several empirical studies have dealt with the factors which influence the 'attitude' to self-employment from a regional perspective. A recent British study⁴ found that, for the United Kingdom, there was no recession-push effect (through which the unemployed went into self-employment) evident at the regional level. However, an increase in the ratio of unemployed to vacancies did exert a negative influence on self-employment as did an increase in the number of long-term unemployed. Meanwhile, positive influences on self-employment at the regional level included net housing wealth, a high proportion of the workforce aged over 45, and an above average dependence on the construction, distribution, and banking and finance sectors. Education and vocational qualifications in the workforce appear to have had no effect on self-employment.

From a different perspective a recent study⁵ concerned with French regional disparities in new firms creation (a slightly different, but related, concept to 'self-employment') concluded that whilst there was not a unique factor that explained all regional differences in the level of new firm creation, the rate of new firm creation was found to be closely related to the existing regional economic and cultural environment. The study also pointed out that, apart from Ile de France, the geographical areas characterised as being: important tourist resorts; having high unemployment rates; having high secondary residence levels; and with increasing populations, have very high levels of new firm creation. On the other hand the regions particularly badly affected by industrial restructuring show low levels of new firm creation. An Irish study⁶ found similar results, with the number of new enterprises emerging being related to several features of the local area, especially the size distribution of existing enterprises, the degree of urbanisation, the sectoral mix, and the rate of manufacturing employment change.

¹ For a further discussion see Lafuente A., *Creación de Empresas y Desarrollo Regional*, in *Economía Industrial*, Septiembre-Octubre, pp 27-36, 1986.

² Jens Frøslev Christensen in 'Ledels og erhvervsøkonomi' n° 4 1991.

³ Isaksen, A., 1990, *op. cit.*

⁴ Robson Martin, *Self-Employment in the UK-Regions*, Discussion Paper, Economic Department, University of Newcastle-upon-Tyne, 1994.

⁵ Mesléard P., C. Tondolo and S. Finance, *Approche Territoriale de la Création et de la Reprise d'Entreprises en France Métropolitaine*, 1994.

⁶ O'Farrell P.N. and R. Crouchley, *An Industrial and Spatial Analysis of New Firm Formation in Ireland*, in *Regional Studies*, vol 18 n 3, 1984.

5 EXPORT AND INTERNATIONAL ORIENTATION

Co-ordinated by Danish Technological Institute (DTI)

MAIN POINTS

- The value of international trade is increasing, but an increasing share of European countries trade is with other European countries. There is therefore trend of 'Europeanisation' in the pattern of trade within the EU. The 'Europeanisation' trend is more dramatic for the smaller EU-countries.
- For all industrial sectors the proportion of enterprises that export increases with enterprise size, but the number of exporting smaller enterprises is growing.
- The manufacturing and wholesale sectors tend to be more export oriented than other sectors, but other sectors are becoming increasingly international.
- The correlation between the export intensity and the enterprise size is not as clear as the relationship between the proportion of enterprises that export and enterprise size. However, in most countries, the export intensity of manufacturing enterprises does rise with the number of employees. This said, some small and medium sized manufacturing enterprises have very high export intensities.
- SMEs in smaller countries often have higher export intensities than those in larger countries. Figures for the recent years suggest that the difference may be narrowing.
- The internationalisation of production seems to force an increasing number of the SMEs, especially innovative SMEs, to export, and to enter the export markets with a new product at the same time as they enter their domestic market.
- The quality of the product is the determining factor in initial export success, but a key factor for on-going success in export markets is the capabilities of the management, and 'direct engagements' with the market. These characteristics are found more often in larger enterprises than SMEs.
- There is no single export strategy for SMEs, but exporting behaviour is typically a mixture of learning-by-doing, strategic commitment, and random factors.
- The export barriers for SMEs are closely linked to the general barriers to growth and development of SMEs. The main export barriers are a lack of capital and insufficient management capabilities.

continued

continued

- The importance of public procurement is increasing, but cross-country public procurement has remained at a very low level.
- The number of EEIGs is increasing significantly and they are becoming an interesting new legal form for transnational business co-operation whilst allowing enterprises remain economically and legal independent. EEIGs mainly serve medium sized service enterprises.

5.1 INTRODUCTION

In the future SMEs will have to become more oriented towards foreign markets but they will face increasing problems and new challenges. Several factors have influenced the increasing internationalisation of the production¹. Some of the main factors are listed below to set the scene within which the international activities of SMEs take place:

- Deregulation of international trade tariffs and the harmonisation of standards and norms; this includes the 'single market' and the GATT agreement.
- New patterns of organisation and business location have emerged. These include using foreign suppliers, indirect exporting, foreign direct and indirect investments, joint ventures, and international co-operation. These take place to obtain better access to markets and to enhance competitiveness by exploiting specific local production factors, such as favourable labour cost, labour skills, or tax conditions.
- Exports and imports have increased considerably. These have intensified competition in both domestic and foreign markets.

A feature of the internationalisation of the production is the increasing competition between enterprises, a more widespread division of labour, and specialisation of production. The ability to become competitive depends on, amongst other factors:

- A balance between the international competition and the local business environment. The latter is the specific local production factor which underlies the competitiveness of enterprises. It includes: natural resources; labour costs and skills; R&D; business services; the legal environment; taxation etc.²
- The enterprise's product and its quality, design, and price characteristics. For the individual enterprise this is a crucial factor for achieving success in domestic and international markets.

Considering the above mentioned conditions for doing business in ever more open international markets, the objectives of this chapter are to analyse SMEs international orientation and performance in terms of exports. The chapter will also comment on two EU-initiatives that encourage SMEs to internationalise. The chapter takes a micro-economic approach, focusing on individual enterprises. General development in business conditions will not be analysed, but are considered as preconditions to the internationalisation process.

¹ See also The European Observatory for SMEs, First Annual Report 1993, chapter 10.

² See also chapters in Part II Business Environment of this Report.

However, data on exporting and other international activities by enterprise size is not easily obtained for all the EU-countries. The extent to which SMEs are involved in direct exporting and other activities will be assessed through national surveys and statistics, but as the data is often in different formats comparative analyses is difficult.

5.2 EXPORT BY COUNTRIES

The importance of international trade continues to increase. The trade in goods from European OECD-countries increased from 14.3% of GDP in 1962 to 21.6% of GDP in 1992¹. However, the geographical structure of the trade in goods from the European OECD-countries reveals an increasing 'Europeanisation' of trade, with trade between European countries taking an ever greater proportion of total European trade. Intra-European trade rose from 61.5% in 1962 to 71.8% in 1992.

Over the last decades the trade intensity, or 'openness', of all EU-Member States has increased, but marked differences remain. The larger countries remain relatively less 'open' to international trade than the smaller countries. The specialisation of the production and the division of labour will especially squeeze the SMEs in the smaller countries to address larger geographical markets. Exporting is increasingly necessary for SMEs, especially in smaller countries, to break even.

Among the smaller EU-countries those most 'open' economies to international trade are, in descending order: Luxembourg and Belgium; Ireland, Norway and the Netherlands; Denmark, Austria and Sweden; Finland, Portugal and Greece. The larger countries: Germany, the United Kingdom, France, Italy and Spain, have trade intensities about the same level as Finland, Portugal and Greece. Consequently, SMEs in the smaller countries are more likely to export.

The main target markets for EU-exports are the intra-EU markets, and particularly neighbouring countries. This is especially true for the smaller countries, see Table 5.1. Lower intra-EU trade, as a proportion of total trade, is evident amongst the larger countries (Germany, the United Kingdom, and Italy) which have very large scale enterprises addressing global markets. Denmark's intra-EU trade is also relatively low due to its extensive trade with other Scandinavian countries.

During the recent years EU-countries situated close to Central- & Eastern Europe (e.g. Austria) have experienced a remarkable increase in export to these countries. Actually, the Austrian SMEs export to Eastern Europe has doubled between 1990 and 1993. In 1993 13.6% of the total SME export from Austria was aimed at Eastern Europe. Roughly one third of the Austrian export to Eastern Europe was aimed at Hungary.

¹ OECD: The OECD Jobs Study, Evidence and explanations, Part 1, 1994.

Table 5.1 Destination of export by EU-12 and EFTA-4, 1992 (%)

Country	Intra EU-12	Extra EU-12	Total
Belgium - Luxembourg	75	25	100
Denmark	55	45	100
France	63	37	100
Germany	54	46	100
Greece	64	36	100
Ireland	74	25	99
Italy	58	42	100
Netherlands	75	24	99
Portugal	75	24	99
Spain	66	33	99
United Kingdom	55	44	99
EU-12	61	38	99
Austria	64	36	100
Finland	53	47	100
Norway	67	33	100
Sweden	56	44	100
EFTA-4	61	39	100

Source: Eurostat CD 1993 2nd edition.

5.3 SMEs AND EXPORT MARKETS

Involvement in direct exporting provides an indication of the degree of internationalisation of SMEs. However, the data available does not allow a complete picture of the export activities of all SMEs to be drawn.

In general, Large Scale Enterprises (LSEs) are highly export oriented and account for a dominant share of the total value of exports. In Spain, LSEs account for 7.3% of all enterprises but account for 70% of all exports. Of 140,000 exporting enterprises in France, 250 enterprises account for half the total exports, and 2,000 enterprises account for 75% of all exports.

The proportion of enterprises that export varies considerably between the EU-countries, but there is a general trend that the proportion of exporters tends to increase with enterprise size. In Portugal 4.8% of small enterprises with less than 10 employees export while two-thirds of the enterprises with more than a 100 employees export. In Italy and the Netherlands a higher proportion of small enterprises export but there is still a trend of increasing export orientation with increasing enterprise size, see Table 5.2.

Table 5.2 The share of exporting enterprises by size class within all industrial sectors, selected countries (%)

Size of enterprise	Italy	Netherlands	Portugal	Spain
	1991	1993	1992	1991
0 - 9	-	7	5	18
10 - 19	39	26	25	
20 - 49	57	38		44
50 - 99	75	55	63	
100 - 249				77
250 - 499	64	86	86	84
≥ 500				

Italy: '50 - 250' is one size class.

The Netherlands '100 -' represents one size class.

Portugal: '10 - 99' is one size class.

Spain: ' - 19' is one size class and an other size class' are used: '51 - 200' and '201 - 500'.

Source: Mediocredito Centrale 1994, Italy.

Instituto de Esstudios Fiscales, 1992, Spain.

INE - External Trade and FUE, Portugal.

ERBO Statistics 1993, The Netherlands.

Recent evidence suggests that SMEs are becoming more involved with exporting. While the number of small enterprises that export is still low, it is increasing. In Portugal 3.6% of enterprises with 0-9 employees exported in 1988, but by 1992 this had increased to 4.8%. In the Netherlands the number of exporting SMEs has increased with 3% from 1992 to 1993, and in France the number of exporting enterprises with less than 19 employees increased by 30% (from 21,000 to 28,000 enterprises) between 1988 and 1992. Similar developments have taken place in Ireland, where the number of exporting manufacturing enterprises with less than 20 employees has increased by 28% over the 1988 to 1990 period.

Some sectors, notably manufacturing and wholesale, are more export oriented than others, but there is evidence of increasing internationalisation in sectors that previously had little international trade. Export can nowadays be found within all SME sectors. For example in the United Kingdom, 26.7% of all enterprises exported in 1992, and by sector the highest percentage was amongst manufacturers at 45%, followed by wholesaling, but it is notable that 14% of the retailers and 20% of service enterprises (business and other services) also exported. An increase in export can be expected to be found within all SME sectors. The increasing export from Denmark has not only affected the manufacturing industries, but there has also been a considerable increase in export from the service sector. In Portugal there was a significant increase in the volume of exports between 1988 and 1990 from both manufacturing industries, especially the Leather Goods Industry, and from services, especially Building & Civil Engineering.

The manufacturing industry is an important exporting sector, with a large proportion of enterprises exporting. The proportion of manufacturing enterprises that export generally increases with enterprise size (by number of employees), but it is also common for smaller manufacturers to export. Typically between a third and two thirds of enterprises with between 20 and 100 employees will export, the proportion will be lower amongst smaller enterprises, but it is common for 80% of manufacturing enterprises with more than a 100 employees to export, see Table 5.3.

Table 5.3 The share of exporting enterprises within the manufacturing industry, selected countries (%)

Size of enterprise	France	Ireland	Netherlands	Portugal
	1992	1990	1991	1991
1 - 9	-		17	11
10 - 19	-	62	44	39
20 - 49	32	59	61	
50 - 99	49	72	76	85
100 - 199	62	80	87	
200 - 499	72			
500 - 1,999	87	64	29	97
2,000 -	91			
Total	43			25

Ireland and the Netherlands, '100 -' is one size class.

Portugal the size class' are '1-10', '11-100', '101 - 250', '251 - 500' and '500 -'.

Source: Statistical service of the Ministry of Industry, France.

ERBO Statistics 1993, the Netherlands.

Census of Industrial Production 1990, Ireland.

INE - FUE and External Trade, Portugal.

5.4 EXPORT INTENSITY

Export intensity in *exporting enterprises*, is export sales as a proportion of the total turnover. It is a measure of enterprises dependence, or involvement in export markets. A positive correlation between export intensity and enterprise size might be expected at the national level due to the fact that the scale of production and available resources also increase with enterprise size.

However, several factors disturb this trend, particularly competitiveness and the inter-relationship between the size and sectoral distribution of exporting enterprises. Furthermore, as enterprises are increasingly affected by the internationalisation and specialisation of the production they are faced with an increasing need to export. This is true of small enterprises as well as large, and is particularly true of enterprises in the smaller countries, see 5.1.

The correlation between the export intensity and the enterprise size is therefore not unequivocal, and Austrian data shows that there are small enterprises with very high export intensities and large enterprises with lower export intensities. However, the overall trend is for average export intensity to increase with enterprise size, see Table 5.4

Table 5.4 Export intensity by size class for all SME-sectors, Austrian SMEs 1993 (%)

Size class	No data available	Export intensity					Total
		-10%	10-25%	25-50%	50-80%	80-100%	
0 - 5	43	24	9	8	7	9	100
6 - 100	3	38	18	15	15	12	100
101 - 250	1	25	17	20	20	16	100
251 - 500	1	17	15	18	30	20	100
501 -	3	18	11	13	28	26	100
Total	8	36	16	13	14	14	100

Source: Austrian Chamber of Commerce, survey-data.

In Portugal a large proportion of enterprises have export intensities below 5% (50.8% of all enterprises that export within the EU, and 41.0% of all enterprises that export outside the EU). The distribution of export intensities is similar for small and larger enterprises.

Spain has the opposite experience, there is decreasing export intensity with enterprise size. In Denmark the export intensity amongst SMEs in all sectors increases with enterprise size to about 100 employees, after which there is then a minor decline amongst larger enterprises.

The increase in the international trade has not affected all EU-countries uniformly. In Spain the average export intensity of enterprises increased from 26% to 34% between 1985 and 1992, it is expected to increase by another 5% between 1992 and 1996. This increase is mainly due to increased exports from smaller enterprises that had very low export intensities.

In Denmark the average export intensity has been increasing since the end of the 1980s. However, the average export intensity of Danish start-ups has declined from 44% in 1985 to 28% in 1991. This was mainly caused by a sectoral change in the distribution of start-ups with a decrease within manufacturing industry and a minor increase within construction.

By considering only the manufacturing sector, an export intense sector for SMEs, it is possible to get a clearer picture of the correlation between export intensity and enterprise size. Two main observations emerge. Firstly, in all the observed countries the export intensity in manufacturing increases with enterprise size, see Table 5.5. However, the export intensity within manufacturing has developed differently in countries. In some countries, Denmark, France, Portugal, Germany (for small enterprises) and the United Kingdom, export intensity is increasing, while export intensity is decreasing in Austria, Ireland and Germany (large enterprises).

Secondly, enterprises situated in the smaller countries generally have a higher export intensity than enterprises located in larger countries. Small enterprises from small countries will very often have export intensities above the export intensities of small or even large enterprises situated in large countries. One explanation for this is the general increase in trade intensity has been more marked amongst the smaller countries, see section 5.2.

Table 5.5 Export intensity for exporting enterprises within manufacturing industry (%)

Size class	Denmark	France	Germany	Ireland	Netherlands	Spain	Sweden
1 - 9	12	-	10	40	28	18	-
10 - 19	27	-			28		-
20 - 49		27	27	60	32	21	12
50 - 99	39	30	14	67	41	22	-
100 - 199	42	32	21	78	56	23	31
200 - 499		33	24			21	35
500 - 1,999	47	36	37			22	52
2,000 -		44					
Total	38	38	-	73	50	-	-

The size classes are:

Denmark: '10 - 49', '100 - 499' and '500 -'.

Germany: '1 - 49' and '500 -'.

Ireland: '- 19' and '100 -'.

The Netherlands: '100 -'.

Spain: '- 19' and '500 -'.

Sweden: '20 - 49' and '500 -'.

Source: Danmarks Statistik, Denmark.

Statistical service of the Ministry of Industry, France.

ERBO Statistics, 1993, the Netherlands.

IFM Bonn, Germany.

Census of Industrial Production, 1990, Ireland.

ESEE, 1991, Spain.

NUDATA, Finansstatistikken, Sweden.

5.5 METHODS OF EXPORTING

An increasing number of SMEs are exporting, and some have very high export intensities, but the way SMEs handle their exports will have a marked effect on their success in foreign markets.

Before turning to exporters a few comments relating to non-exporters are pertinent. Non-exporting, especially amongst smaller enterprises, is typically explained by the fact that the national demand is sufficient to satisfy the ambitions of the enterprise. Managers, particularly of family enterprises and sole proprietorships, often do not have growth ambitions, and their business strategy is based on avoiding risk. They therefore have no desire to begin exporting. If however they do wish to grow, growth through exports may be difficult. These enterprises are typically self-financed and have limited access to capital and skills. They may have insufficient knowledge and ability to gather the necessary information for exporting, that is the knowledge of how to export, including the marketing and administrative procedures required. If the product has export potential the key reason for failing to export will probably be a lack of sufficient management skills¹.

¹ Based on surveys carried out by:
 IFM Bonn, 1982 and 1991, Germany
 Centre de Promotion et de Recherche, 1991, Luxembourg
 KMO Studiecentrum, 1991, Belgium
 DTI Industrial Analyses, 1995, Denmark.

Apart from exporting direct enterprises can sell products to other domestic enterprises for indirect exporting. Information on indirect exporting indicates that the use of indirect exporting is between 15 and 30% higher amongst small enterprises than amongst large enterprises.

With the internationalisation of the production there is a tendency product life-cycles to become shorter. Consequently, enterprises must decide quickly whether they wish to exploit foreign markets in addition to their own domestic markets, and export rapidly if the decision to export is taken. In Denmark, the lag between domestic product launch and entering export markets has been reduced. In 1985, 7.6% of start-ups exported within the year of their products launch in the domestic market, by 1991, this had increased to 9.1%. Other Danish surveys on newly started innovative enterprises have found that these enterprises are keen to export as soon as the product is ready, and an Italian survey found that high-technology enterprises start to export much earlier in their lives than enterprises operating in more traditional sectors¹.

The results of a survey of business start-ups in the United Kingdom shows that exporting enterprises are technologically more advanced; the managers of the exporting enterprises are better qualified having had previous experience as director and managers; and they are better educated being three times more likely to have a University Degree². Similar results were found in Danish surveys of entrepreneurs who started their own business in 1985 and 1991. These surveys indicate that managers of exporting enterprises have a growth-orientation and a more professional approach towards running their business.

A survey of eight European countries found that enterprises size does not constitute a key factor in explaining success in export markets. Factors such as: direct export engagement (knowledge of the foreign markets, its competitive situation and way of life), active exporting; and the ability to conduct business in the local language are factors which are important for success in export markets³.

SMEs can use different sales channels to export such as direct sales, agents or sale organisations, direct representatives, or subsidiaries. The choice of sales channels does not have any relationship with the size of the enterprises, or with the number of years the enterprise has been active in the export market. The choice is influenced by:

- The nature of the target market: a consumer market or capital goods market
- The importance of user-producer relations
- The export turnover, or export rate.

It is notable that SMEs do not use a single sales channel but will typically use several channels simultaneously. There is no clear indication of an evolution in the choice of sales channels, with enterprises starting with 'simple' sales channels and move towards more 'committed' forms of distribution. Instead enterprises seem to increase their number of sales channels by increasing their engagement with export markets. This follows

¹ Leif Jakobsen, *Innovative Entrepreneurs*, 1994, DTI, and D. Deppem & C. Paroline: *Growth and internationalization of small and medium sized high tech companies*, Academia Italiana de Economia Aziendale, 1991.

² From National Westminster Bank start-up tracking exercise of start-up businesses in 1988.

³ Results from The INTERSTRATOS-Project (Internationalization of Strategic orientations of European SMEs), referred EIM: *Export success of SMEs: an empirical study*, Research report 9306A.

from the fact that enterprises which have been exporting for several years will often have a higher export intensity than enterprises that have just entered the export markets.

The internationalisation of SMEs is often considered to be a 'regular process of gradual incremental change and learning', that is moving ahead with an increasing commitment to exports¹. The export behaviour of SMEs indicates that this may not truly reflect decisions as to whether to enter export markets², or when to enlarge or strengthen the enterprises' position in an export market.

A Nordic study concluded that SMEs exporting behaviour is a mixture of learning-by-doing, strategic commitment, and random factors³.

Surveys in many EU-countries stress the following features as characteristic of SMEs that start exporting:

- The SMEs are reactive towards export possibilities, that is, exporting follows a demand, often a specific opportunity, and so exporting begins almost casually.
- Many SMEs do not calculate or make plans as regards to the possibilities and ways of approaching the export market. They do not take a proactive approach.

These results indicate that SMEs are passive exporters, but on the other hand, other results point to a more strategic orientation:

- SMEs situated in industrial districts or regions where they must export to survive are likely to begin exporting by imitating other local enterprises and by using informal information networks to discover the 'best practice'.
- An increasing number of SMEs are involved in inter-firm co-operation or networking, these provide SMEs with good opportunities to strengthen their competitive position and to improve their export performance.
- The managers of the exporting enterprises learn and become more professional through the export experience.

5.6 BARRIERS TO EXPORTING

Barriers to exporting have been identified in all countries. There are more similarities than differences between the countries in the nature of these barriers.

The barriers to SMEs engagement in exporting are closely linked to their barriers to growth and the barriers to SME development in general. The products, characterised by their quality, design, price, etc., are one of the crucial factors in becoming competitive and achieving success in international markets. When this 'precondition' is fulfilled success in the export markets will depend on the enterprises' ability to overcome internal and external barriers that hinder effective exporting.

Some of the crucial barriers for effective export performance will be found inside the enterprise. Internal barriers to exporting are:

¹ European Network for SME Research: The European Observatory for SMEs, First Annual Report 1993. Poul Rind Christensen: The small and medium-sized exporters' squeeze: empirical evidence and model reflections, *Entrepreneurship and regional development* 3/1991.

² Several studies have indicated that SMEs tend to enter export markets without proper planning. It is even reported that more than 50% of all 'first export orders' are contracted just by case.

³ Lindmark et al. *Småföretagens internationalisering - et nordisk jämförande studie*, NordREFO 1994:7.

A lack of capital:

- Needed to build up an international market position and to maintain international business relations.
- Needed to bear possible losses and to provide for the increased costs of longer credit lines, fluctuating exchange rates, etc.

A lack of human capital:

- Managers of SMEs often do not have the time needed to engage in export activities such as setting up a proper sales organisation as they have to take care of their existing management tasks as well. Many SMEs are more product and technology oriented than they are market oriented.
- The lack of managers with international experience and foreign language skills can cause problems for exporting. Recruiting personnel with these skills is a problem especially for many smaller SMEs.

The influence of external barriers to exporting are closely linked to the internal barriers. If the SMEs have the resources and motivation to export they can usually overcome the external barriers, either by themselves or by seeking external assistance. Nevertheless, this will also be more difficult for smaller enterprises. Some typical external barriers are:

Technical trade restrictions and bureaucratic procedures:

- National standards, environmental and packaging requirements, and other such technical barriers which exist in the EU. A Danish survey has found that 62% of the enterprises met technical barriers, but two-thirds were able to solve these problems.¹

Marketing and distribution problems:

- Problems with identifying and getting information on customers, for example on their credit-worthiness.
- Problems with finding suitable representation in the target market and establishing a relationship of trust.
- Transport - distance to the market:
- Countries on the periphery of the EU have problems with high transport costs and experience communication problems.

Therefore, the development of competitive products, or business concepts, as well as the elimination of export barriers, are an important element of SME-policy.

5.7 THE EU'S ENCOURAGEMENT OF INTRA-EU BUSINESS ACTIVITIES

The European Commission has taken several initiatives, relating to information, education, and innovation, to encourage intra-EU business activities and to encourage the internationalisation of SMEs. In this section two initiatives that encourage international business activities are discussed.

¹ The Danish Agency for Development of Industry and Trade: Tekniske Handelshindringer, Notat Dec. 1993.

*Cross-border public procurement*¹.

When the value of a public contract for goods, services, or construction in the EU exceeds a certain value there must be an invitation for enterprises to tender for the contract. The number of contracts based on public procurement has increased considerably since 1990, see Table 5.6.

Table 5.6 Public procurement within the 12 EU Member States, 1990-1993

	GOODS		CONSTRUCTION	
	Number of entered agreements	Number of foreign suppliers	Number of entered agreements	Number of foreign suppliers
1990	2,991	128	1,145	11
1991	3,682	115	1,525	3
1992	5,707	187	3,495	30
1993	7,399	134	3,335	39

Source: The Danish Agency for Development of Industry and Trade and PLS-Consult.

However, cross-country public procurement has not increased significantly and even decreased in relative terms. In 1993 public procurement in all sectors (goods, construction, services, and sectors excluded from the EU public procurement directives) amounted to 12,982 signed contracts, but only 285 (2%) were won by foreign enterprises.

When it does occur public procurement by foreign contractors is most common amongst neighbouring countries and countries with a shared language, see Table 5.7. Half of all the tenders won by foreign enterprises were won by German, French, and Belgian enterprises, but the most open markets for public procurement are the Netherlands, France, and the United Kingdom.

Of all the public contracts offered in the Danish market, 60% were won by SMEs. Nevertheless, the tendering poses several problems for SMEs. The tenders included in the EU-directives for public procurement tend to be far too large for SMEs to manage alone, and interviewed SMEs gave a number of factors as being crucial to successful tendering.

These were:

- being able to present relevant national references
- being able to influence the decision makers before the tenders were published.
- having a permanent office or an agent in each country in which the enterprise is competing for tenders. This office or agent should collect relevant market information and make direct contact with the contracting organisation.

When tendering SMEs often face problems relating to cultural differences, language problems, insufficient knowledge about the foreign market, and a lack of resources for promotional activities. Lack of information concerning contracts, insufficient information

¹ Based on the report: PLS-Consult: Små og mellemstore virksomheders muligheder i forbindelse med udbud med unbud og licitatering af offentlige opgaver i Danmark, Norden og EU, 1994 (Erhvervsfremme Styrelsen).

on standards included in tender specifications, failure to conform to a recognised Quality Assurance standard, etc¹.

Table 5.7 Cross border public procurement between EU Member States, total number of signed contracts in 1993

Origin of enterprises winning tender	Country making the procurement												Total
	B	DK	F	D	GR	IRL	I	L	NL	P	E	UK	
Belgium			14	4			1	5	15			6	45
Denmark			1	4			1		1			2	9
France	6	4		11		6	8	3	12			4	54
Germany	3	9	7		1	3	2	3	31			9	68
Greece				1									1
Ireland		1	3									6	10
Italy	1		9	3		2					3	3	21
Luxembourg	2						1						3
Netherlands	2	1	2	9								5	19
Portugal		1				1							2
Spain	1												
United Kingdom		7											
Total	15	23	47	34	1	25	21	11	65		3	41	285
Total in % of the total number of contracts in each country	10.4	5.3	2.0	0.1	3.8	23.8	1.5	18.6	22.2	-	15.0	1.3	2.2

Source: The Danish Agency for Development of Industry and Trade and PLS-Consult.

European Economic Interest Groupings (EEIGs)

Since 1989, when the first European Economic Interest Groupings (EEIG) were established, the total number has increased rapidly (to 322 by June 1992). The greatest number of EEIGs are located in Belgium, followed by France, and the Netherlands (see Table 5.8). The concentration of EU-offices in Brussels probably explains the high number of EEIGs in Belgium. However, each EEIG will typically represent enterprises from several countries with a broad geographical distribution.

¹ Hanock, C.A., A report on public purchasing in the Community in relation to SMEs - An overview with particular reference to the specification of European Standards in tenders, Brussels, 1991.

Table 5.8 Number of EEIGs, June 1992

	Number of EEIGs
Belgium	104
Denmark	2
France	83
Germany	24
Greece	0
Ireland	2
Italy	6
Luxembourg	2
Netherlands	62
Portugal	2
Spain	10
United Kingdom	23

Source: Commission of the European Communities: EEIG - The emergence of new forms of European co-operation, 1993.

Some updated figures for 1994 (Denmark (4), Ireland (4) and Italy (20)) show an increasing interest in EEIGs.

Most of the enterprises that belong to EEIGs are in the service sector, these are followed by industrial enterprises, which tend to be medium sized enterprises. On average each EEIG has 5 members, typically operating in the same line of business.

The EEIGs are an interesting new legal form of transnational business co-operation in which the enterprises remain economically and legally independent. The EEIGs have been both a platform for traditional business co-operation and a platform for developing and testing the possibilities of co-operation in new fields. One disadvantage of them is that the partners are liable to the full extent of their assets and are jointly liable for the EEIGs activities.

PART II BUSINESS ENVIRONMENT

6 MACRO ECONOMIC ENVIRONMENT

Co-ordinated by EIM Small Business Research and Consultancy

MAIN POINTS

- GDP growth in Europe-16 fell back in 1992 and 1993. In 1994 a remarkably quick recovery occurred, which is expected to continue in 1995. Increasing exports in particular are driving the recovery. Growth in Europe-16 is slower than that in the USA, but exceeds that in Japan.
- Investments and private consumption in Europe-16 were reduced in the recession, but in 1994 there was a clear upturn. In 1995 a strong increase in investments is expected and a modest recovery in consumption is also expected.
- Although growth is accelerating within Europe-16, inflation is low (2,5% in 1994). Inflation differences between European countries remain considerable, but are diminishing.
- The labour market situation in Europe-16 still causes for concern, with employment declining between 1991 and 1994. In 1995 a modest increase in employment is predicted.
- Wage increases in Europe-16 have been small in recent years. Because productivity growth remained high unit labour costs showed a sharp decrease in 1994. This improved both the price competitiveness of European industries and their profitability.
- European currencies have been volatile in recent years. Currency markets will remain vulnerable in 1995.
- The six highest spending governments in Europe-16 are Sweden, Denmark, the Netherlands, Belgium, Italy, and Norway. These spend over 55% of GDP, compared to 38% in the USA, and 31% in Japan.
- Governments receipts in Europe-16 amounted to 45% of GDP, compared to 34% in the USA and Japan.
- European governments have accumulated large debts in recent decades. Only seven countries comply to the EMU-criterion of a 60%-debt.
- Net government borrowing in EU-12 is 6% on average. In six EU-12 countries it amounts to between 7 and 16% of GDP.

6.1 INTRODUCTION¹

Both SMEs and LSEs are affected by the macro economic environment. Questions such as: how has demand for goods and services developed during recent years? What patterns can be observed with respect to inflation? How have macro economic developments affected competitiveness? What is the size of the public sector? Are all pertinent? This

¹ This chapter is mainly based upon European Economy, Suppl. A, no. 11/12, November/December 1994.

chapter tries to answer to these questions by analysing macro economic developments in Europe. It thus provides an input to Chapter 1. This chapter also focuses on the SME business-environment in general, which is relevant for the SME Internal Market Monitor (Chapter 17).

The chapter starts with an analysis of macro economic developments between 1988 and 1995 (section 6.2) addressing GDP and demand development, labour productivity and employment, interest rates, and inflation. Following this the development of competitiveness is analysed from a macro economic point of view (section 6.3). Finally section 6.4 describes the size of the public sector in the European economy.

6.2 MACRO ECONOMIC DEVELOPMENT 1988-1995

6.2.1 GDP and demand development

GDP and demand developments have an important impact on the demand for goods and services from both SMEs and LSEs. In this section the international perspective of economic development is analysed first by comparing developments in Europe with developments in the United States and Japan. Following this, GDP-development in Europe will be dealt with in more detail. Finally, the development of demand in Europe will be analysed.

The international perspective

Table 6.1 shows GDP-development in the world's main economic regions.

Table 6.1 Real GDP by main economic region, 1988-1995

	1988-1990	1991	1992	1993	1994	1995
	% per annum					
Europe-16	3.3	1.4	0.9	-0.5	2.6	3.0
USA	1.7	-1.1	2.6	3.0	3.9	2.7
Japan	4.8	4.0	1.2	0.1	0.7	2.2

Source: European Economy, Supplement A, 11/12, November 1994, European Commission.

Europe-16

In 1991 most economies in *Europe-16* went into recession, and reached an absolute low in 1993 (a real decline by almost 0.5%). This economic slump also became manifest in increased unemployment and rising government deficits. In 1994, the economies picked up rapidly, mainly due to growth in world trade. Other signs of improvement in 1994 were rising consumer confidence and lower surplus capacity in enterprises. In 1995 and 1996 a transition will occur from an export led recovery to investment led growth. An strengthening of growth is expected, inspired by the favourable global economic climate and outlook, flexible monetary policy, an optimism amongst manufacturers and consumers, and the underlying strength of enterprises which were not affected by a strong deterioration in their capital structure during the recent recession.

United States

Of all the world's large economies, the US was the first to be hit by the recession. During the late 1980s, the first signs of recession emerged, and in 1991 growth of GDP reached its lowest point. In 1992 recovery began and has subsequently strengthened. In 1995 some slowing of the growth rate is expected.

Japan

Japan was the last country to encounter the economic downturn. Following the collapse of the 'bubble' economy, growth slowed in 1992. In 1993, despite the pick up in the world economy, recovery did not materialise in Japan, as the country experienced a double dip recession. A rather piecemeal recovery began in 1994 only, which was clearly slower than that of Europe and the US. In 1995, a further gradual recovery is expected.

GDP by country in Europe-16

Table 6.2 presents data regarding GDP-developments in the separate countries of Europe-16.

Recession 1990 -1993

All countries in the European Union were more or less affected by economic decline, albeit to varying degrees. As early as 1990, the United Kingdom, Sweden and Finland were affected by an economic recession which was to persist for several years.

More recently, the United Kingdom has mirrored the US experience. Of all countries, the United Kingdom economy picked up the fastest: while other countries experienced their absolute low in 1993, economic recovery was already underway in the United Kingdom.

The deep recession in Sweden was partly caused by monetary problems, as a result of increasing international liberalisation of the Swedish financial sector.

Sweden and Finland were affected by the negative impact of the growing pains associated with Eastern Europe's transition to market economies.

Denmark and Norway are remarkable, as these countries did not go into recession. In the late 1980s growth slackened but did not fall under 1%. Faster growth materialised in 1992, and was particularly rapid in Norway. Norway obviously benefited from its abundant oil reserves, which limited the impact of the world recession.

Table 6.2 Real GDP in Europe-16 by country, 1988-1995

	1988-1990	1991	1992	1993	1994	1995
	% per annum					
Belgium	3.3	2.3	1.9	-1.7	2.2	2.7
Denmark	1.0	1.0	1.3	1.4	4.8	3.2
France	3.4	0.8	1.2	-1.0	2.2	3.2
Germany	4.6	4.5	2.1	-1.2	2.5	3.0
Greece	1.2	3.3	0.9	-0.5	0.4	1.1
Ireland	8.0	2.9	5.0	4.0	6.0	5.6
Italy	2.5	1.2	0.7	-0.7	2.4	3.0
Luxembourg	4.9	3.1	1.9	0.3	2.3	3.0
Netherlands	4.4	2.3	1.3	0.3	2.3	3.2
Portugal	4.8	2.1	1.1	-1.1	1.0	2.6
Spain	4.1	2.2	0.8	-1.1	2.2	2.8
United Kingdom	1.3	-2.3	-0.5	2.0	3.8	2.7
EU-12	3.3	1.6	1.1	-0.4	2.6	3.0
Austria	4.0	2.7	1.6	-0.3	2.8	3.1
Finland	2.8	-7.1	-4.0	-2.6	3.7	5.0
Norway	1.1	1.6	3.3	2.5	4.7	2.8
Sweden	1.9	-1.1	-1.9	-2.1	2.2	2.7
EFTA-4	2.9	-1.0	-1.0	-1.5	2.8	3.3
Europe-16	3.3	1.4	0.9	-0.5	2.6	3.0

Source: European Economy, Supplement A, 11/12, November 1994, European Commission.

In Ireland growth averaged 8% in the late 1980s. In 1991 the growth fell to less than 3%, which was still significantly above the EU-12 average. *Ireland's* early recovery was due to the influence of the US and the United Kingdom. Growth is expected to remain high in the near future.

All the other countries experienced the nadir of the recession in 1993, although both *the Netherlands* and Luxembourg narrowly avoided experiencing negative growth.

The recession in Germany, which experienced extraordinary growth until 1991, was reinforced by the problems arising from re-unification, this exerted heavy pressure on private consumption in particular. The recession in *Belgium* was coupled with a considerable deterioration of government finances, producing very large government deficits. In 1993, GDP-decline in the entire European Union totalled almost 0.5%.

Recovery 1994 -1995

In 1994, recovery in European countries was marked by an acceleration to growth of more than 2.5%. In relative terms, growth was lagging in Greece, Portugal and Spain, countries which struggled with weak economic structures and political tensions. Growth in

these countries lingered around 1 to 1.5%. In 1994 GDP increased fastest in Denmark, Ireland and the United Kingdom.

In 1995, a further acceleration of growth in the European Union is expected. In Denmark and the United Kingdom, countries in which the recovery began early, growth will probably slow in 1995. In 1996 and following years continued growth is expected.

Demand development

Table 6.3 summarises the main information about the development of macro economic demand.

Table 6.3 Real final demand in Europe-16

	1988-1990	1991	1992	1993	1994	1995
	% per annum					
Exports	7.3	5.5	3.3	0.2	8.8	7.5
Domestic demand	3.2	0.9	1.2	-1.8	2.0	2.8
of which:						
- Investment	5.3	-0.5	-0.6	-5.3	2.4	5.9
- Private consumption	3.0	1.9	1.6	-0.2	1.5	2.0
- Government consumption	1.7	1.7	1.6	0.6	0.7	0.7

Source: European Economy, Supplement A, 11/12, November 1994, European Commission

The vigorous growth of the late 1980s in European countries did not persevere in the 1990s. Affected by slower growth in world trade and by decreasing growth of intra-European trade, domestic spending, and investments in particular, came under pressure. An explanation for the economic recession may include inability of governments to respond due to budgetary which limited the stimulus they were able to create. In 1993 real exports showed zero growth, while domestic demand declined. A remarkably rapid export led recovery materialised in 1994. Recovery is expected to continue in 1995 and the following years.

Investment demand has been under considerable pressure due to economic decline. In 1991, 1992 and 1993, real investments were low and fell by over 5% in 1993. In 1994, gradual recovery materialised, which is expected to continue in the near future. In Finland in particular a significant reduction in investment occurred in the early 1990s, but in 1995 and 1996 a strong recovery of investment expenditures is expected.

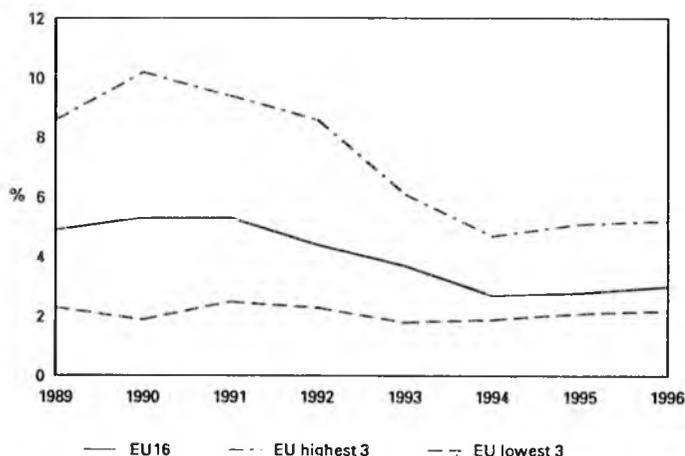
The decline in private and government consumption was less intense. Private consumption declined slightly in 1993, and recovery began in 1994. Government consumption increased marginally from 1993 onwards.

6.2.2 Inflation

In recent years inflation in Europe has declined continuously (see Figure 6.1). In the early 1990s, inflation was well over 5%, but it had declined to 2.5% by 1994. Explanatory factors for this modest inflation are the high level of surplus industrial capacity, and wage moderation in most countries. Relatively low levels of inflation were found in France, the

United Kingdom, Ireland, Belgium, the Netherlands and Germany, while inflation was relatively high in Greece (11% in 1994). Inflation levels are expected to be stable in the near future.

Figure 6.1 Inflation in Europe-16 on average and for three high inflation countries and three low inflation countries, 1989-1996



It is evident from the figure that differences between the countries are still considerable, but are reducing. At the beginning of the 1990s inflation in southern European countries was over 10%, while in the northern countries it was only 2%. After 1992 a sharp decline occurred in countries with previously high inflation, while in low inflation countries inflation remained around 2%.

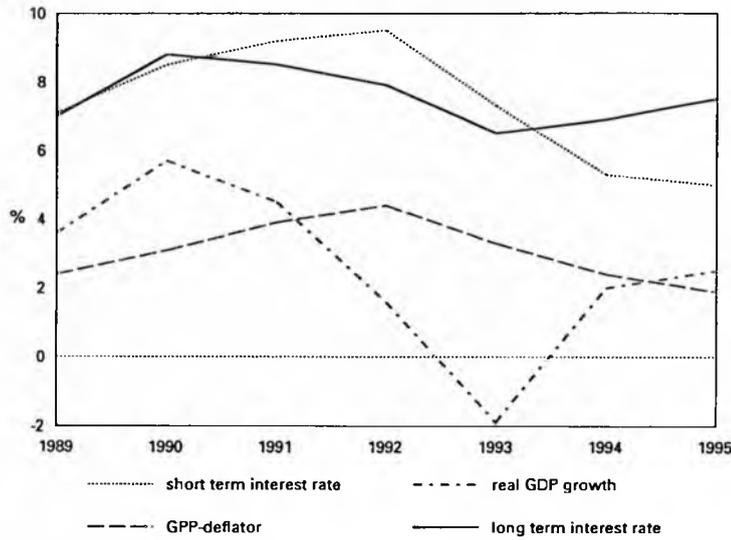
6.2.3 Interest rates¹

Except for developments in 1992, interest rates in European countries have by and large followed German interest rates, with central banks trying to keep exchange rates within the bands of the ERM. Generally, German interest rates closely reflected developments in:

- GDP-development. Especially the long term interest rate is related to GDP since it has been used as an instrument in business-cycle policy because of its impact on investment demand;
- inflation rates. This holds especially for the short term interest rate, the revealed semi-elasticity of the short term interest rate with respect to the GDP-deflator being roughly between 1.5 and 2.

¹ Data on interest rates are taken from: OECD, Economic Outlook 56, December 1994.

Figure 6.2 Interest rates, real GDP-growth and inflation, Germany



Source: European Economy, Supplement A, 11/12, November 1994, European Commission, and OECD: Economic Outlook 56, December 1994.

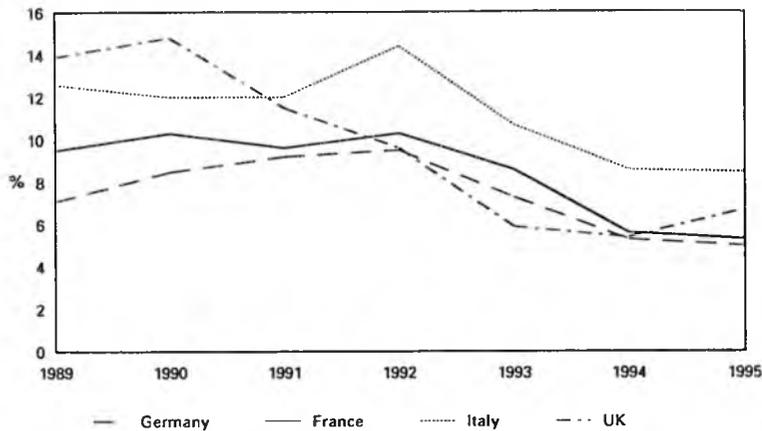
As can be seen from Figure 6.2, the short term interest rate was rising until 1992, as a reaction to increasing inflationary pressures. These came in the aftermath of the German re-unification. The recession, however, created lower inflation rates and led to a gradual decrease in the short term interest rate. From the same figure, it can also be seen that the German long term interest rates increased until 1990, followed by three years of decline: the same pattern as the GDP growth rate. In 1994 and 1995, GDP-growth is expected, and so another small increase in the long term interest rate is also expected.

In Figure 6.3, the development of short term interest rates in the 4 largest countries during 1989 -1995 is shown. Germany, Italy and France experienced slightly increasing or stable interest rates until 1992, followed by a significant decline thereafter. Amongst other things, Italy and France had to track the German interest rate quite closely, so as to remain within their bands of the ERM. Turmoil in the currency markets forced Italy to increase its interest rate in 1992¹. Interest rate developments in the United Kingdom have been different from those in other countries, showing a continuous decline from 1990 onwards, and a modest increase is expected this year. There are several reasons for this different development. First, the United Kingdom only entered the ERM in 1993, and within wide bands; therefore, there was less reason to follow the interest rates of ERM-countries². Secondly, the United Kingdom entered the recession much earlier than the other countries.

¹ Finally, between 1991 and 1993, the Italian Lira devaluated by 19% against the ECU. On exchange rates developments, also see section 6.3.2.

² In fact, the pound sterling devaluated over 3% against the ECU between 1990 and 1992.

Figure 6.3 Short term interest rates in the 4 largest countries



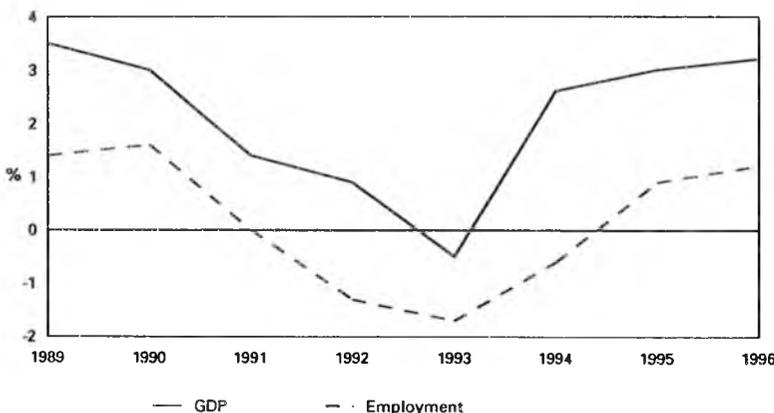
Source: OECD: Economic Outlook 56, December 1994.

6.2.4 Employment

From 1991 onwards European countries have encountered unfavourable developments in their employment situation. Because economic recession, which prompted business re-engineering and reorganisations in private enterprise, employment decreased annually during the 1991-1994 period (see Figure 6.4).

In 1992 and 1993 especially many jobs were lost and the unemployment figures showed a sharp increase. A particularly large decline in employment occurred in Southern Europe. Over the period 1992 to 1994 the net job loss in Europe-16 was greater than the net job increase in the period 1989 to 1991. In the same six year period employment in the USA increased by more than 6%. Gradual recovery of employment growth is expected in 1995 and 1996. In Figure 6.2 growth figures on GDP and employment are presented.

Figure 6.4 Real GDP and employment growth, Europe-16



In 1990 a slowing down of GDP growth occurred, but employment continued to increase. This was due to labour hoarding effects, especially within SMEs. From 1990 onwards, a further reduction in GDP growth occurred, followed by a cessation of employment growth. Large enterprises especially decided to reduce their work-forces, but SMEs also faced serious problems in maintaining jobs. In 1993 an absolute low was reached in GDP and employment growth. In 1994 a recovery of GDP growth occurred, but employment growth was still negative. Especially in SMEs entrepreneurs were very cautious and postponed the hiring of new employees. A modest recovery in employment growth is expected in 1995 and 1996.

6.3 COMPETITIVENESS

6.3.1 Labour costs

Wages

Given their labour intensity, changes in labour-costs are of particular importance to SMEs. At the end of the 1980s wages increased at a high rate in all countries. Increases were extremely high in the Southern European countries, especially in Greece and Portugal (well above 10% annually). A very moderate wage increase was manifest in the Netherlands and Belgium. After 1992 a slow down in the annual growth of wages occurred. This was primarily due to the economic recession and a growing awareness in the economy that high labour costs would weaken the economic performance of enterprises. Governments were, and still are, strongly committed to allowing only moderate growth in labour costs, in order to increase the competitiveness of their countries' industries. In recent years trade unions have been willing to accept this moderate growth of wages.

Table 6.4 shows data on compensation per employee, inflation and labour productivity. The figures for inflation and productivity growth are indicative for the maximum potential wage rise. Therefore this is an important variable when social partners are negotiating employment conditions. It appears that European countries have been able to cut their labour costs drastically, apparently through job losses and an accrescence of unemployment. As a consequence only a part of the wage rise potential was passed on in actual wage increases during 1993 and 1994. Consequently real unit labour costs declined. It is also expected that wage increases in Europe-16 during 1995 and 1996 will be moderate. The profitability of enterprises will improve accordingly.

Table 6.4 Wages, inflation and labour productivity, Europe-16

	1988-1990	1991	1992	1993	1994	1995	1996
	% per annum						
Actual wage growth per head	6.6	7.0	6.7	4.1	3.4	2.6	3.9
Potential wage growth:							
- GDP deflator	5.2	5.3	4.3	3.7	2.7	2.8	3.0
- Labour productivity	1.7	1.1	2.0	1.1	3.1	2.1	2.0
- Total	6.9	6.4	6.3	4.8	5.8	4.9	5.0
Residual wage growth	-0.3	0.6	0.4	-0.7	-2.4	-2.3	-1.1

Source: European Economy, Supplement A, 11/12, November 1994, European Commission.

Unit labour costs

Unit labour costs are an important factor in determining price competitiveness between countries. Due to the strong wage moderation at the beginning of the 1990s, and improving labour productivity, Europe has improved its competitive position compared to the USA (Table 6.5). In the late 1980s unit labour costs were highest in Europe-16, but in 1994 they were lowest. It is expected that in the near future the USA will have the largest rise in unit labour costs. Employment in America is growing fast, while the growth of labour productivity is relatively low compared to Europe-16 and Japan. Europe-16 is in the middle position, while Japan is expected to have the lowest increase in unit labour costs.

Table 6.5 Unit labour costs in the main economic regions

	1988-1990	1991	1992	1993	1994	1995
Europe-16	4.9	5.5	4.4	2.7	0.2	1.4
USA	4.2	4.6	2.7	1.5	2.6	2.8
Japan	2.2	2.5	1.5	-0.5	0.4	-0.2

Source: European Economy, Supplement A, 11/12, November 1994, European Commission.

6.3.2 Exchange rates

Exchange rates in the European countries were volatile in the last three years. The assumption that a framework of exchange rate agreements in the run-up to EMU would provide stability was found wanting. In September 1992 and July 1993 ERM-currencies came under severe pressure and the United Kingdom and Italy were forced out of the ERM. Greece also experienced a large depreciation in its currency, but was never an official member of the ERM. Besides this, it was necessary for most countries to move to widen the fluctuation bands from 2.25% to 15%, of the countries remaining in the ERM, only Germany and the Netherlands retained their narrow bands.

In 1994 currency markets were initially quite calm. Currencies were stable and fluctuations were small. Political turmoil in several countries caused a change for the worse in the autumn and winter of 1994. In Italy political problems surrounding the Berlusconi government damaged the lire, and in Spain the problems of the Gonzalez government caused the peseta to come under pressure. The political situation in Sweden also dete-

riorated, particularly in relation to severe budgetary problems, which caused the Swedish crown to depreciate.

In the winter of 1994/95 the Mexican peso crisis threatened currency markets world-wide, including those in Europe.

From these disturbances in currency markets anxiety grew in 1994 about the increasing use of derivatives by financial institutions. Discussions about the influence of financial derivatives still go on. Although monetary authorities increasingly agree that derivatives have no destabilising effect on currencies there remains quite some uncertainty on currency markets. The awareness is growing that the exchange rate system still is very vulnerable to external shocks. In 1995 it is expected that this volatility of exchange rates will remain.

6.4 FISCAL POLICY

One of the ways in which the government affects economic life is by means of fiscal policy¹. Several aspects of which are relevant:

- government expenditure. With respect to this, it is necessary to distinguish between government consumption, investments, and transfer payments;
- government receipts, such as taxes (direct and indirect), social-security premiums, and so on;
- net lending or borrowing by the government, and government debt.

Several aspects of fiscal policy are relevant. These are government expenditure, government receipts, net lending or borrowing by the government and government debt.

Fiscal policy is important to SMEs for a number of reasons, because government expenditure and receipts affect demand for goods and services as well as firms' cost because government investment affects the infrastructure in which SMEs operate, and because government debt affects EMU-criteria. In this paragraph a comparison of fiscal policies in Europe-16 countries is presented.

6.4.1 Government expenditure

When analysing government expenditure, no distinction is made between current expenditure and capital expenditure. Both types of expenditure are taken into account, to obtain a comprehensive image of the share of the public sector in the economy. Table 6.6 shows the total expenditure of the Europe-16 countries. The table reveals that the top-six spending governments are Sweden, Denmark, the Netherlands, Belgium, Norway and Italy, all of which spent over 55% of GDP. The 'middle-six' countries, which spent around 50% of GDP, are France, Greece, Luxembourg and Germany, Austria and Finland. The lowest spending countries are Portugal, Ireland, Spain and the United Kingdom, which spent less than 45% of GDP. Total government spending of all these Euro-

¹ Government is defined in a broad sense here, *i.e.* including the social-security system. Among other things, this is necessary to arrive at uniform definitions for Member States regarding the tax burden. In Denmark, for instance, social-security premiums make up only a very small percentage of the wage bill, but this is compensated by higher taxes. In such a situation, defining government in a narrow sense would hamper a comparison between Member States.

pean countries is much higher than that in the US and Japan. In the US, public expenditure is around 38%, and in Japan it is around 31%, of GDP.

Table 6.6 shows that no strong relationship exists between total expenditure and government consumption and investment. Two countries where total spending is high, Belgium and the Netherlands, have the lowest rates of final consumption, and the United Kingdom which has the lowest total expenditure has one of the highest levels of final consumption. The most important reason for this variation is that in some countries large parts of the social security expenditure are paid for by the central government, for example Denmark or Sweden, while in other countries, such as the Netherlands and Germany, the bulk of social security expenditure is paid for by the social funds. This implies that final government consumption is high in Denmark and low in the Netherlands and Germany.

Further analysis of the differences in fiscal policy between the Europe-16 countries requires a look at the different types of expenditure. Firstly, the expenditure on 'basic' services can be examined. 'Basic' services are general public services, defence, public order and safety, education and gross fixed capital formation. Totals for these services do not differ greatly between countries, amounting to around 15%.

An important area of expenditure is that on health care, social security and welfare. Ranging from 14 to 28%, this amount differs considerably between countries. This is an important explanation for the total difference between countries, but there is another important explanation. After adjusting total government expenditure for expenditure for health care, social security and welfare, total expenditures still vary between 23 and 33%, without important changes of the ranking of the countries. When excluding total expenditure for health care, social security and welfare and expenditure for traditional 'basic' government services, other types of expenditure remain.

Table 6.6 Government expenditure*; 1991

Country	Final	Gross fixed capital		Interest		Total
	consumption	formation	Subsidies	payments	Other**	
Percent of GDP						
Belgium	15	2	3	11	27	57
Denmark	25	2	3	7	22	60
France	18	3	1	3	25	52
Germany*	18	2	2	3	25	49
Greece	20	4	1	13	15	52
Ireland	16	2	2	8	16	44
Italy	18	3	2	11	22	56
Luxembourg	16	5	4	1	25	51
Netherlands	14	3	3	6	32	59
Portugal	17	3	1	8	15	44
Spain	16	5	2	4	17	43
United Kingdom	21	2	1	3	16	43
Austria	18	3	3	4	21	49
Finland	24	4	3	2	16	48
Norway	22	4	6	4	22	57
Sweden	27	3	5	5	23	64
Europe-16	19	3	2	5	22	51

* Government in a broad sense, *i.e.* including the social-security system.

** Unfortunately, as it appears from the availability of data, it is impossible to further disaggregate this item consistently for all countries.

Source: OECD, National Accounts.

These expenditures comprise those for housing, economic services, recreational and cultural facilities, capital outlays other than fixed capital formation, interest payments and some other expenses. Ranging between 8 and 17%, these areas of expenditure differ substantially between countries. In explaining the difference in total expenditure, these areas of expenditure are of equal importance to those of health care, social security and welfare¹.

6.4.2 Government receipts

Government receipts amount to 45% in Europe-16 (Table 6.7), and to around 34% in both the US and Japan, where receipts can be lower because expenditure on basic services, social expenditure, and other expenditures are lower.

¹ Unfortunately, since insufficient harmonised statistical data are available, a further disaggregation of this item is not possible.

Table 6.7 Government receipts*; 1992

	Indirect taxes	Direct taxes	Social-security		Total
			contributions	Other	
Percent of GDP					
Belgium	13	17	18	2	50
Denmark	17	30	3	7	56
France	14	9	21	4	48
Germany*	13	12	19	4	47
Greece	19	7	11	3	40
Ireland	17	16	6	3	41
Italy	11	15	15	3	44
Luxembourg	15	16	14	5	49
Netherlands	13	16	18	5	52
Portugal	16	11	11	4	42
Spain	12	12	14	5	42
United Kingdom	16	12	6	2	36
Austria	16	14	12	5	47
Finland	15	18	6	3	42
Norway	17	18	12	9	55
Sweden	18	20	15	7	61
Europe-16	13	13	16	4	45

* Government in a broad sense, *i.e.* including the social-security system.

Source: Tables on Public Finance, June 1993, Commission of the European Communities.

Revenue can be raised by direct taxes, indirect taxes, social-security contributions and other receipts. Other receipts mainly comprise refunds or charges, profits from state firms and exceptional kind of receipts like oil receipts in the United Kingdom or natural-gas receipts in the Netherlands.

It can be true that social-security contributions are not equal to spending on social security. In most cases, part of the spending on social security is financed through taxes or other government receipts. The highest difference between social-security contributions and social-security spending is found in Denmark and the United Kingdom.

In the European Union as a whole, indirect and direct taxes are equally important. In the United Kingdom, Portugal, Greece and France, indirect taxes are more important than direct taxes. In Belgium, Denmark, Finland, Italy, and the Netherlands, direct taxes are more important than indirect taxes.

6.4.3 Government lending and borrowing, and government debt

In most countries there is an important discrepancy between government expenditure and receipts. For many countries this difference has generated large debts. Seven coun-

tries comply with the EMU-criterion of a 60%-debt. These countries are Austria, France, Germany, Luxembourg, Spain and the United Kingdom. Norway also complies with this criterion, but is presently not a potential participant in the EMU. There are three countries with a debt of more than 100% of GDP. These countries are Belgium, Greece and Italy. An important problem for these economies are the interest payments on these debts, which amounted in 1991 to 10.6% of GDP in Belgium, 12.8% of GDP in Greece, and 10.6% of GDP in Italy. In these countries higher taxes must be levied for a very long period to finance the interest payments and repay the debt.

In 1992, government borrowing in the European Union was higher than that in Japan and the US. In the US, this was around 5%, and in Japan government lending was 2%.

It cannot be expected that those countries with debts of more than 60% of GDP will comply with the EMU-criterion before the year 2000. Only for Portugal does this seem possible¹. Between 1988 and 1992, Portugal's debt fell from 75% to 66% of GDP. Apart from Ireland, debt was rising in all the countries in which debt exceeded 60% of GDP.

Table 6.8 Government* debt, and net lending (+) or borrowing (-); 1992 as compared to 1988

	Debt			Net lending (+)/borrowing (-)		
	1988	1993	Change	1988	1993	Change
	Percent of GDP					
Belgium	132	139	7	-7	-7	0
Denmark	61	80	19	1	-4	-5
France	34	46	12	-2	-6	-4
Germany*	44	48	4	-2	-3	-1
Greece	80	115	25	-12	-13	-1
Ireland	118	96	-24	-5	-3	2
Italy	93	119	26	-11	-10	1
Luxembourg	10	8	-2	5	1	-4
Netherlands	79	81	2	-5	-3	2
Portugal	75	67	-8	-5	-7	-2
Spain	42	60	18	-3	-8	-5
United Kingdom	50	48	-2	0	-8	-8
Austria**	58	57	-1	-3	-4	-1
Finland**	17	62	45	n.a.	-7	n.a.
Norway**	43	45	2	n.a.	-3	n.a.
Sweden**	54	84	30	n.a.	-13	n.a.
Europe-16	60	64	4	-4	-6	-2

* Government in a broad sense, *i.e.* including the social security system.

** Based on OECD, Economic Outlook, no. 56, December 1994, and national data.

Source: European Economy, Supplement A, 11/12, November 1994, European Commission.

¹ In conformity with the recently adopted decision regarding Ireland.

7 RECENT POLICY DEVELOPMENTS AFFECTING SMEs

Co-ordinated by SME Centre, Warwick University

MAIN POINTS

- Most enterprises within the European Union are SMEs. It is recognised that amongst the most effective support that governments can deliver to these enterprises are improvements in general business conditions (ensuring low inflation, stable exchange rates, low taxes etc.)
- Administrative burdens are widely recognised to fall relatively heavily on SMEs. Across the Union efforts are being taken to reduce these burdens.
- SME policies have two complementary themes. There are policies which use new firm creation and the expansion of existing enterprises as a means of combating other problems, notably unemployment; and there are policies designed to strengthen the existing population of SMEs without an explicit ulterior motive.
- The existence of policies which encourage business formation and expansion is a recognition that SMEs and entrepreneurship have a role to play in job generation, reducing regional inequalities, and diversifying the economic base.
- Policies designed to strengthen SMEs include: assistance with innovation, product development, and risk taking investments; assistance with exporting; and better access to finance. To reduce SMEs dependence on bank finance several countries have introduced schemes to encourage equity investments in SMEs.
- Efforts have been made in relation to improving the human capital within SMEs. These are mainly in the form of management and workforce training programmes.
- The establishment of information and service infrastructures that complement the internal competencies of SMEs are significant developments in the support available to SMEs. These are usually regional networks of information providers designed to be accessible and to provide transparent policy support to SMEs. They are a recognition that easy access to information is a key requirement of many SMEs.
- Environmental policies have now become a significant component of policies which affect SMEs in many Member States. Taxes and subsidies are the most common environmental policy instruments.

7.1 INTRODUCTION

The purpose of this Chapter is to review recent policy developments that concern SMEs within the European Union. The Chapter is divided into two sections, the first will contain

a review of developments in European and national policies that support SMEs, the second will discuss general environmental instruments and policies without specific reference to their impact on SMEs.

The first part of the Chapter (Section 7.2) is not a comprehensive guide to new SME policies, rather it highlights new directions of support for SMEs within the Union. Two types of recent SME policies will be discussed: those intended to strengthen the SME sector by overcoming difficulties peculiar to smaller enterprises; and those designed to assist the creation and expansion of small enterprises as a means of combating macro economic problems, particularly unemployment. Whilst the former acknowledges that smaller enterprises face specific problems, the latter recognises the potential of such enterprises as job creators and as a means of diversifying the economic base.

The first part will briefly review recent developments in European SME policies, followed by a review of recent national policy developments on a country by country basis. The second part (Section 7.3) reviews the principals behind, and recent developments in, environmental policies. These are not specifically targeted at SMEs but nonetheless have increasingly important implications for their performance.

Two issues are not covered in the national commentaries: macro-economic conditions; and the reduction of administrative burdens. Firstly, governments across the Union recognise that most businesses are small and that amongst the most effective assistance they can deliver to SMEs are macro-economic improvements to the business environment, such as maintaining low interest rates and inflation, and simplifying or reducing taxation on enterprises. However, these measures are rarely specifically designed to assist SMEs, so despite their importance they are not reviewed in this Chapter. Secondly, legal and administrative burdens are also widely acknowledged to fall more heavily on smaller enterprises. There are widespread efforts across the Union to reduce and simplify such burdens on business. However, these issues are documented elsewhere in this Report and as many of these efforts are not specific to SMEs they too will not be comprehensively covered by this Chapter. However, a few schemes established specifically to address burdens on SMEs are mentioned. Again, this does not imply that such efforts are unimportant.

7.2 RECENT DEVELOPMENTS IN EUROPEAN AND NATIONAL SME POLICIES

7.2.1 Recent developments in European SME policies

The European Union's White Paper on Growth, Competitiveness and Employment¹ stressed the need to create an environment as favourable as possible to business, particularly for SMEs. To carry through these objectives of Commission has initiated the Integrated Programme in favour of SMEs and the Craft Sector in May 1994². The aims of this programme are to alleviate constraints on small enterprises, and to support business development and the creation of jobs. The programme gathers together existing initiatives and proposes new ones.

¹ Growth, Competitiveness, Employment. The Challenge and ways forward into the 21st Century. White Paper. European Commission. Brussels-Luxembourg, 1994.

² COM(94) 207 final of 3 June 1994.

One particular issue being addressed by a new initiative concerns the problems of transferring businesses from one generation to the next. Studies have shown that only a small proportion of family firms are passed on to subsequent generations¹, with a large number of previously healthy businesses disappearing because of problems of ownership transition. By this initiative the Commission aims to harmonise the regulations across the Union, reduce the administrative and tax implications of transferring a businesses, and to encourage existing owners to prepare for the eventual transfer of their businesses.

Another recent measure has been the introduction of subsidised loans to SMEs from the European Investment Bank². These loans are part of the Growth Initiative, and they are restricted to investments projects which create jobs.

The White Paper on Growth, Competitiveness, and Employment, and the Growth Initiative are both covered in greater detail in the Second Annual Report of the European Observatory.

7.2.2 Recent developments in national SME policies

Austria

Recent Austrian SME policies have targeted three main areas: administrative burdens; the provision of information and training; and a new savings schemes for enterprises.

The 1994 tax reforms contained measures to reduce administrative burdens, with particular concern for the burdens on very small enterprises. These now have the option of paying lump sum taxes based on a limited number of simple criteria, such as turnover. This reduces the information they are required to provide for tax purposes. Furthermore, tax reforms which increased corporate tax rates, but decreased personal income tax, should favour small owner managed small enterprises. However, a new communal levy, based on a percentage of labour costs, will increase the tax burden, particularly on SMEs which are labour intensive.

To prepare SMEs for Austria's entry into the European Union there has been an increase in the provision of 'soft-aid'. This includes counselling, information, and training for SMEs.

A new savings scheme is being prepared to promote start-ups by helping potential entrepreneurs save capital with a view to establishing a business. Analogous to a savings scheme for housing, the state pays yearly premiums during the savings period. The entrepreneur will also be eligible for low interest credit after the new enterprise is established. The scheme will probably be introduced in the middle of 1996.

At a more general level, recent changes in the proficiency requirements for a number of trades have made market entry easier for those without the formal qualifications previously required. The process of establishing a new enterprise has been simplified, and

¹ A study carried out in 1989 in the United Kingdom by Stoy Hayward Consulting in association with the London Business School found that only 24% of family businesses were passed on to the second generation, and only 14% survived to the third generation.

² In April 1994 the Council approved a grant to a maximum of ECU 1 billion over 5 years for subsidised loans (2% below the standard interest rate) to SMEs in the Union.

policies to promote R&D and investments in modern technologies will benefit medium sized enterprises.

Belgium

Recent policy measures towards SMEs in Belgium have focused on administrative burdens, employment, and investments.

Administrative burdens on business are being addressed by the recently established Auditform. The Auditform is particularly concerned with burdens on small enterprises; its purpose is to reduce the number of administrative requirements to only those that are absolutely necessary, and to make the remaining forms 'user-friendly'.

To combat unemployment measures have been introduced at the national level which reduce employment costs by offering employers lower social security contributions. Reductions are available if employers can show a net increase in the number of employees within their enterprise without a reduction in the number of working days¹, or if they recruit certain categories of people: long-term unemployed people²; manual workers³; or people employed on low wages⁴.

Investments support is available on a regional basis, but generally the level of support depends on the nature of the investment and its consequences. In the Brussels area three investment areas receive particular support⁵: adjustments to European norms; environmental protection; and the economic use of energy, water, and raw materials. In addition, grants are available each investment and for up to half the costs of consultations with experts, feasibility studies, and investment related training.

In Flanders, investment support includes measures to encourage the expansion of small enterprises⁶. Other support is available to assist the expansion of medium sized businesses⁷. Investment support in Wallonia is comparable with that in Flanders.

¹ A reduction in social security contributions is made for each new job created.

² Through 'The Plan for Jobs'. People unemployed for more than a year, and fully entitled to unemployment benefits, qualify under this scheme.

³ Through the 'MARIBEL Operation'. The decrease is bigger for enterprises with fewer than 20 workers is greater for industries exposed to international competition.

⁴ Those whose gross monthly wages are below 1,270 ECU.

⁵ Through grants to larger small firms: those with between 50 and 250 employees, and whose turnovers do not exceed 20 MECU.

⁶ Amongst other criteria, those with no more than 50 employees, with turnover not exceeding 5 MECU on a balance total not exceeding 2 MECU. A small producer whose investment leads to increased employment would receive support equal to 11% of the investment (3% basic support, plus 8% for employment creation).

⁷ Those with no more than 250 employees, and whose turnovers do not exceed 20 MECU, and with a balance total of no more than 2 MECU. An SME is defined in Wallonia as an enterprise with up to 250 employees, with a turnover of up to 20 MECU.

Denmark

Danish SME policy is primarily concerned with developing a favourable business environment and helping enterprises develop of their competencies. Amongst the measures taken to improve the business environment for SMEs are the development of an information and service infrastructure, and efforts to strengthen public research and development in strategic areas. Direct financial support is restricted to enterprises in selected strategic schemes.

With regard to competence development, an infrastructure of approved centres¹ has been established to complement enterprises' internal abilities. This provides information and assists with testing, certification, and standardisation. To help enterprises develop their internal competencies grants are available to encourage highly educated professionals into strategic positions within SMEs. Furthermore, entrepreneurs can receive public co-financing for courses and counselling². Innovative entrepreneurs are eligible for extended counselling, grants for product and market development, and scholarships.

Recent policy developments also include the 'Growth Fund'. This provides joint financing on a loan basis for risky development projects initiated by SMEs; it reflects the ongoing aim of establishing a market for private risk capital, particularly for SMEs. The government aims to further develop the Fund and proposes to underwrite up to half the value of equity investments made by approved development-companies³ in growth-orientated SMEs.

The government is also keen to develop viable service sector companies. A first aim is to develop a market for household services. Companies in this sector are eligible for state aid.

Finland

The SME Policy Programme completed in 1993 defined the development objectives and operational guidelines for SMEs in Finland. Under this programme, economic and industrial policy measures should contribute to strengthening SME activities. Three goals were set for promoting SMEs: strengthening competitiveness; improving preconditions for the establishment and growth of industrial SMEs; and improving opportunities for SMEs through procurement reforms.

To achieve these, a number of measures were proposed. These concern: financial policy; indirect labour costs; labour markets; training and development services; administrative burdens; and public procurements. Most of the goals were achieved during 1994, but some follow-up measures will be implemented.

Financial initiatives include measures to ease the unexpected increase in debt servicing costs for firms with foreign currency loans. These were precipitated by the depreciation

¹ These include technological and managerial service institutes, and regional information centres.

² This applies to those with approved business plans. Further financial support is given for 2.5 years if the entrepreneur was unemployed.

³ Venture capitalists.

of the Finnish currency. Support in the form of interest rate subsidies are available to SMEs with long-term investment loans.

Concerning labour costs, increases in national insurance costs have affected many SMEs, due to their relatively high labour intensity. Policy is now focused on reducing employer's contributions. Further legislative action has been taken to remove the restrictions surrounding statutory working hours and salary/wage requirements with the intention of improving the flexibility of SMEs.

Education and Training have been targeted to establish a more positive attitude towards entrepreneurship. Closer links between business and academia are being promoted, and more business courses are being provided at the secondary school level.

To ensure that SMEs do not lose out in domestic and European public procurement through a lack of information. A database with details of public procurement contracts has been established as a source of information to SMEs. More generally, regional service points are being formed to bring under one roof all the various counselling services for SMEs.

Other aspects of Finnish policy are export promotion through information and assistance, and through incentives for co-operation between firms. In addition, the Ministry of Trade and Industry's regional business service offices have a six stage training programme designed for start-ups. Each stage forms a separate entity. The second stage, ProStart, launched in 1994, emphasises the development of the business idea.

France

France's support for SMEs has been enhanced by five recent measures: the Madelin Act and Pasqua Acts, the Labour and Employment and Training Act, the establishment of the Ministry of Industry's Development Fund for Industrial SMEs, and a new loan guarantee fund.

The Madelin Act of 1994 encourages self-employment and entrepreneurship. The law affects both existing enterprises and start-ups and addressed three main issues: the status of Sole Traders; the financing of SMEs; and administrative burdens.

Prior to the Act Sole Traders had a less legal and social protection than limited companies, the Act sought to reduce this inequality. The position of Sole Traders was improved by providing greater security and legal protection, simplifying their administrative and accounting obligations, improving their tax situation, and making it easier to set-up as a Sole Trader.

To stimulate equity investments in French SMEs, the Act introduced tax incentives for 'Business Angels', and modernised the 'enterprise saving book' system.

The Act also reduced administrative burdens on business. It introduced the novel approach of giving enterprises rights with respect to the administrative demands made on them by the State. The State now has an obligation to minimise its administrative demands on business by simplifying requirements and avoiding duplication. Another innovation has been to make optimal use of electronic data interchange (EDI).

A second measure was the Pasqua Act (1994). This established a National Fund for Development in Enterprises which supports employment and enterprises in development

areas. The Fund supports SMEs by: providing loans to individuals who start or take-over enterprises; underwriting loans; and providing guarantees to venture capitalists and regional development companies. In addition, enterprises in these areas benefit from new tax concessions.

The Labour and Employment and Training Act has three main strands. The first, reducing national insurance contributions and providing tax relief for new employees, is designed to maintaining existing jobs and creating new employment. The second focuses on deregulation and the removal of working hours legislation. The third has decentralised the system of vocational training and develops the apprenticeship system.

The Ministry of Industry continues to provide direct support for SMEs in the fields of technology, non-physical investments, and adaptation to new industrial conditions. With respect to the last of these, the Development Fund for Industrial SMEs was established. This provides regional funding for investments in physical and non-physical assets. Its dual focus is intended to promote the use of specialist consultants, and to encourage technological investments that enhance employment growth. Apart from granting direct financial support (168 MECU in 1994) the Ministry's regional agents (Agents des DRIRE) provide active support to SMEs. During 1994 they made 13,000 visits to SMEs all over France.

Lastly, in December 1994, SOFARIS established a new guarantee fund¹, which will guarantee 305 MECU in loans to SMEs.

Germany

German SME policy has three themes: general measures to improving the business environment; national measures to assist SMEs; and special assistance in the new Länder (the former East Germany).

Specific administrative measures include the recently enacted Transformation Act (1994) which enables small enterprises to adopt the legal form of joint-stock companies². The Act will advance the introduction of the European Union's SME policies.

In recent SME policy two major trends are apparent: there has been an emphasis on getting the unemployed back into work; and there has been a move towards establishing 'One-Stop-Books' that increase the accessibility of information and support measures to SMEs. A further reduction in the number of state holdings which should create new opportunities for smaller enterprises.

Measures to assist the unemployed include bridging aid for six months for those starting their own business, and The Federal Institute for Employment provides grants and assistance for companies to recruit the unemployed. Separately, in the craft sector subsidised loans are available to attendants of courses leading to the final Meister qualification.

¹ Fonds Capital PME: 30.5 MECU.

² Previously this status was not available, now even Sole Traders are allowed to form joint stock companies. Workers now only have a right to a seat on the supervisory board if the joint-stock company has more than 500 employees.

Specific financial aid policies include: the reintroduction of the 'Eigenkapitalhilfe Programm' (EKH) which offers subsidised loans to start-ups¹; a new programme offering subsidised loans to high-risk innovative start-ups; and a special depreciation scheme which enables SMEs² to write off investment reserves in advance has been introduced for 1995. Furthermore, the European Recovery Programme schemes are to be improved³.

Following German reunification specific policies have been introduced to assist the new Länder, and these are continually updated. Many of the existing infrastructure and SME support schemes remain, but new measures planned include extending the advantages previously conferred on West Berlin⁴ to the whole of the former East Germany. Notably, this would provide 30% tax concessions on investments.

Greece

Greek SME policy targets two areas: improving SMEs access to finance; and improving the competitiveness of SMEs.

The new financing measures include establishing venture capital funds, credit co-operatives, subsidising the interest rate on loans, and leasing subsidies. These measures are to encourage start-ups, the expansion of existing enterprises, and to support economic development at the local and regional level,

Measures to improve the competitiveness of SMEs include: technical assistance; improvements to the existing support infrastructure; the establishment of a Register-Network that includes SMEs, the support institutions, and private consulting companies; promoting co-operation between companies and sub-contractors; and encouraging the handicraft sector.

Ireland

Since January 1993 the Irish industrial agencies have been restructured with implications for SME policy. The development of Ireland's indigenous industry, and the promotion of enterprise at a local level, are the a specific concerns of the newly formed institutions.

In January 1993 a new Department of Enterprise and Employment was established, with responsibility for industrial policy. This includes: planning; the development of indigenous industry; and the implementation and co-ordination of new labour market measures, including training. In January 1994, the Industrial Development agencies responsible to the Department were reorganised. The IDA Ireland was formed with responsibility for overseas industry, whilst Forbairt gained responsibility for the promotion of indigenous industry. 'Foras' gained responsibility for co-ordinating IDA Ireland and Forbairt, and for devel-

¹ The loan ceiling has also been raised to 1 MECU for new partnerships between enterprises in the new and old Länder.

² Enterprises with a trading capital of less than 250,000 ECU.

³ Especially those that focus on industrial SMEs in the old Lander, and those aimed at easing liquidity problems in the new Lander.

⁴ By Article 16 of the Berlin Act (1970). The original Act expired in 1991.

oping an industrial policy. In addition, County Enterprise Boards (CEBs) promote and stimulate SMEs at the local level. These now give employment grants in addition to the capital grants they previously offered¹.

Following this reorganisation, the Task Force on Small Business reported in March 1994. Amongst its recommendations were: mandatory maximum payment times in public sector contracts; a shift from grants to loan support as the main form of state aid to established business; a national business information system to provide basic information and advice to small business; and the Task Force proposed that greater recognition and reward be given under the tax code for entrepreneurs.

The Small Business and Services Division of the Department of Enterprise and Employment was established to pursue the implementation of the recommendations of this report² and the recommendations of the Report of the Task Force on Jobs in Services. The Division is also responsible for bringing the concerns of the small business and service sector to the fore of public policy making.

Italy

Italian industrial policy towards SMEs has remained fairly consistent since the introduction of Act 317/1991, but a programme supporting R&D expenses has recently been launched. This programme reflects the innovation stimulation focus of Italian industrial policy. More generally, short-term measures have had an impact on industry: the introduction of an incomes policy has effectively lowered real wages, with implications for labour costs, especially in SMEs where unit labour costs are typically higher than in larger enterprises.

In addition, developments in the financial credit markets have occurred which are intended to provide SMEs with access to the most up-to-date financial instruments for re-investment purposes. These include the Consolidation Act which allowed banks to take an equity stake in industrial companies. However, the percentage of Italian SMEs with stock market listings is very small so the Act may have a limited impact.

The recession has left Italian SMEs with relatively high debt to equity ratios, and there has been little investment on the part of firms. Therefore, policies aimed at supporting investment and easing access to capital for SMEs have been largely ineffective.

One policy measure has, however, had considerable success in supporting businesses start-ups by young entrepreneurs in rural and declining areas. Act 44/1986, revised in 1994, provides investments totalling around 1.7 MECU to such businesses. Relief is provided on management costs in the first two years of trading. In addition, technical and professional assistance is given to businesses that qualify.

Other policy measures have been implemented which aim at reducing the tax burden and level of bureaucracy on smaller enterprises. These measures have been targeted the unemployed, especially the young, and the disabled. Existing firms who employ additional workers can also claim for tax relief, and reinvested profits are exempt from tax.

¹ Employment grants are available to the value of about 6,300 ECU, while the maximum the capital grant is about 18,900 ECU.

² There are over 100 in total.

Luxembourg

There are no specific SME policies in Luxembourg but a number of general policies have been fine-tuned so as to support new and small firms. These include support for: start-ups and growth capital; initial and continuous vocational training; export promotion; entrepreneurs' management competencies; technological stimulation; and the clarification of environmental standards.

Investment subsidies are available for largely self-financed investments and investments in physical capital¹. Furthermore, reduced interest loans are granted for investment purposes, with bonuses for start-ups primarily based on the savings of the entrepreneur. Regarding training provision, several of the formal schemes aimed at increasing the managerial capabilities of entrepreneurs are being reorganised to better reflect the needs of SMEs. Lastly, to enhance the exports performance of Luxembourg's SMEs the government is currently holding bilateral talks on this issue with several other countries².

The Netherlands

The new Dutch government³ recognises the importance of SMEs in the Dutch economy, especially as new employment creators. SME policies aim to create a business environment favourable to risk-taking and entrepreneurship. An important goal is to reduce both the financial and administrative burdens on business. Costs associated with government regulatory procedures, information demands and other compliance requirements are relatively high for SMEs, and consequently they hamper growth and job creation.

In order to stimulate economic growth the government has announced 4,260 MECU worth of tax reductions over the next four years, including 236 MECU which has been earmarked for reducing the financial burdens on SMEs.

To reduce the regulatory and administrative burdens, a ministerial committee has been established, under whose authority proposals for deregulation will be developed. Laws which restrict competition and/or are burdensome for business will be considered. Annually a number of existing laws will be tackled by task forces, and an annual programme will establish which new laws should be assessed for their impact on business.

Another important aspect of SME policy relates to the information and advice services. There are several organisations involved in providing information and counselling to SMEs in the Netherlands, and the government stimulates co-operation between these organisations through 'one-stop-shops' ('Enterprisehouses'). The aim is to increase the effectiveness and efficiency of the services.

Lastly, attention has been paid to SMEs financing difficulties. A government credit guarantee scheme has been established which has proved effective and efficient. Over the next few years special arrangements within the scheme will be made for innovative start-ups.

¹ The tax system also encourages, through tax relief, long-term investments in real fixed assets.

² An export credit scheme already exists.

³ Formed in August 1994.

Norway

Policy in Norway can be divided into three major areas: improving the business environment; financial support; and the development of competencies within enterprises.

To improve the business environment employers' social security contributions were reduced in 1994¹, and at present enterprises in the far north of Norway (north of Troms and in Finmark) are exempt these contributions². Tax reforms in 1991 widened the tax base and were particularly favourable to profitable enterprises, and those previously unaware of, or unable to exploit, tax concessions. In addition, reforms to the industrial statistics information requirements has reduced the administrative burden on SMEs with fewer than 10 employees.

Direct financial assistance to SMEs is available through the Norwegian Industrial and Regional Development Fund which was established in January 1993 as a merger of the Norwegian Bank for Industry, the Industrial Fund, the Small Business Fund, and the Regional Development Fund. The Fund offers a wide range support that does not favour any particular sector, but one of its target groups is small enterprises. Established support is divided between loans, grants, and guarantee schemes, to which a new scheme has been added for investing in equity, particularly that of SMEs.

Furthermore, the Ministry of Local Government and Labour annually allocates to industrial funds under the Regional Development scheme.

For the transfer of competencies, a broad range of advisory services (both public and private) are available to SMEs, entrepreneurs and inventors. Education programmes are available in the areas of: encouraging business start-ups; entrepreneurial training courses; and management training relevant to SME. Programmes initiated and administered by the Norwegian Research Council³ exist to encourage the development of competencies, and the formation of networks of SMEs. These assist small enterprises by the pooling and making better use of their total resources.

Portugal

Under the Community Support Framework Programme four major new programmes directly relating to SMEs have been implemented. These programmes are: PEDIP II; PROCOM; SIFIT (III); and SIR, the Regional Incentives Scheme. The first three programmes are applicable to the more developed regions of the country⁴, whilst the last is aimed at supporting the development of peripheral regions.

The PEDIP II Programme aims to modernise and regenerate Portuguese Industry by focusing on business structure and organisation, the business environment, and business attitudes. With regard to organisation and structure the programme helps firms develop their businesses strategies in order to become more competitive. Specific measures in-

¹ By 2.4% to an average of 12.8%.

² Further special measures exist to assist enterprise development in northern Norway.

³ Established in January 1993 as a merger of 5 research councils.

⁴ Although for investment projects above a certain threshold (0.6 MECU in the PEDIP Programme) they are applicable nation-wide.

clude co-financing for development projects, and funding for strategic analysis. With regard to the business environment, the measures incorporate technical and technological support, and training support. These aim to strengthen the competitiveness of firms by improving quality, design, innovation, co-operation and training. Related to this is a policy of fastening closer links between industry and universities in order to develop a commonality of purpose.

The PROCOM Programme relates specifically to the trade sector; it aims to raise the competitiveness of this sector through modernisation. Eligible projects include investments relating to rationalisation, innovation, and expansion. These can attract subsidised loans or grants. The programme is applicable to both individual firms and groups of companies.

Another measure of particular relevance to SMEs, is the SIFIT (III) programme. This aims to diversify and improve the quality of tourism, and to correct structural inequalities in this sector. Eligible projects include investments in new buildings and leisure facilities, and the developments of Portugal's historic and cultural heritage.

SIR, the Regional Incentives Scheme, is specific to SMEs. It is aimed at supporting the development of peripheral regions by raising the competitiveness of companies, creating new employment opportunities, and diversifying production. It includes investment grants in addition to relocation allowances to assist in the transfer of industries from congested areas.

Apart from the above, other measures have been implemented, notably environment and R&D programmes, but these were not specifically designed for SMEs.

Spain

Spain is currently rationalising its fragmented system of SME support, which were carried out at a regional level. One of the main aims of the SME Initiative, this reorganisation process, is to prevent duplication of support from different organisations.

The SME Initiative has been mainly funded by regional governments, with central government contributing about a third of the total. It has targeted five areas: inter-firm co-operation; information; support for manufacturing; finance; and the development of regional networks. In monetary terms over 45% of the total budget is for developing regional networks, with the rest evenly shared. It is anticipated that around 15,000 SMEs will benefit from this Initiative.

Inter-firm co-operation is considered desirable on the assumption that collaboration, particularly in the areas of production and technology, will increase competitiveness. Attention is being paid to widening and improving SMEs access to information. Initiatives include, the Industrial Product Initiative to support manufacturing enterprises, which places particular emphasis on product design. Finance measures include reducing SMEs dependence on bank borrowing by developing increased access to other sources of finance. The establishment of regional networks aim to encourage the formation of mutual guarantee institutions and establishing 'collective action societies'.

Sweden

In Sweden recent SME policies have primarily aimed to remove obstacles and bottlenecks that inhibit business development. This is being done through the provision of various instruments such as: information and qualified advisory services; venture capital; and measures to enable the development of competencies.

Sweden's existing SME policy assistance is complicated, especially to the self-employed. This is due to multiple providers with overlapping and ambiguous roles. The government is striving to simplify these structures. To avoid disrupting business, the restructuring builds on the existing structure, and is being implemented in stages. Another aim is to remove unnecessary and expensive regulations.

As an effective small business policy requires a proximity between the providers of assistance and the enterprises they assist, much of Sweden's SME policy is provided through a regional network of 'business partner' companies (ALMI Foretagspartner). These have been established in all counties and provide advice and financial assistance.

Substantial funds¹ have been directed at business start-ups and the development of small and medium sized businesses within the framework of industrial, labour, and regional policies. A special effort has been made to encourage women entrepreneurs².

The United Kingdom

The UK's SME policy focuses on three main areas: creating a favourable economic climate³; reducing the legislative and administrative burdens on business; and providing direct assistance where required. Several measures have been introduced to provide direct assistance, the most significant being the introduction of a Business Links network⁴.

Business Links are a network of independent local business information and advice centres which offer a range of services tailored to local business characteristics and individual firm requirements. They bring together a previously fragmented range of business assistance into 'One-Stop-Shops', thereby replacing rivalry and duplication between service providers. They will be the delivery point for government funded business support services but will be run by local intermediaries⁵

Central to Business Link will be the role of Personal Business Advisors whose role will be to develop a long term relationship with SMEs in order to ensure that they receive the necessary support at all stages in their development.

Other developments in the SME support include: the introduction of The Enterprise Investment Scheme which helps small unquoted trading companies raise equity finance; a

¹ This year about 700 MECU.

² 21 MECU has been reserved for loans to women entrepreneurs.

³ By curbing inflation, maintaining stable interest rates, and simplifying the tax structure.

⁴ Business Links is an English scheme, but similar schemes exist in Scotland and Wales.

⁵ These will normally include the Chamber of Commerce, the Training and Enterprise Council, and the Local Authorities.

new Consultancy Brokerage Service¹ to be introduced in 1995; and, concerning training and skills development, Small Firm Training Loans were introduced in 1994, with the Small Firms Training Initiative to begin in 1995².

7.3 ENVIRONMENTAL POLICIES

The Rio Conference of 1992 was a watershed in terms of our attitudes to the environment. For the first time the attention of the world was focused on the promotion of sustainable development strategies for the global economy. To this end the European Union has taken a proactive stance on environmental issues over the last two years. This section outlines the philosophy behind the main policy instruments and then examines the actual policy instruments used by Member States within the Union. It does not review of policies specific to SMEs.

7.3.1 The polluter pays principle

Perhaps the most widely accepted tenet in environmental policy is that the polluter should be liable for the environmental costs associated with their actions. The rationale for this policy is that the price of the end product will then reflect the 'true', or social costs, of production. Yet even such a basic principle, which implies a pollution levy, is not adopted as a basis for policy in all Member States: some prefer direct regulation, whilst others use a combination of taxation and subsidy.

For governments, the question is how best to implement environmental policy. Fundamentally, there are four measures: Taxation; Quotas; Licensing; and Subsidies. The majority of the Member States use a combination of these instruments.

7.3.2 Polluter taxes

The most common instrument acting against environmental abuse and encouraging efficient resource allocation is the tax system. For example, in Denmark and Italy there are direct taxes on carbon dioxide and sulphur dioxide emissions, whilst in Spain effluent discharges are taxed. There are clear implications associated with taxing polluters. Polluting firms face higher costs than non-polluting firms, thus giving non-polluters a competitive advantage. The tax system therefore acts as an incentive for enterprises to reduce pollution. The benefits of such policies go beyond the individual member state. For instance, much³ of the airborne environmental pollution in Sweden is derived from the United Kingdom. Reduced pollution in individual Member States may therefore have valuable additional benefits for other Member States.

¹ This will provide a consultancy selection and project management service to businesses wishing to use consultants.

² Both these schemes are for firms with 50 or fewer employees.

³ Estimates suggest as much as 80%.

7.3.3 Quotas and licensing

Quotas are also widely used as a means of limiting damage to the environment and impose legal limits on discharging firms. Amongst the countries that use this instrument are France, Norway, and the United Kingdom. The rationale for quotas is that they keep environmental damage within pre-defined boundaries which are deemed acceptable to society. They also impose economic costs on firms required to reduce discharges, and impose fines on offenders.

Licensing is similar in rationale to quotas. Broadly speaking, licenses have two purposes: they act as a system for controlling and enforcing environmental criteria by ensuring enterprises maintain predetermined standards as a condition of the licence; and they can be used as a means of controlling the depletion of natural resources. This method of control is particularly favoured in Germany, Ireland, the Netherlands, and Portugal.

7.3.4 Incentives

Another approach which is particularly relevant to SMEs is the incentive method. Here policy measures are aimed at providing financial incentives to encourage firms to use new 'clean-technology'. This can be achieved via the tax system, a common method is to allow generous depreciation on investments, or by capital subsidies and 'soft loans. As an adjunct to this, a number of countries, notably Italy, offer tax incentives to new firms setting up in energy efficiency, recycling, and similar sectors, to encourage economic growth in environmentally friendly areas. There is also financial support available in some cases, notably Spain and Sweden, for conversions of existing technology and machinery that reduce pollution emissions.

7.3.5 Training and infrastructure

Other important measures in the European Union include the provision of training and information relating to the environment, and the regulations concerning it. This is directed at both managers and the workforce. The United Kingdom in particular favours the provision of advice rather than more formal actions such as tax incentives, subsidies, or quotas.

Although not mandatory, there are a number of ideas and trends which have been enthusiastically embraced and which are encouraging from an environmental perspective. Environmental labelling and auditing is seen as a positive marketing tool, and in Denmark the use of 'environmentally friendly' technology is seen as having a positive influence on exports. In Italy there is an eco-labelling accreditation body which officially recognises 'environmentally friendly' enterprises. Finland, Portugal, and the United Kingdom have also established environmental accreditation policies. Another proactive measure has been encouraging a fast-track for clean technologies by linking national research and development expenditure to the needs of industry. This should increase the rate of diffusion of new 'clean' technologies.

7.3.6 Conclusions

In the majority of Member States there have been some significant advances in environmental standards and policy, however, there are still major differences between the most environmentally advanced countries, particularly the Scandinavian countries, Austria, and Germany, and the less advanced countries. Indeed, there may be a North / South divide in terms of environmental policy developing, with the poor Southern flank of the Union regarded as polluters whilst the rich North are seen as the environmentally clean.

In a number of countries policy measures have met with considerable opposition from industry. Yet estimates from the Netherlands suggest that the net costs to industry of conforming to environmental regulations are less than 1% of turnover. It would be negligent to reject the obvious long-term benefits of such policies for such small short-term costs.

Given the cross-border effects of emissions and discharges, the European Union has a legitimate role in improving environmental protection across the Union. It could reduce the inequalities in standards by improving Union wide protection in line with the 'best practice' already implemented in the member states with the most developed environmental protection. This however, cannot be achieved immediately, rapid policy implementation would increase costs to enterprises too dramatically in those countries without the high standards of protection already enforced in Austria, Germany and Scandinavia. On the other hand, it should also be recognised that without a levelling of standards enterprises in the less regulated countries have a competitive advantage which acts as an incentive for enterprises to relocate to unregulated countries. A levelling of standards should therefore be a medium to long term aim of the European Union.

On a final positive note, consumers are often willing to pay more for 'green' labelled goods, thus offsetting the extra costs imposed on the producer in complying with environmental legislation.

8 LABOUR MARKET

Co-ordinated by Danish Technological Institute (DTI)

MAIN POINTS

- Labour supply in the Union is increasing. Given the high and increasing unemployment rates labour supply is also abundant relative to demand. Due to increasing segmentation of the labour market this does not necessarily guarantee that enterprises can satisfy their labour requirements.
- Skills shortages are identified in the majority of Member States, although no major problems are anticipated for SMEs arising from these general conditions.
- In general, the environment for the use of numerical flexibility has improved since the 1980's, but with substantial differences emerging between countries.
- There are active labour market policy schemes in all the countries of the Union. The content of these policy schemes differs between countries, but the prime objective is usually to provide training activities for the labour force. In a number of countries there are also schemes which provide wage-subsidies to employment for different categories of the unemployed.
- Start-up grants are also an integrated part of active labour market policies in a number of countries, and these may provide a means of stimulating self employment.
- There are substantial differences between countries in the amounts spent on active labour market policy schemes, even when national differences in the level of unemployment are taken into account. This indicates that the general business environment in the area of labour force training is still uneven across the Union.
- Of interest to SMEs, and related to their labour requirements, are schemes in Denmark, France and Sweden, aimed at increasing the number of professionals in SMEs by, for example, enhancing existing managerial skills.

8.1 INTRODUCTION

In spite of, and also as a consequence of the increased use of new technology in the European production, the labour market is still central to the business environment for SMEs. The availability of appropriately skilled workers in both high-tech and low-tech enterprises is important for both kinds of enterprises for survival and to maintain and increase competitiveness.

In this chapter the labour market is viewed from the point of view of SMEs, and by using this approach, we ask whether SMEs are able to recruit and/or maintain the workforce necessary for their production.

At the moment, the most striking feature of the European labour market is the seemingly abundant supply of labour. High unemployment rates in all the Member States suggest that the supply side of the labour market is not generating problems for SMEs. On the other hand, a number of surveys express concern, for example, about the current skills mismatch and levels of long term unemployment. This suggests that the labour market is not working as smoothly as it might appear at first, and that the supply side of the labour market might cause problems for SME survival and competitiveness.

The structure of the chapter is as follows.

In section 8.2, the supply of labour in the European labour market is described. Reference is made to the increasing segmentation of the labour market and by implication the problems of satisfying the labour requirements of SMEs. A characterisation of the labour market environment for the use of different kinds of flexible labour is included as a part of an assessment of labour market flexibility.

In section 8.3, the extension of the problems which SMEs face, for example, recruitment problems and skills shortages, are described and some of the causes listed. Furthermore, there is a discussion on the consequences for SMEs arising from identified skills shortages and recruitment problems.

In section 8.4, with the starting point as identified problems, the content of the labour market policies is described, focusing on active labour market policies and policies aimed more specifically at the needs of SMEs.

8.2 AN OVERVIEW OF THE LABOUR MARKET

In the first instance, the purely quantitative aspects of the labour market are described, and no qualitative assessment of the situation is made.

Labour force participation rates are moderate throughout the Union as compared with the OECD average. There is a clear tendency towards higher rates in the northern countries and lower rates in the southern countries, but also in Ireland. An increase in the labour force available for enterprises due to an increased participation rate is thought to be most likely in the southern countries, even though changes in participation rates in the last decade are not providing an unequivocal picture of this development (see Table 8.1).

The high and increasing unemployment rates in almost all countries (the exception being Luxembourg) suggest that the immediate supply of labour, measured in purely quantitative terms, is high. Further evidence for this is the high level of mobility in the labour market, which, in the period 1986-92, averaged at 12.5% across the Union¹. Unfortunately declining employment in most of the countries that has occurred during the reces-

¹ European Commission, *Employment in Europe 1994*, Luxembourg, 1994. Page 97. The figure covers the Union excluding the Netherlands and Italy, and is an expression of the number of people not employed in the same sector as they were one year earlier, hereby the figure underestimates the actual labour turnover.

sion is also indicative of an abundant supply of labour, though (as we shall see later) not necessarily with the right skills.

Table 8.1 The unemployment, the participation rate and the change in employment

	Unemployment rates (%)		Labour force participation	Change in participation
	1990	1993	rate (%)	rate (Percentage points)
	1990	1993	1993	1983-93
Austria	3.2	4.2	69.1	2.3
Belgium	8.7	11.9	63.8	1.0
Denmark	9.6	12.2	81.6	1.3
Finland	3.5	17.9	73.3	-3.2
France	8.9	11.7	66.4	0.0
Germany	6.2	8.9	69.6	2.3
Greece	7.0	9.8	58.8	-1.1
Ireland	13.9	16.6	63.2	0.5
Italy	11.5	10.4	57.7	-1.2
Luxembourg	1.3	2.1	-	2.2*
Netherlands	7.5	8.1	69.9	5.4
Norway	5.2	6.0	76.8	0.3
Portugal	4.7	5.5	67.8	-2.1
Spain	16.3	22.7	57.7	1.9
Sweden	1.7	8.2	79.9	-1.0
United Kingdom	5.9	10.3	74.4	1.5
OECD average			70.6	

* 1983-1991.

For sources and definitions see OECD, Economic Outlook no 55, June 1994.

An additional pool of labour is, at least partially, available for SMEs in the coming recovery, via the high level of 'discouraged' and involuntary part-time workers, a group which has recently increased in numbers¹. This group constitutes a section of the potential labour force which, in a recovery, might either re-enter the labour market or change status from part-timers to full-timers. Whether the part-time employed are willing or intending to change status to full-time is of course dependent on whether they are forced into part-time employment by demand from employers or have chosen part-time status themselves.

Whether this adequate quantitative supply is going to remain so in future has been discussed in a number of surveys of labour force development². From the forecast in 'Employment in Europe 1992'³ it also appears 'that the Community labour force could, under a combination of relatively favourable - but by no means unrealistic - circumstances, in-

¹ OECD, Employment Outlook 1993, Paris 1993.

² For example Commission of the European Communities, Employment in Europe 1992, Luxembourg 1992.

³ Op. cit. page 67.

crease by over 11%, or by some 17.5 million, between 1990 and the year 2000. This increase was exceeded over the 10 years to 1990'.

8.2.1 The increasing segmentation of the labour market

Even though the immediate quantitative supply of labour seems to be fulfilling the needs of enterprises, there are barriers in the labour market which question the assumption of a single Union-wide labour market in which all enterprises are able to recruit labour.

One of these barriers is due to the fact that the labour market now is more segmented than ever, and despite an intense theoretical debate on the processes which have caused, and continue to generate this segmentation¹, there is no doubt of its importance for an understanding of the functioning of the labour market.

This segmentation of the labour market has led to the establishment of a number of 'labour sub-markets' each characterised by a specific set of 'employment relations' or (e.g.) sector-specific characteristics. These sub-market-specific characteristics do to some extent hamper the mobility of labour between the different labour market segments.

An extension of, and to some writers a reason for the segmentation, is the rising demand for new or higher worker qualifications. This development, which has occurred over a considerable period, has been a consequence of the development of the technology used. For example, where the use of Information Technology in production has created a demand for greater skills. This is manifested in a decreasing number of blue collar workers in the 1980s in almost all Member States².

The increasing number of long term unemployed may also be seen as an indicator of a segmented labour market, where difficulties in re-entering the market after a period of unemployment is apparently still difficult. Belgium, Ireland, the Netherlands, Italy, Greece and Spain, for example, have particularly high long term unemployment rates (see Table 8.2.). This brings concern for labour market re-entry chances in these countries. In a period of recovery embodying new technology-based investments, for example, the difficulties of the unemployed matching the qualification demands set by the employers should not be underestimated.

¹ See for example Atkinson, 1985. Harvey, 1989. Kern & Schumann, 1989. Gordon, Edwards and Reich 1982.

² OECD, Employment Outlook 1994, Paris, 1994 and Lauritzen, Finn et. al., Technology, education and unemployment, Ministry of Business and Industry, Copenhagen, 1994.

Table 8.2 The long-term unemployment 1993

	Unemployment of one or more years as a % of total unemployment
Austria*	17.0
Belgium*	56.9
Denmark	27.0
Finland*	18.4
France	34.2
Germany*,**	26.6
Greece**	49.7
Ireland *	44.3
Italy**	58.2
Luxembourg**	17.6
Netherlands*	46.8
Norway	27.2
Portugal**	30.9
Spain	50.1
Sweden	10.9
United Kingdom*	36.9

* Indicates registered long-term unemployment.

** 1992.

Source: OECD Employment Outlook 1994. Incidence of long-term unemployment from survey-based data.

On the basis of these findings, it is impossible to treat the labour force as a single entity and to provide estimates of the degree to which enterprises can meet their labour force requirements without moving on to qualitative considerations of labour supply.

8.2.2 Flexibility as a qualitative measure of the labour market

In the White Paper¹ the increased flexibility² on the European labour market is considered very essential for the further increase of the total employment in the Union. It is, however, often discussed in what extent the labour market is hampering the economic development in Europe, and whether an increased deregulation of the labour market is needed to improve the business climate. However, to quote from *Employment in Europe 1994*:

'Blame is commonly levelled at the labour market, both internal and external, which is judged insufficiently flexible to enable businesses to organise production and their workforce in the most effective way and to hire - and fire - employees when and where needed. The evidence which exists on this, however, is largely anecdotal and, in prac-

¹ White Paper Com (93)700.

² In the White Paper there is a distinction between internal and external flexibility, and a number of issues are mentioned: the development of the human resources, the geographical mobility, wage flexibility, the legislation on dismissals, the demarcation lines on the labour market and the search behaviour on the labour market.

tice, it is not easy to assess the extent to which an inflexible labour market in various parts of the Community is damaging the competitiveness of the European producers....¹

In some of the European countries, like the United Kingdom and Denmark, a great measure of the flexibility required in the White Paper is achieved, yet both countries continue to experience high unemployment rates. The United Kingdom deregulation of the labour market in the 1980s has not resulted in considerably lower unemployment rates or even lower structural unemployment. For example, the severe reduction of the wage replacement rate² in the United Kingdom has only lead to a reduction of structural unemployment by 0.5 percentage points³.

Some definitions

Two different types of flexibility are taken into consideration in this section, namely, numerical and the functional flexibility. The use of numerical flexibility is based on the current adjustment of the workforce to the actual needs of the enterprise. This includes both hiring and firing, but also the ability to adjust for example the actual hours worked by each employee.

Functional flexibility is related to the way enterprises administer their human resources. Functional flexibility is managed by the enterprise itself, and is manifest in the way the workforce produce, e.g., the number of work tasks which each worker is able to handle. A focus on functional flexibility includes the strategic use of continuing vocational training in conjunction with an organisation of work that results in more integrated work tasks⁴.

In chapter 3, the use of temporary working contracts and part-time employment are described, and it is evident, that the use of temporary employment differs a lot within the Union. More than 30% of the total employment in Spain is temporary and less than 10% in Luxembourg, Belgium, the United Kingdom, Italy, the Netherlands and Ireland.⁵

The environment for the use of flexibility

The use of temporary working contracts may be a useful tool for SMEs to cover their immediate labour requirements. It is, however, often limited by national governments, as enterprises can by using the temporary working contracts avoid the legal obligations associated with permanent contracts.

Regulations on the use of temporary working contracts or fixed term contracts vary considerably between the countries of the Union. On the basis of this regulation the Member States can be divided into three groups.

¹ European Commission, *Employment in Europe - 1994*, Luxembourg, 1994. Page 83.

² The wage replacement rate is the percentage of the previous wage which the unemployed receives as allowances, afterwards just 'replacement rate'.

³ National Institute of Economic and Social Research, *The UK labour market, 1994*.

⁴ The use of functional flexibility is described in a number of research papers in the FAST programme under the Commission of the European Communities, for example Brandt, D., *Advanced experiences with APS concepts, design strategies, experiences*, Aachen, 1991.

⁵ European Commission, *Employment in Europe 1993*, Luxembourg 1993. Page 181.

Degree of government regulation on temporary working contracts*

Low	Moderate	High
Austria	Belgium	France
Denmark	Finland	Italy
Ireland	Germany	Luxembourg
United Kingdom	Greece	Portugal
	Netherlands	Spain
	Norway	
	Sweden	

* The grouping is made on the basis of the government regulation on: general contract regulation, restrictions on the use of contracts, the maximum duration of the fixed term contracts, whether they are renewable, whether there are paid termination benefits, whether there are paid open-ended benefits, whether there are dismissal protection and whether they are possible to convert to open-ended contracts.

Source: OECD, Employment Outlook 1993, Paris, 1993 and ENSR.

During the 1980s in France, Germany, Italy, Spain, Portugal and the United Kingdom it was made easier for enterprises to employ workers on a temporary basis¹. Also Sweden has recently (in 1993) experienced eased restrictions on the use of temporary working contracts. The increased number of employees in temporary jobs in Spain and France can be partly explained by the relaxation on the use of fixed term contracts², but is also a consequence of the general development in the economic cycles in these countries.

Also, the use of part-time workers may fulfil some of the labour requirement of SMEs. There is no unequivocal trend in the development of part-time working in the Union. In some countries, such as the Netherlands, Germany and Belgium, part-time jobs have constituted a significant fraction of the jobs created in the 1980s, and in others, for example, Spain, Portugal and Italy, the proportion of part-time jobs has actually decreased or remained unchanged³.

In all the Member States regulation on unfair dismissal and collective redundancies exists, the latter also being regulated by EU directives. In general the degree of regulation changed little in the 1980s, though employment protection was strengthened in three countries, namely, Italy, Spain and Ireland. In Italy national regulation was extended to cover small enterprises too. To this must be juxtaposed growing indications of structural problems in Spain and Italy due to the restrictions on the scope of enterprises to adjust their labour force to their current needs⁴.

In general, the conditions for the use of numerical flexibility has been eased in the countries. We must allow, however, for exceptions, such as Italy, which has regulated employment protection still further, and the United Kingdom which has continued the existing labour market deregulation policies apace.

¹ Commission of the European Communities, Employment in Europe 1993, Luxembourg, 1993.

² A fixed term contract is defined as one which expires on a predetermined date without notice from either side.

³ OECD, Employment Outlook 1993, Paris 1993 and Commission of the European Communities, Employment in Europe 1993, Luxembourg, 1993.

⁴ Commission of the European Communities, Employment in Europe 1993, Luxembourg, 1993.

The use of functional flexibility is to a great extent determined by the behaviour of SMEs themselves and their investments in human resources. But also national governments have an influence. This operates, for instance, through the educational framework provided by individual states and through the incentives national governments create for enterprises to invest in human resources. Just as the development of the human resources in enterprises is a means of satisfying labour requirements, it is also one for the enterprise itself to use the state-of-the-art in the technological development and hereby experience an increase the competitiveness.

8.3 RECRUITMENT PROBLEMS AND SKILLS SHORTAGES

As described in the previous sections, the abundant supply of labour in absolute figures does not necessary indicate that enterprises have access to a satisfactory supply of labour in qualitative terms.

8.3.1 Quantitative and qualitative dimensions

Enterprises may experience skills shortages when they want to recruit new employees and there are a numerical shortages of people who are qualified for a job (here referred to as quantitative skills shortages). Further, they may experience skills shortages among the employees working in the enterprise, or when they are hiring new employees, whose qualifications do not match the skills required to do a certain job (here referred to as qualitative skills shortages).

A number of surveys¹ conducted on behalf of the Union in 1985, 1989 and 1991 show that for only a minority of enterprises in manufacturing, has the shortage of labour limited production. In 1991 only between 1% and 6% of enterprises (11% in Portugal) stated that this was the case, whereas a much higher percentage of enterprises stated that shortage of adequate skilled applicants was the reason for not employing more workers.

This shows that enterprises might experience skills shortages, which only manifest themselves in fewer employed, rather than in a reduction in output. Although the latter might become manifest in the longer run. This is a interesting finding, as an immediate conclusion that skills shortages are limiting output in enterprises not always is valid. On the other hand this finding does not exclude, that an abundant supply of high qualified labour might improve the competitiveness and output in enterprises. An explanation for these finding could be that enterprises, when they experience skills shortages, change their performance and for example increase the use of working over-time or they have to employ people who have not the qualifications demanded.

¹ Here from OECD, *Employment Outlook 1992*, Paris, 1992, page 27.

Table 8.3 Labour shortages in the European Union, manufacturing sector, harmonised business surveys (questions to which the answer was yes, in percentages)

Country	Is a shortage of adequately skilled applicants an important or very important reason for not employing more people in your enterprise?***						
	Is a shortage of labour a factor limiting your production?*			1985/86		1989	
	1985	1989	1991	All sizes	All sizes	Less than 200	1,000 employees and more
Denmark	7	2	1	-	-	-	-
France	3	7	6	36	53	61	44
Germany	5	11	4	53	66	65	66
Greece	1	2	1	35	50	53	67
Ireland	4	2	4	20	28	30	-
Italy	-	3	1	42	75	59	88
Luxembourg	-	2	1	43	-	-	-
Netherlands	3	4	3	44	70	68	82
Portugal	-	10	11	-	67	-	-
Spain	-	4	3	-	37	37	42
United Kingdom	18	22	5	37	62	76	48
Total	6	9	4	43	62	62	59

* Source: Quarterly industry survey for October; various issues of the Results of the European Community Business Survey.

** Source: 1985/86: CEC (1986); 1989: CEC (1991). Here from: OECD, Employment Outlook 1992, Paris 1992.

- Indicates 'not available'.

In some studies¹ the changes in the registered skills shortages from one year to the other are explained by movements in the economic cycle, but it is doubtful if the cyclical development from 1989 to 1991 alone can fully explain the large decrease in skills shortages in the United Kingdom between 1989 and 1991, as there is an increase in unemployment to match the decrease in skills shortages over this period. Neither can the large differences between countries, for example between the United Kingdom and Ireland, be explained simply by different points in the economic cycle (represented for example by the level of unemployment).

In Austria, a similar survey was conducted, and in 1994, 42% of enterprises report skills shortages, with the smallest enterprises, less than 5 employees, having the fewest shortages (29%) and larger enterprises, with more than 50 employees, having the most prob-

¹ For example in Employment Gazette, April 1994.

lems (52%)¹. In Belgium too, a survey shows that micro enterprises (less than 10 employees) face fewer skills shortages than larger enterprises².

The explanation for these findings might of course be that the large enterprises, due simply to their size, recruit more often and are thereby more often exposed to the risk of facing skills shortages. Hereby, may be SMEs do not experience the fewest problems in relative terms.

Also on behalf of the Task Force Human Resources, there has been carried out a number of studies on skills shortages in the Union. In 1990-91 studies were carried out in 26 regions in the Union³, and in short the main findings were that:

- skills shortages existed in all regions;
- all regions reported on skills shortages in manufacturing;
- skills shortages were often connected to the use of Information Technology in enterprises;
- at occupational level, skills shortages were found especially in management, in skilled employees (technicians), in white collar administrative staff, and in sales and marketing.

In 1993-1994 the skills shortages study was updated in five regions in the Union, namely, the Greater Copenhagen Area (Denmark), East Anglia (the United Kingdom), Weser Ems (Germany), Mid-West (Ireland) and Campania (Italy)⁴.

The main findings of the survey were that:

- Between 1991 and 1994 all regions have faced a general reduction in both quantitative and qualitative skills shortages, mainly due to the economical recession;
- New skills shortages are expected to arise in an economic recovery;
- Qualitative skills shortages are mainly manifested in the need for multi-skilled personnel, especially in the combination of technical and managerial skills;
- Quantitative skills shortages are generally limited to a few categories of personnel, which vary significantly among the regions.

The regional differences regarding the quantitative skills shortages are evident, and there are no unequivocal tendency in 1994. The quantitative skills shortages in Copenhagen are in nursing, while in East Anglia they concern specific types of engineers, marketing specialists, news reporters for the radio and television, and in Weser-Ems on printers, building cleaners, milers, photographers etc.

The qualitative skills shortages are, however, more alike in the regions. In Copenhagen it regarded basic managerial skills for managers and others and in for example Weser-Ems it were on multi-skilled personnel for example commercial and technical skills.

¹ Institut für Gewerbe- und Handwerksforschung, Konjunkturbeobachtung, Wien, 1994.

² Donckels, R., Cottyn, M. and J. Lambrecht, Hoekstenen voor een specifiek middenstands- en KMO-beleid in het Brussels hoofdstedelijk gewest (Cornerstones for a specific SME-policy in the Brussels Metropolitan Area), Small Business Research Institute, Brussels, 1994.

³ TARGET, EC skills shortages project 1990/91, Final synthesis report, 1991.

⁴ Oosterhuis, J.A.J.J., R.K.W. van der Velden, Skills shortages in the 90s: EU skills shortages update project: synthesis report, Maastricht, 1994.

In the Second Annual Report of the Observatory, all Member States reported on skills shortages in the craft trades, and this pattern is in general the same in 1994.

In some Member States, for example Germany, Luxembourg and the Netherlands there are primarily reported on skills shortages in the craft trades (in Germany only in the craft trades) as for example construction. In Luxembourg the skills shortages are reported to be of a qualitative nature, while in Germany they are of quantitative nature.

In the Netherlands the situation is, however, not quite so unequivocal, as another study¹ shows that there has been an immense crowding out of low qualified people by medium and high qualified people, which indicates that the employers have the opportunity to select better qualified at the expense of the low qualified people. This has been possible, as the high unemployment provides enterprises with an abundant supply of high qualified labour.

This process of crowding out of the low qualified people may have positive as well as negative consequences. A negative consequence is that the number of discouraged workers could increase, as some low qualified workers will experience that the required level of qualifications in their traditional segment of the labour market has increased beyond their capability. On the other hand, the employment of more highly qualified workers could generate a better productivity in enterprises, and hereby increase the competitiveness. The process of crowding out of low qualified persons is both taking place in the long time perspective as a ongoing process, where the number of blue-collar workers is decreasing (see section 8.2.1), but also as a more immediate consequence of changes in the economic cycles, where the supply of unemployed better qualified people is higher in economic recessions.

In industries where working conditions are comparatively unfavourable, such as construction, hotel, catering and restaurants, problems exist in recruiting unskilled labour. In some countries solutions have been found by 'importing' labour. In Austria, for example, such jobs have been increasingly filled by immigrants from Eastern Europe.

Some of these problems are also identified in the United Kingdom where recruitment problems persist, for instance, in textiles and in hotels and catering, both sectors in general characterised by poor working conditions. The general tendency in the United Kingdom is, however, for a decline in the number of enterprises which report recruitment problems.

In the Flanders region of Belgium there are listed more than 20 different 'bottleneck' professions which vary from engineers to hairdressers. These bottlenecks have been found to occur more often in small enterprises than large. The skills shortages are more often qualitative than quantitative in nature, with employers asking for 'additional' qualifications to those available. This might be, for example, in requiring of the worker relevant work experience or the ability to work without supervision. However, bottlenecks are especially likely in the technical professions (for example technical engineers). The same picture emerges for the other two Belgian regions, Brussels and Wallonia².

¹ Bosch, L.H.M., G.Th. Elsendoorn, W.H.M. van der Hoeven, *Werken aan de onderkant*. EIM Small Business Research and Consultancy, Zoetermeer.

² VDAB, *Analyse Vakaturen 1993 - Deel III Knelpuntenberoepen (Analysis of Vacancies 1993 - Part III - Bottleneck Professions)*, Brussels, 1993.

In Norway a survey was conducted on the matching of skills held with skills required for the job. Skills of workers occupying jobs were assessed as were the ideal qualifications for the posts¹. This study revealed quantitative skills shortages for vacancies where 'higher education' and 'secondary school, occupational' were considered the most suitable. These jobs were therefore occupied with people with lower skills than ideal.

Skills shortages are identified in the majority of the countries, but severe problems for SMEs are not anticipated to arise from these shortages (see for example Table 8.1). Both qualitative and the quantitative skills shortages are correlated with industrial structure in the regions in question, together with market trends for the industries located there.

8.3.2 The causes for the skills shortages

The increasing demand for higher level skills are in some cases the cause of both quantitative and qualitative skills shortages. In the cases where the general educational attainment of the labour force is not matching current demand, SMEs might experience problems simply due to immediate lack of supply of qualified labour. In some Member States, Greece and Spain, poor educational systems are mentioned as one of the reasons for the weakness on the labour market and this is identified as one of the main reasons for the problems which SMEs in particular face concerning the labour market. Also the OECD draws attention to current weaknesses in the educational systems in France, Ireland, Portugal, Spain and the United Kingdom as some of the reasons for the high unemployment in these countries².

Human resource management

In a number of other countries, the Netherlands, Spain, and Finland, insufficient investments in continuing vocational training is now identified as a cause of skills shortages, a point already made in the Second Annual Report. Studies from Spain and Denmark show that SMEs in general are using continuing vocational training less than LSEs, and where it is used in SMEs, the training is for a shorter time (Tables 8.4 and 8.5).

Table 8.4 Number of enterprises (%) using continuing vocational training Spain, 1989

Total	43
With 6-50 employees	15
More than 500 employees	86

Source: Ministerio de Trabajo, Madrid, 1989.

The Spanish survey shows that the average length of the training activities was 23 hours in enterprises with 101 - 250 employees and 234 hours in enterprises with more than 500 employees.

¹ Norges Offentlige Utretninger 1992; 26 appendix 10, Oslo 1992.

² OECD, Assessing structural reforms: Lessons for the future, Paris 1994.

Table 8.5 Number of enterprises using private continuing vocational training, Denmark, 1992 (%)

5 - 9 employees	62
10 - 19 employees	72
20 - 49 employees	75
50 - 99 employees	83
100 - 199 employees	89
200 - 499 employees	93
500 - 999 employees	100
Total	80

Source: Privat efteruddannelse (Private continuing vocational training), DTI Arbejdsliv, 1994.

The Danish survey also shows that larger enterprises relatively are using more resources on training than smaller enterprises, that the use of continuing vocational training to a large extent co-vary with the degree of institutionalisation of the activities and that larger enterprises in general have institutionalised their training activities in a better manner, (for example training departments, a training budget or written training plans for the employees) than SMEs.

The Danish survey does also confirm other surveys¹ that the increasing segmentation of the labour market is also manifest in the use of continuing vocational training. The use is extensive in some economic sectors, such as business service and financing, and slight in others, for example, construction and retail.

These findings lead to the conclusion that enterprises must be included in the solution of the problems, and that some of the reasons why enterprises face skills shortages might be due to the fact that they pay insufficient attention to future labour requirements. Increased planning in conjunction with the use of continuing vocational training would help to reduce these skills shortages. Planning alone does not solve the problems, however, as there has to be an adequate institutional set-up including provision of training facilities.

Increased human resource planning in conjunction with continuing vocational training will further ease the use of functional flexibility. The introduction of new types of production processes (like the anthropocentric production systems²) are eased as it more likely that better skilled workers will participate in the new production systems.

The search behaviour of job seekers

The discussion on search behaviour is a part of the debate on whether SMEs are able to get their labour requirements covered. The effect of the unemployment benefit on the search behaviour is often discussed. Does unemployment benefits create an option of leisure and low income, which some people choose instead of full-time work with a

¹ Auer, Peter, Further Training for the Employed: A description of country models and an analysis of European Labour Force Survey Data, Wissenschaftszentrum für Sozialforschung Berlin (WZB).

² These production systems are described in research papers from the research programme FAST of the European Community. For example Wobbe, W., Anthropocentric Production Systems: A Strategic Issue for Europe - Vol. 1, APS Research Papers Series, 1991.

higher income? Additional parameters for the unemployed which affect the search behaviour are for example the wage and the quality of the job.

The discussion on the unemployment benefits and replacement rates is on the agenda in a number of countries as integral to the discussion of job search. There are, however, a number of ways which the unemployment benefit may affect the behaviour of the unemployed, and the net effect of unemployment benefit on job search appears to be ambiguous.

A high replacement rate might lead to increased numerical flexibility by providing enterprises with labour who are willing to take temporary jobs or jobs with low job-security. On the other hand high replacement rates might also lead to modified search behaviour due to disincentives to work (if people choose leisure and low income), but this is only likely in the lower-skilled groups on the labour market, for which there is a very good supply. The increasing segmentation of the labour market and the fact that the majority of new jobs are created as white collar jobs¹, provides further evidence for the assertion that high replacement rates will not create problems for SMEs in filling labour requirements.

A longer duration of unemployment benefit can encourage more job search and thereby a better matching of skills. This is in the interest of the individuals themselves, the employing firms and society as a whole. Too long duration on the other hand can lead to tailing off in search behaviour and may create problems for enterprises and for society via a general loss of skills due to depreciation of the worker's human capital. Furthermore, prolonged job search periods will mean increased expenditures by the government on unemployment benefits.

If the benefit length is short, or the replacement rate low, people may be forced to take lower-qualified jobs and thereby lead to loss of qualifications, as unused skills are eroded. Furthermore, there may be an increase in the number of discouraged workers as search becomes fruitless².

In a number of countries, Belgium, Denmark, Germany, Norway and the Netherlands there are current discussions on whether high replacement rates and lengthy unemployment benefits are causing problems for SMEs in satisfying labour requirements. It must, however, also be kept in mind, that unemployment benefit is a labour market policy instrument which can be used not merely to control search behaviour of the unemployed. It is also an important tool in efforts to increase social cohesion, which, at least indirectly, can improve the general business environment of Member States.

Table 8.6 provides examples of replacement ratios for an industrial worker aged 40 years, with 20 years of continuous work experience at the average wage, and who becomes unemployed.

¹ For example in Lauritzen, Finn et. al, Technology, education und employment, Ministry of Business and Industry, Copenhagen, 1994 and OECD, Employment Outlook 1994, Paris 1994.

² European Commission, European Economy No 56, 1994.

Table 8.6 Replacement rates

	1st period % of earnings	Duration months	2nd period % of earnings	Duration months
Belgium	79	12	55	Indefinite
Denmark	73	84 *	63	Indefinite
Germany	63	12	56	Indefinite
Greece	28	12	0	n.a.
Spain	80	6	70	18
France	80	12	67-33 **	Indefinite
Ireland	41	12	32-35 ***	Indefinite
Italy	30	6	0	n.a.
Luxembourg	85	12	46	Indefinite
Netherlands	74	24	49	Indefinite
Portugal	81	21	44	21
United Kingdom	23	12	23	Indefinite

* Adjusted by information from ENSR.

** August 1992: 67% for 4 months, then 46%, 38% for another 4 months and 33% hereafter.

*** 32% for 3 months, then 35%.

Source: Social Protection in Europe, European Commission, 1993.

In eight of the Member States the replacement rate is 63% or more, in Ireland it is 41% and in the United Kingdom, Italy and Greece it lies between 23 and 30% of the previous net wage.

Exact evidence that high replacement rates cause problems for SMEs in satisfying their labour requirements are however difficult to obtain. There are considerable differences between the countries, and an immediate comparison between the results in Table 8.3 covering the problems of skills shortages and Table 8.6 covering replacement rates, does not provide evidence for problems in enterprises due to high replacement rates.

SMEs attractiveness as employers

There might be special problems arising for SMEs in covering labour requirements if their attractiveness as employers is low. It is, however, a subject covered in few surveys, and those conducted have limited validity due to the small survey populations. As problem of enterprises covering labour requirements appears to be particularly acute with SMEs, some of the surveys are presented here.

In Spain, SMEs are generally not very attractive for qualified professionals. The main reason for this lack of attractiveness might be the rather limited promotion and professional development within SMEs. SMEs provide less attractive conditions in areas of job-security, salary, and professional challenges¹. Also in Belgium SMEs have image problems. From a Belgian small scale survey among SME businessmen it appears that about a third of the respondents agree with the statement, that 'SMEs enjoy little spontaneous

¹ Martin, E., Incorporacion de recursos humanos en las pymes, 1994.

sympathy on the labour market¹. It must, however, be presumed that the value of these assertions are declining with enterprise size, in other words, these findings are most frequent in small and not in medium sized enterprises.

The case studies from Belgium and Spain underline to a certain extent the attractiveness of large enterprises. Both the salary and the career possibilities are expected to be superior. In this regard, it is possible that SMEs could face problems covering their labour requirements - especially among highly qualified professionals and especially in an economic upturn where image problems of SMEs might add to general recruitment and skills shortage problems in that sector.

In the Second Annual Report the Craft Trades in some countries were also reported to have a poor image, which to some degree explained reported skills shortages². But there is only weak evidence that the attractiveness of larger enterprises should result in recruitment problems for SMEs, as also indicated in the Second Annual Report.

8.4 LABOUR MARKET POLICIES

The labour market policies are often dealt with as two different types, the active and the passive, where the latter is the means spent on the unemployment benefits and related schemes which aims at the support of people who not are able to get work, or who are encouraged to go for early retirement, etc. Most of the initiatives in the active labour market policies in general are aimed at the preservation of the qualifications in the labour force to improve matching of demand and supply and the creation of additional (subsidised) employment either in the private or the public sector.

8.4.1 Characteristics

In all the countries training activities are included in active labour market policies. In two countries, Italy and Luxembourg only the unemployed participate in such training activities, while in all of the remaining countries both employed and unemployed participate.

In all countries, there are schemes which provide wage-subsidies to employment of different groups of unemployed (for example young people or long-term unemployed), and particularly in Belgium, France and Germany these schemes are highlighted as attractive opportunities for SMEs.

Also in all countries, there are schemes which provide start-up grants for unemployed who want to start up businesses. The effects of these schemes are discussed in a number of countries, for example Denmark and Finland. The survival rate for the new enterprises (based on the allowance schemes) is fairly good (in Denmark and Finland) and in Finland it is the assessment, that the new jobs are created at low costs. On the other hand, the new enterprises are in some cases accused of 'crowding out' existing enterprises because they not are competing on a level playing field.

¹ Donckels, R., (ed), *Mensen in KMO's. Over het vinden, plaatsen en motiveren van de juiste medewerkers* (People in SMEs. About finding, planning and motivating the right collaborators), King Baudouin Foundation, Roularta Books, Small Business Research Institute, Brussels, 1991.

² In the Second Annual Report of the Observatory, it was described that some of the craft trades in the Netherlands had high attractiveness as employers, thus indicating on the opposite situation.

Only a few labour market policy initiatives are aimed directly at SMEs, most initiatives having a very general focus. There are, however, some general initiatives of special interest to SMEs, for example, the wage-subsidy schemes in Belgium, France and Germany. In three countries, namely, Denmark, France and Sweden there are also established schemes aimed at producing a higher proportion of professionals in SMEs.

Case A

'The Icebreaker project' in Denmark deals with skills shortages of Danish SMEs at the management level. These are thought to result in barriers to growth once the workforce reaches a size of approximately 20 or 30 employees. The scheme is aimed at getting enterprises with less than 50 employees to hire people with higher education, and to provide the enterprise with strategic competencies for further development. The trainee should be employed on an ordinary basis when the subsidy period is expired if the results are satisfactory (the enterprise receives the unemployment benefit in a training period of six months). The project was started up in 1994, and until now 960 'icebreakers' have been employed.

Case B

In France a similar project 'Support to executive staff recruitment' is developed - it is financed fifty-fifty by the national government and the regional authorities. It is aimed to strengthen executive staff in industrial SMEs, by encouraging SMEs to employ high skilled executives when they face important steps in their development. The SME receives a maximum of 50% of the wage and the social contributions as a subsidy (a ceiling of 31,000 ECU). The project has been in action since 1989 and in total 4,400 executives have been employed in SMEs under the project.

8.4.2 Expenditure on labour market policies

Even though the national governments are aware of the problems connected to the present and the future supply of well-qualified labour, there are considerable differences in the amounts spent in this area.

From Table 8.7 these differences are clear. As an example, labour market training covers 0.02% of GDP in Italy and as much as 0.83% of GDP in Sweden. There are also considerable differences on the amounts which are spent on the other kinds of labour market initiatives, and the general picture shows considerable differences between the countries. These differences are not explained by different levels of unemployment, as the expenditures per % unemployed also differ considerably between the countries.

The large differences in the national spending on labour market policies could cause concern for an uneven development in the Union, and the differences are to a certain degree an expression of differences in the general business environment which exist in the countries. The high expenditures on training in countries as Sweden and Germany are in glaring contrast to the amounts spent in for example Italy and Luxembourg.

Table 8.7 Expenditures on labour market policies, per cent of GDP 1993

	Labour market training	Subsidies employment	Unemployment compensation*	Other**	Total	Relative ex- penditure***
Austria	0.10	0.04	1.45	0.19	1.77	0.42
Belgium	0.23	0.53	2.91	0.34	4.00	0.34
Denmark	0.42	0.50	4.89	0.96	6.77	0.55
Finland	0.46	0.83	5.12	0.48	6.89	0.38
France '92	0.39	0.14	2.01	0.46	2.99	0.26
Germany	0.55	0.46	2.60	0.57	4.19	0.47
Greece '92	0.19	0.09	0.80	0.11	1.19	0.12
Ireland '91	0.48	0.28	2.81	0.71	4.27	0.26
Italy '92	0.02	-	0.91	0.91	1.84	0.18
Luxembourg '91	0.02	0.02	0.77	0.25	1.04	0.50
Netherlands '92	0.19	0.12	2.22	0.84	3.36	0.41
Norway	0.37	0.37	1.60	0.56	2.90	0.48
Portugal	0.25	0.10	1.00	0.54	1.90	0.35
Spain	0.12	0.19	3.46	0.19	3.95	0.04
Sweden '93-'94	0.83	0.32	3.14	1.42	5.69	0.69
United Kingdom '93-'94	0.14	0.02	1.23	0.36	1.75	0.17

* Including early retirement for labour market reason. Total passive measures.

** Including public employment services and administration, youth measures and measures for disabled.

*** Total expenditures on labour market policies, per cent of GDP per % unemployed.

Source: OECD, Employment Outlook 1994, Paris, 1994.

Other types of labour market policies are of course also elements which influence the business conditions for SMEs, but often in a more indirect and less visible way. For instance, it is discussed whether the passive labour market expenditures, the unemployment compensation, are elements in the flexibility of SMEs, by providing SMEs with labour which is willing to take jobs on temporary working contracts or with low job security, as is the case in Denmark (see section 8.3.2).

It is important to emphasise that the national government does have an influence on the actions taken in private enterprises, and by providing the right framework, the desired development might be achieved. National governments could encourage enterprises to increase investments in education and training by providing the right incentives. One way would be to introduce tax deductions of more than 100% or other kinds of benefits for enterprises or persons investing in continuous vocational training, to place investments in human capital on an equal footing with investments in capital equipment. Another way would be for governments to provide support to establish the necessary framework for increased use of continuing vocational training in enterprises.

9 CAPITAL AND FINANCE

Co-ordinated by Instituto de Apoio às PME e ao Investimento (IAPMEI)

MAIN POINTS

- The majority of external financing for SMEs is provided by banks. Regarding the financing of SMEs, the banking system in Europe has always been characterised by a short-term approach, on secured lending and on less risky investments. In practice there is to some extent, an inverse correlation between enterprise size and interest rates paid.
- In most countries, small and medium sized enterprises in general, and the smaller ones in particular, only have access to debt finance, when in fact, a balance of debt and equity is more suitable. Typical SMEs have been financed by the entrepreneur's personal equity stake and that tends to increase from retained profits rather than an internal-external mix of funds.
- Formal venture capital is relevant for only the largest of SMEs due to the high fixed costs associated with this type of capital. Seed and venture capitalists have also been noticeably absent in the high-technology sector and start-up or early stage financing (although informal venture capitalists in the Netherlands and in the United Kingdom have become more involved).
- Start-ups and high-technology enterprises find it difficult to raise funding. Enterprises which operate in some traditional sectors subject to fierce competition also have reduced chances of obtaining funding.
- Raising funds directly through money market instruments is almost impossible for SMEs. The number of SMEs using commercial paper remains marginal and in countries like Portugal, it can only be legally issued by SMEs that benefit from banking guarantees for this purpose.
- For protection from the different types of financial risks, SMEs need, and have, a large selection of hedging instruments available. However, the hedging position will be more expensive the smaller the magnitude of the business conducted by the SME. It seems then that through grouping solutions among SMEs, the use of these instruments could improve.

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continued

- A marked lack of dynamism and inefficiency typically characterise second-tier markets, when established. However, greater potential lies in what may come to be a Pan-European market for SMEs, that is presently taking shape.
- Small enterprise owners, traditionally very strongly independent, are very reluctant to share equity. Either for cultural, competitive or taxation reasons, SMEs do not like to give out too much information. This adversely affects banks' and investors risk perception, and the subsequent financing conditions of the business.
- SMEs are not provided with enough information on available financial tools and sometimes have underdeveloped management capabilities.

9.1 INTRODUCTION

There is considerable evidence on market failure concerning SMEs access to external finance, at reasonable terms and conditions¹. The constraints which generally affect the integration of smaller enterprises in wider and strongly competitive markets are particularly evident when it comes to financing, where a strict, market-driven approach is prevalent.

The first two Reports of the Observatory dealt in detail with the main issues related to SME financing. The aim this year, is to take a more integrated look at the issues, and examine the main factors that in each of the European countries influence the role of the markets, institutions and financial mechanisms as an environment for SME activity. Within this framework, the following structure has been adopted in this chapter:

- Information-gaps in the SME market;
- Appropriateness of the credit solutions offered SMEs;
- Equity financing of SMEs;
- Management capabilities in SMEs.

9.2 INFORMATION-GAP IN THE SME MARKET

The information-gap is an obstacle towards developing closer relations between banks and SMEs. Financial institutions generally complain that information on SMEs is not sufficient. On the other hand, SMEs are often unhappy at the fact that bank staff do not, for example, possess enough knowledge of developments in their sector, and that they are unable to judge whether their business ideas are viable².

¹ Commission of the European Communities, On the financial problems experienced by small and medium-sized companies, Brussels, 1993.

² Snijders, J., Financing of product innovations; a first research into financial aspects of the innovation process, EIM Small Business Research and Consultancy, Zoetermeer, the Netherlands, 1990.

9.2.1 Availability of general economic information

Studies of a sectoral/regional nature are sporadic at best and size-specific data are rarely available. For banks and investors in general, gathering and analysing information is simply too costly to carry out on their own. Thus there is value in extending the following support schemes, already available in certain countries. They are provided from two main sources:

Governmental departments:

1. In the United Kingdom, consistent time-series data on SMEs produced on VAT statistics, employment surveys and production censuses;
2. Agencies to support SMEs and other public institutions collect both general and SME-specific information, undertake specific topic surveys and publish reports focusing directly on smaller enterprises;
3. Central Banks and the fiscal data bases provide an exploitable source for analysing aggregate financial profiles.

Private Bodies:

1. Business associations from particular sectors offering fairly good information on their particular industries;
2. Studies on SMEs carried out by research institutes.

9.2.2 Information produced by SMEs

SMEs are reluctant to provide information for a number of reasons. Firstly, information is not free of charge. Secondly, many business leaders are reluctant to provide sensitive information which may be used by competitors. Thirdly, many of the very smallest of enterprises do not have the managerial capabilities for the provision of high-quality information. Regulatory and taxation factors likewise have an effect on information supply. In fact, government initiatives aimed at reducing the amount of red-tape with which SMEs have to deal, naturally affects the quality of the information produced, often producing a strong accounting bias for fiscal reasons.

In this context, the effective legislation aimed at dealing with the wilful submission of fraudulent or misleading information, and with fraudulent agency behaviour, is of great importance.

9.2.3 Solutions for informational deficiencies

The main financial institutions tend to collect relevant information gathered from their clients and set up their own databases. To complement their own data sources, information on SMEs can be obtained from a number of bodies or enterprises providing specialised information services:

- In several countries a register containing the annual reports of enterprises is available, since all limited liability companies are obliged to publish both a company report and an auditor's evaluation on a yearly basis.
- Organisations in Finland, supported by the banks that specialise in collecting economic information from financial statements or other relevant sources, have set up databases comprising the credit statements of both enterprises and individuals.

- A register of enterprises in Sweden with outstanding debts provides information on an enterprise's solvency. This is also the case with several services in France. German banks have set up an agency which keeps a list of customers that have not repaid their loans.
- The German Bundesbank is the body that normally deals with the credit-worthiness of an enterprise in Germany. This institution has first-hand knowledge regarding the financial standing of enterprises via its sole in bill discounting of the commercial banks.
- In Portugal, the governmental agency that supports SMEs subsidises the costs borne by enterprises when preparing strategic business plans as a basis for investment decisions. Once submitted to credit institutions, this improves information used to obtain funding.
- There is a large number of private sector enterprises that specialise in providing commercial information at enterprise-specific level and in particular on their credit standing.

It should be emphasised that information regarding the financial standing of enterprises must be handled with care so as not to give rise to the so-called 'self-fulfilling prophecy'; in other words, the fact that the real financial situation of an enterprise could be influenced by misinformation or speculation in general.

Credit Rating mechanisms have recently been introduced in some markets. Although this instrument is becoming more widely used, it is not particularly useful for SMEs, for whilst rating is considered a useful instrument for bond issuing purposes, this is not a common financial procedure for SMEs. However, some interesting applications of the concept must be highlighted:

- A Dutch bank has taken the initiative of setting up a 'Foundation for Technology Rating'. This evaluates projects in terms of their success chances. The evaluation should make it easier for banks and other financiers to decide on whether they should extend credit to the SME.
- A governmental agency in Portugal has agreements with two rating enterprises which it uses to select high quality SMEs and to raise their profile in the market. These then serve as role models for access to financial innovation.
- Under the aegis of the European Commission, the European Foundation for Business Qualification has been established.

A long-term relationship between financial institutions and the SMEs helps to establish a relationship based on mutual trust and provides a continuous flow of information. Countries such as Germany and Belgium have a tradition of loyalty between SMEs and their banks. This means that in general, bankers know their SME customers well and risks are thereby reduced.

Some interesting experiences related to SME-bank interaction may be worth mentioning:

- SMEs in certain countries, like Austria and Germany, commonly have a 'Hausbank' which is also their first address for bank loans, since the relationship between the client and the 'Hausbank' is often a long-standing one, a certain amount of goodwill is commonly found on both sides.
- In Portugal, a governmental agency and a public bank annually select approximately 500 high-profile SMEs which are assigned the status of 'Prestige SME'. Possessors of this status automatically benefit from preferential financing conditions and have their

reputation reinforced. Agreements with auditing enterprises have been secured to stimulate the production of better quality information from them.

- One of the major UK banks provides a service that monitors start-up businesses. This comprises account information, information on lending habits and personal characteristics of the business founders, as well as other enterprise-specific data.

9.3 APPROPRIATENESS OF CREDIT SOLUTIONS

9.3.1 Expertise and competence on SMEs

Due to stiff competition and a growing knowledge of the significance of SMEs in economic development, the banks are trying to draw closer to SMEs, although typically there is still an absence of banks specialising in SME business, and of SME-specific branch networks. In some cases the development of an understanding SMEs has largely followed a learning-by-doing-approach.

Some of the major banks appear, nevertheless, to have become increasingly aware of the financial products and services that SMEs require in the course of their business lives. Several banks (Denmark, the United Kingdom, the Netherlands, Austria) offer special courses to staff directly involved with SMEs, training them to deal with this category of enterprise. In Austrian banks, there are also regular and compulsory in-house training courses emphasising government-sponsored loans for SMEs. Banks in the United Kingdom, France and now in Portugal, have set up a number of small business-oriented branches.

9.3.2 Risk Assessment Methodologies

Financial institutions, and banks in particular, are moving towards standardised credit-rating techniques and expert systems to deal with funding proposals with the aim of rendering risk assessment and operation pricing more objective. Risk judgements made solely on the basis of hard figures will however somewhat contribute to an even more hands-off relationship with the smallest enterprises.

The problem from the viewpoint of the SME is that neither the entrepreneurs' plans nor the potential of the enterprise are taken into proper consideration.

The most common problems associated with the implementation of risk assessment, especially when dealing with SMEs are:

- Balance-sheets forwarded to the bank are normally one or more years old and the legal possibilities of 'cosmetic' adjustments might further decrease the reliability of the data.
- Profit (cash flow) analysis becomes very important for dynamic credit assessment, but only a few SMEs have adequate cost accounting (10 to 15% in Austria, according to one survey¹).
- Very few SMEs have regular budgeting.
- Evaluation techniques are only available for quantitative factors, such as ratios. Qualitative aspects are not systematically analysed. Credit assessment thus depends

¹ Schmoll, Theorie und Praxis der Kreditprüfung, Austria, 1990.

on the qualification, intuition and the personal risk-evaluation of the customer's consultant.

Thus, greater importance is generally placed on the provision of loan collateral and the debt levels of the business than on the enterprise's potential and long-term viability. In practice quality aspects are only duly weighed up in unfavourable circumstances as is the case with start-ups or projects involving greater risk.

However, in conjunction with the 'Hausbank' approach, risk assessment performed by banks in Germany is normally very effective. The same can very often be said of the mutual guarantee societies. The tight relations between the enterprise and the 'housebank' or the mutual guarantee society afford better conditions for a more regular flow of information.

9.3.3 Supply of medium and long-term credits

Structurally, SMEs tend to have more short-term than long-term loans, and a significant number of these enterprises cannot consider long-term loans as a source of funding. One of the main reasons seems to be their poor bargaining power when dealing with the banks and difficulties in meeting common banking requirements, in comparison with large enterprises. Credits tend to be only available when the necessary collateral is provided and this is less forthcoming for smaller businesses. Also, a recent survey¹ carried-out in Belgium revealed that SMEs themselves are often reluctant to use long-term loans.

Governments have therefore implemented a wide scope of programmes offering SMEs direct support and long-term loans, mostly under favourable conditions, thus permitting the financing of projects which would otherwise be frustrated by lack of resources. Thus, government-supported debt instruments are available in almost all countries and play an important role in SME growth.

Leasing is also a reasonable alternative to long-term banker's loans to finance². However, it is still a small proportion of total funds and there are significant differences among countries. Germany and the United Kingdom together represent more than 55% of the total equipment leasing operations in 1993 at Europe 16 level³.

9.3.4 Grouping solutions

The grouping of SME operations, aimed at promoting a 'scale effect', is rarely applied as a solution to the SME finance gap. This technique will however increase as co-operation activities between businesses increase generally.

Spain has created some restricted credit lines aiming to encourage co-operation among SME groups. The Mutual Guarantee Society constituted in Portugal last year, also fore-

¹ Van Caillis, D., Key elements for financial management in familial SMEs, Small Business Research Institute, Brussels, 1993.

² The European Observatory for SMEs, Second Annual Report, ENSR, 1994.

³ APELEASE, Portugal.

sees SME groupings for certain purposes, namely in commercial paper issues and hedging mechanisms.

9.3.5 Securitization of SMEs bank loans portfolios and other funding schemes

Securitization of portfolios of bank loans to SMEs involves common debt funds issuing marketable securities representing long term loans. This instrument is being gradually introduced in some countries (e.g. Spain). Where it already exists, however, (e.g. in France), this financial instrument covers very few loans to SMEs. In most countries, in fact, there is no legal facility for the instrument, making its use impossible.

With few other funding schemes being available, the European Investment Bank (EIB) provides 'global' loans to designated credit institutions. Linked to those credits, SMEs have access to a new facility, an interest rate allowance scheme based on their ability to create new jobs.

9.3.6 Guarantee requirements

SMEs that would not otherwise be able to obtain funding due to lack of collateral or absence of a track record, can benefit from state guarantee schemes offered in the United Kingdom, Ireland, Norway, Austria, Sweden, the Netherlands, Denmark, France, Germany, Finland, Belgium and Greece. The mutual guarantee system is also run in several countries, with the aim of increasing the enterprise's capacity to resort to external financing. Mutual guarantee societies act as intermediaries between entrepreneurs and financial institutions whilst also providing various forms of assistance, information and even training. There are mutual guarantee schemes currently in operation in France, Italy, Spain, Belgium, Germany, Luxembourg and these are expected to be established very soon in some other countries. The mutual guarantee scheme is currently in its implementation phase in Portugal.

EIB and the main European financial institutions recently set up the European Investment Fund (EIF). It is hoped that EIF will play an important role in providing support to SME financing by providing partial loan guarantees.

9.4 EQUITY FINANCING

The possibility of access to equity to finance SME expansion, are limited. Furthermore, the SME reality is that of highly concentrated ownership, with a desire to maintain independence.

9.4.1 Attitude towards opening up of business capital

Typical SME attitudes towards open up capital seem to range from neutral to negative. In a recent survey carried-out in Portugal¹, 35% of enterprises questioned were in favour of opening up capital, while in a survey in Belgium², showed that only 10.3% of enterprises are prepared to do so.

¹ Estudo de mercado, IAPMEI, Lisbon, 1994.

² Donckels, R., P. Michel, J. Degadt, and L. Bragard, Financial policy and financing of SMEs in Belgium, CBRA, Leuven, 1987.

New generations seem to have another attitude. According to a recent Swedish survey¹, one of the most important reasons entrepreneurs have for admitting new partners is to obtain additional skills. The study showed that between 70 and 80 per cent of SME respondents were willing to accept other enterprises in the sector or entrepreneurs with experience of the industry as partners. Within this scope, an interesting scheme was created in Denmark, combining equity capital investment in growth-oriented enterprises with industrial know-how. Thus, the so-called Development Companies have to use their know-how 'actively' as members of the board or as 'supporting managers'. The state will cover half of the possible losses on investments made.

9.4.2 Taxation policy

The taxation policy pertaining to equity (savings invested in SMEs, dividends and capital gains) is naturally a determining factor both for the enterprise and for the investor's decisions. Despite this conclusion, few fiscal initiatives have been taken at European level either in the reinforcing of the enterprises capitalisation or in the channelling of savings to SMEs. Measures to avoid the double taxation of dividends is one of the most important measures currently implemented. Special rules for retained profits reinvested in the enterprise are also currently being applied. The treatment applied by British tax authorities to equity investments in small enterprises, which are exempted from capital gains tax, is also worthy of note. To boost growth and employment in small enterprises, some countries have implemented special provisions such as lower taxation rates, simpler rules, and tax allowances for new enterprises registered.

9.4.3 Private investors ('business angels')

'Business angels', individuals who invest in unquoted growing SMEs on the basis of personal ties, are very common in some countries. 'Business angels' are characteristically self-made, high-net-worth individuals with backgrounds in industry and commerce, many of whom have had substantial entrepreneurial experience. They have a fair degree of financial sophistication and are capable of evaluating the merits and risks of prospective investments².

According to a study carried-out in Finland³, the willingness of private individuals to make informal venture capital investments could be encouraged through the following measures:

- establishing business introduction services to improve the flow and quality of information between businesses seeking finance and business angels.
- developing co-operation between venture capitalists and business angels.
- promoting syndication among business angels.
- developing indirect models to encourage investments in unquoted companies.
- taxation and guarantees.

¹ Olofsson, C., *Småföretagarens riskkapitalförsörjning*, Sweden, 1993.

² Kenny, S., *Financing Small and Medium-Sized Enterprises in Ireland and the European Union*, Dublin, Ireland, 1994.

³ Suomi, M. and A. Lumme, *Informal Venture Capital in Finland*, Sitra 141, Helsinki 1994.

In the United Kingdom, there is a privately produced document, issued at regular intervals, which contains details of a vetted list of enterprises looking to obtain equity finance. Prospective investors can then take things further by contacting the enterprise directly. As referred above, a government scheme encourages private investors to take equity stakes in small enterprises by giving 'generous' tax relief to investors. In France a recent law implemented a scheme comparable to the British one. Due attention must, however, be focused on potential perverse side-effects when implementing schemes of this nature as they can sometimes be used for investments with benefits different from those originally intended.

9.4.4 Venture capital activity

The total amount invested in the venture capital industry continues to grow. However it is fair to say that public sources have had a strengthening impact on the venture capital environment in most countries. For the venture capital industry the need for new sources of funding is one of the important issues.

Another main issue is that venture capital enterprises tend to invest primarily in growth/development enterprises, but not in wholly new start-ups. Structural solutions for the problems of highly leveraged enterprises also seem to be non-existent. State initiatives were created in France, Finland, the Netherlands, Norway and Sweden, with view to urging seed and venture capital societies to more easily grant necessary financial aid to SMEs in the different stages of their development, basically acting as a guarantee (generally at a 50% level) of equity funds. In Portugal and Greece, governmental agencies make instruments available to seed and venture capital operators in order to co-finance their investments.

9.4.5 Institutional investors

Very few institutional investors demonstrated significant activities pertaining to SMEs. According to a survey¹, most maintained a strategy of not entering this market for various reasons:

- Unfavourable conditions existed. Since great emphasis was put on liquidity, institutional investors chose other alternatives to SMEs.
- High risk aversion. Investors still had fresh memories of the disastrous late 1980s.
- It was considered too demanding and time-consuming to follow up these types of investments.
- Most investors maintained that the main problems concerned general conditions in the SME market, which lacks structure and developed networks.

A reference should also be made to the absence of significant data on those enterprises which might represent an interesting investment opportunity.

Because of a principle of not being represented among the investors, the banks would not get involved in SMEs. Even merchant banks, when these exist, mainly operate on the traditional supply of credit lines, and only provide development capital in larger

¹ Norwegian Venture Capital Association, Norway, 1993.

amounts than most SMEs require or can justify. Banks also argue that they don't have the expertise to manage enterprises, thus precluding equity participation.

9.4.6 Access of SMEs to the stock markets

To reduce some of the disadvantages confronted by small enterprises when raising external equity, second-tier markets were set up in most of the European countries. The requirements for being quoted on these markets are less stringent than those which apply for regular listing. This may create a marketplace for holdings in small enterprise shares that will be more liquid and easier to price. However, these experiments have generally failed, resulting in low levels of liquidity, limited interest of investors, issues and market players¹.

However, the recent boom of investment in emerging stock markets clearly illustrates how investors will not be deterred by lack of liquidity, language difficulties, accounting standards, currency risk or other barriers if they consider the growth prospects to be sufficiently attractive².

The climate for revitalising second-tier markets is becoming increasingly favourable. A project for a pan-European capital market for SMEs, on the lines of NASDAQ, has been discussed among the financial community. SME investments could be interesting in the future if the general conditions were to change, especially with improved chances of trading a security that is sufficiently liquid, on the basis of available information, a prerequisite which often cannot be satisfied at national level.

9.5 MANAGEMENT CAPABILITIES

Banking services and innovative finance tools are less used by SMEs than by larger enterprises. One interpretation of these conclusions may indicate that the smaller enterprises have a lack of ability to make use of, and benefit from, the different services provided by banks. Problems with managerial skills in small firms are exacerbated by the lack of a management team, which allows specialisation³. In several countries, the lack of financial knowledge is felt mainly outside main cities, where most of the entrepreneurs prefer to handle the financial aspects of their SME by themselves.

With the greater offer of graduates and the rejuvenation of the entrepreneurial structure, the situation has undergone a significant improvement. Training actions, including financing, are supported in almost all the different countries. These initiatives were set up in response to empirical evidence suggesting that the likelihood of business survival rose significantly in enterprises where training was undertaken. One may foresee that survival is in fact explained by human capital, and lenders have an incentive to lend to longer surviving businesses since they are more profitable to the lender, regardless of the existence or otherwise of capital constraints⁴.

¹ Graham Bannock & Partners, European second-tier markets for NTBFs, August 1994.

² EVCA, Capital Markets for Entrepreneurial Companies: A European Opportunity of Growth, February 1994.

³ Hutchinson, P., A review of financial management from a small enterprise perspective, 1994.

⁴ Cressy, R., Are Business Start-ups Debt-Rationed?, CSME, Warwick Business School, the United Kingdom, 1994.

Managers got used to obtaining the information and advice from accountants and the banks or through their business associations, the chambers of commerce, the innovation centres, the mutual guarantee societies, the business links, or by approaching private organisations. Agencies for SME support and a number of government funded consultancies, take initiatives to create optimal conditions for the development of small business. The regional governments in Belgium provide consulting services at lower costs for SMEs. According to a survey carried out in Austria, about half of all SMEs have never used management consulting in spite of public promotion¹.

There are increasing links between universities and private sector enterprises on a variety of levels. One common scheme, places graduates in enterprises to learn management and technical subjects. There has also been a dramatic expansion in the number of specialist executive development programmes in business schools.

Companies must actively seek the competence they need. In financial matters as in other areas of business, increased competence will be one of the main competitive advantages, this is also true for small and medium-sized enterprises.

¹ Mugler/Lampe: Betriebswirtschaftliche Beratung von KMB in: Betriebswirtschaftliche Forschung und Praxis, 3 JG, 1987.

10 INFRASTRUCTURES

Co-ordinated by Instituto Vasco de Estudios e Investigación (IKEI)

MAIN POINTS

- The huge amount of investment necessary to set up a trans-European infrastructure network offers both great opportunities and challenges for SMEs. The most directly affected will be the enterprises in the construction and public engineering sectors, but through these infrastructures the entire economic and social system will be affected.
- In addition to the construction effect, the infrastructure has a positive effect on productivity and consequently in the growth potential on the long run. The effect on productivity depends on the situation in each country, the type of infrastructure and the presence of an adequate economic fabric.
- The less advanced countries of the Union (Portugal, Spain, Ireland and Greece) have important deficiencies in terms of not only the quantity, but also the quality, of their infrastructures.
- The most advanced and rich cities are endowed with ample and high quality infrastructures, but they are reaching a dangerous level of saturation (especially roads) which threaten to jeopardise their effectiveness.
- In a long run vision, special attention should be paid not only to the traditional physical communication infrastructures, but also to energy, the special infrastructures that support enterprises (like technological parks, venture capital and incubators for new firms) and especially to the rapidly developing information technology and telecommunications infrastructures.
- Nowadays we are assisting to a technological revolution -the Information Revolution - which is changing (and it will change even more) our society in all its aspects: education, way of life, and also the production method.
- The enterprise, and the SME in particular, faces new strategic challenges through information technology. This can provide new business opportunities, in the telecommunications sector itself and in new services and products based around it, and there will be more opportunities for SMEs in an enlarged subcontracting market. The relationship with the public sector, presently a burden on SMEs, will be improved through electronic communications that minimise the duplication of information, and enable the public sector to better serve SMEs with the provision of information.

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- The importance of information technologies to enterprise appear to be obvious, but their use amongst SMEs has not extended far. The reasons for this is their internal weaknesses linked to their small size: they do not have the human or financial resources required, but external elements like the infrastructure's deficiencies and the lack of services specifically designed for SMEs are also important.

10.1 INTRODUCTION

This is the first time that the SME Observatory has analysed infrastructure and its impact on enterprises. There are three main reasons for including this issue in the Observatory: firstly, a good infrastructure is a basic necessity for enterprise; secondly, infrastructure indicators are a useful instrument by which to monitor the harmonisation of the Internal Market; and thirdly, the development of the information and communications revolution, with its associated infrastructure, is affecting all our lives.

The chapter is divided in three sections: the first and second sections cover the physical transport infrastructures and their impacts on SMEs, whilst the last section concerns information technology and developments in telecommunications.

10.2 INVESTMENT IN INFRASTRUCTURES

There is a clearly acknowledged need at the Community and national levels to develop an effective Trans-european and multi-modal transport network with management services which will assist the development of the national, and regional economies, and the single market.

To this end, last July the Commission presented guidelines for the construction of a European Transportation network¹. These guidelines proposed an investment of at least 400,000 MECU in infrastructure over the next 15 years, at the end of which the EU will be crossed by a dense network of railways (70,000 km of which 23,000 would be high speed lines for trains travelling at more than 200 km/h), roads (58,000 km, of which 15,000 would be motorways), maritime ways (12,000 km), harbours, and airports, and there would be the management and traffic control systems necessary to harmonise the entire network.

With this huge investment in prospect, analysis of its impact on the whole economic and social system, on enterprises in general, and on SMEs in particular, is pertinent. For enterprises infrastructures are a determining factor for commercial activity, the geographical division of production and therefore the means of production, and of the geographical nature of markets. Infrastructures are directly relevant to costs, through transportation

¹ COM(94) 106 final, Propuesta de DECISION DEL PARLAMENTO EUROPEO Y DEL CONSEJO sobre las orientaciones comunitarias para el desarrollo de la red transeuropea de transporte (proposal for a European Parliament and Council Decision on Community guidelines for the development of the trans-european network Codecision Procedure Initial proposal). Brussels, 07.04.1994. 94/0098 (COD).

costs, but also affect the development capability of firms and consequently their competitiveness.

The large infrastructure investments proposed will obviously raise the demand in the construction and the civil engineering sectors, and those sectors closely connected to them, but it will ultimately benefit all the productive sectors. For enterprise, and SMEs in particular, infrastructure investments offer new opportunities, and new challenges, if firms are to maximise their benefit from these investments. In Spain it is estimated that an investment increase equivalent to a one percent of GDP generates an additional annual increase in GDP of between 0.6% to 0.8%¹. In the Netherlands it is estimated that the 24,000 MECU to be invested in Amsterdam's Schiphol airport between 1992 and 2015 will create 74,000 new jobs and will generate 52,000 MECU of extra GNP².

This does not mean however, that only enterprises within the country or region where the investment is made will benefit from the new infrastructure. The increasing internationalisation and competitiveness of world markets means that new infrastructure provides opportunities for external enterprises as well, through market entry and greater penetration. In general larger enterprises benefit more directly from such developments, but smaller enterprises can also gain through subcontracting.

Apart from the direct effects of construction, a debate exists about the effect of public investment on private and global productivity, and on the long run growth. This long-standing debate received new impetus with a controversial article by Aschauer in 1989 who claimed that American data for the period 1949 to 1985 showed a strong positive relationship between public capital investment, with infrastructure having the strongest effect, and the productivity of the whole economy. Other authors have supported this hypothesis using different data sets³. For Spain, Argimón et al⁴ show (with data from 1964 to 1990) a significantly positive output elasticity with respect to public capital investments (0.6), and that public investments in infrastructure have a positive impact on private productivity. A similar study in Denmark found (with data from 1970 to 1991) that an increase in public investments of 1% led to an increase in productivity of 0.20% within the private sector⁵.

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¹ Forecast presented by The Spanish Infrastructure Master Plan (PDI) 1993 2007. Ministry of civil engineering and Transportation (Ministerio de Obras Publicas y Transporte), 1993, based in the MOISEES model of the Spanish economy.

² Concurreren met infrastructuur: Nederland Distributieland, 1992.

³ Munnell, A. H. 'Infrastructure Investment and Productivity Growth'. Journal of Economic Perspectives, 6(4), pp. 189-198, 1992.

⁴ Argimón, I, J.M. González-Páramo, M.J. Martín, J.M. Roldán, 'Productividad e Infraestructuras en la Economía Española' Documento de Trabajo N° 9313, Banco de España, 1993.

⁵ The Trade Review, The Danish Ministry of Business and Industry, 1993.

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The relationship in Sweden was not as strong, but Berndt and Hansson proved that infrastructure investments reduced private costs, even though in 1988 Sweden's public capital in infrastructure was above its optimal stock¹. Furthermore, Seitz has estimated shadow prices (the cost reduction caused by the provision of new infrastructure) for 31 manufacturing industries in Germany. The results illustrate the impact of new motorways on private industrial costs. He found that the average costs of producing on output equivalent to 1 million DM decreases by about 32 DM if the motorways network is expanded by one additional kilometre.

These results are however not uncontroversial and other researchers claim that the effects of infrastructure on productivity could be subject to decreasing returns depending of the initial infrastructural endowment, and some even claim that the estimated relationships are simply spurious correlations².

Without a reference to particular countries and their infrastructures it is difficult to take a definitive position in the debate referred to in the text boxed above. Macro-economic studies are too general and it is necessary to consider detailed micro-economic studies that take into account the characteristics (the quality and technical nature) and type of the infrastructure, as well as the size and sectoral distribution of the industries affected by them. The next section will examine infrastructural developments from a more specific and localised perspective.

10.3 THE EFFECTS OF NEW INFRASTRUCTURES

The impact of new infrastructure on the total productivity of the economic system depends on multiple factors. Among these three are the most relevant: the starting point, or 'the initial infrastructural endowment'; the type of infrastructure being considered; and the existence of a dynamic and productive fabric able to exploit it.

The initial infrastructural endowment.

In those countries or regions deficient in a new infrastructure, or in the maintenance of their existing infrastructures relative to the demand for it, improvements to the infrastructure should lead to productivity gains in enterprises³ and there is likely to be considerable associated employment generation, especially in SMEs. The more peripheral countries

¹ Berndt, E.R. and B. Hansson, 'Measuring the contribution of public infrastructure capital in Sweden'. NBER, Working Paper, N° 3842, September, 1991.

² Tatorn, J.A. 'Public Capital and Private Sector Performance'. Federal Reserve Bank of Saint Louis, Review 73(3), May/Jun, pp. 3-15, 1991, with American data and Ford, R. and P. Poret 'Infrastructure and private sector productivity' OECD Economic Studies 17, 1991, with data of OECD countries from 1957 to 1989, showed that infrastructure is a significative determinant factor on total productivity only in 5 out of the 11 countries considered.

³ Morrison, C.J. and A.E. Schwartz, 'State Infrastructure and Productive Performance'. NBER, Working paper N° 3981, 1992.

of the EU, where Objective I regions have a strong presence, exhibit important infrastructural deficiencies, not only in terms of quantity, but also in terms of quality (see chapter 4 on Regional disparities). These deficiencies are illustrated by a comparative analysis of the roads, railways, and telephony infrastructures in the EU Member Countries.

Roads

While Luxembourg (20.31 km), Belgium (16.33 km), Germany (14.04 km), Denmark (12.33 km) and France (11.99 km) had more than 11 km of motorways per 100 inhabitants in 1990¹, Portugal and Spain had slightly more than 3 and 6 km per inhabitant respectively, whilst Greece (0.89 km) and Ireland (0.73 km) have extremely low levels of motorway development with less than 1 km per inhabitant, and in Greece 8.3% of the total road network is unpaved. These differences are not just a matter of quantity, but also of quality. A similar pattern is found if the accident ratios are taken as an index of the quality of the road network. However, as the countries converge in welfare terms they will also converge in terms of infrastructure. For example, through huge national and EU investments 529 and 734 new km of motorways were constructed in Spain and Portugal respectively between 1986 and 1992.

Railways

The difference between countries in railways is not as dramatic but there is a clear gap between the central and the peripheral countries of the European Union, especially in terms of the quality of the infrastructure. For instance, Ireland and Portugal lag the EU average in terms of the proportion of electrified lines, whilst there are no electrified lines at all in Greece, and these three countries together with Spain also lag in terms of their percentage of double or multiple tracked lines over their total networks.

Telephony

The pattern described above clearly repeats itself for telephony. The most advanced countries have more than 45 main telephone lines per 100 inhabitants, whilst countries like Portugal, Ireland or Spain have less than 40 lines per 100 inhabitants, well below the EU 12 average (44). The difference between countries is not only a matter of penetration, but also of network availability and quality: the average connection time to the network in Greece can be measured in years, with Portugal and Spain also under the EU average despite improvements in recent years. Due to large investments the gap between countries is rapidly being reduced: Portugal had the highest average of telecommunications investment as a proportion of GDP between 1987 and 1991 (1.18%), it has had the largest annual increase in the number of lines per inhabitant (12,1%) and had caught up with Ireland and Spain by 1993. Spain and Ireland are the next fastest growing countries in telephony (in terms of the average growth rate of in the number of lines). A similar pattern exists in digitalisation, perhaps the best indicator of quality, with Portugal and Ireland digitalising at the fastest rates.

¹ Data from Eurostat. Transport Annual Statistics 1970-1990. Similar ranking is reached, using a ratio of motorways by square km.

Cellular or mobile telephony, one of the most direct applications of new technologies is growing rapidly in all countries, but the rate of penetration differs. The outstanding ratios of Finland, Sweden and Denmark show more than 40 terminals per 1,000 inhabitants, and contrast with Greece which has less than 1 terminal per 1,000 inhabitants. The GSM (digital cellular telephone) is already operational in all western European countries except Spain, where it will become available in 1995. The GSM initiative provides a pan-European infrastructure for the use of mobile phones throughout Europe for voice and data communications. The GSM is of great practical value to business and it has been estimated that the potential market in Europe is more than 20 million subscribers by the year 2000. There were about 2 million subscribers in 1994.

Table 10.1 Telecommunication Indicators

Country	A	B	C	D
Belgium	42.6	50	6.2	0.40
Denmark	58.1	34	40.3	0.45
France	52.1	79	8.1	0.52
Germany	44.0	n.a.	10.9	0.80
Greece	43.7	6	0.0	0.57
Ireland	30.9	63	11.7	0.63
Italy	41.0	n.a.	14.5	0.55
Luxembourg	50.1 *	n.a.	2.3	0.60
Netherlands	48.7	n.a.	11.2	0.51
Portugal	30.6	34	5.9	1.18
Spain	35.3	41	4.6	1.13
United Kingdom	45.7 *	55	25.0	0.60
EU 12	44.0	n.a.	12.5	0.66
Austria	44.0	40	28.1	n.a.
Finland	54.4	62	97.6	n.a.
Norway	52.9	59	85.6	0.64
Sweden	68.2	70	90.8	n.a.
EFTA-4	55.6	60	72.2	n.a.
Europe 16	44.8	n.a.	16.7	n.a.

A. Lines per 100 inhabitants at the beginning of 1993.

B. Degree of digitalisation (% of main lines connected to digital local exchange) in 1992.

C. Mobile telephone lines per 1,000 inhabitants in 1993.

D. Telecommunications Investment as a percentage of GDP, average from 1987 to 1991.

* Data at beginning of 1992.

Source: A: ITU Statistical Yearbook 1992, Geneva 1994. B, C and D: Ewbank Preece Ltd. Analysis of statistical indicators of telecommunications in the less favoured regions 1993, and own elaboration.

Some more advanced countries and especially their largest cities can face different problems in terms of infrastructure not only in relation to the peripheral, less developed countries, but also when compared with other advanced countries. For example, Sweden, Finland and Norway have particularly good and well planned infrastructural systems

without immediate danger of saturation¹, but other advanced countries with well developed infrastructural networks are in danger of reaching a saturation point, especially on roads, which will jeopardise the effectiveness of these systems. A recent study carried out in Brussels² interviewed 552 entrepreneurs with 50 or less employees and found that 43% think that Brussels is a good place to run an SME (with smaller SMEs and those providing personal services the less optimistic) but 58.5% thought that the principal infrastructural problem was congestion, and 46% thought that a shortage of parking space and busy traffic were serious inconvenience factors.

For society in general, and enterprise in particular, this congestion is dangerous as the competitive advantage of local areas, nations, and the Union as a whole, can be damaged by congestion. The solution to this problem will require originality as building more and larger roads is only likely to defer the problem for a few years, meaning more pollution, land consumption, and inefficient energy consumption, all bought through large public works programmes. Planned solutions need combined investments in new infrastructure to overcome particular bottlenecks with other measures like further incentives to use public transport, direct charging for the use of infrastructures (tolling), new traffic regulations, stimulating the 'pooling' of private cars, teleworking, and improving technology that lowers congestion through improved circulation. Such measures are likely to arouse public hostility at first but are necessary to make efficient use of public resources for improving the competitiveness of the region, the country, and the Union. A good example of just such a policy was the infrastructural reconstruction of an area of Amsterdam in 1985 which led to dramatic improvements in traffic circulation and made the area a more attractive commercial sector, with public recognition of the social benefits³.

The type of infrastructure is another element which has an explicit effect on the social benefits of infrastructure investments. Apart from the traditional physical communications infrastructures, attention should also be paid to energy, the support infrastructure for enterprises (like technological parks, venture capital and incubators of new firms), and to the rapidly emerging telecommunications and information infrastructures. Developments in information technology have already affected, and will change further, the structure of economies and the way of life. The emergence of new possibilities will further transform society. The next section will assess information technologies.

Finally, the presence of an adequate economic fabric in the region is a key factor for the impact of new infrastructure. The creation of infrastructures does not directly imply the formation of new enterprises, or a decrease in national or regional disparities. There is now agreement amongst experts that infrastructure is a necessary but not sufficient

¹ The transit traffic - specially the trans-Alps traffic - is a very important issue for Austria. It damages the environment and enters in contradiction with tourism and other economic activities. Moreover the drastic increase in cross border traffic with Eastern Europe calls for further developments in transportation and telecommunications infrastructure along and beyond the EU's border with Central and Eastern Europe. The EU's decisions on this matter, will affect Austrian SME export performance and regional development.

² Donckels, R., M. Cottyn, and J. Lambrecht, *Hoekstenen voor een specifiek Middenstands- en KMO-beleid in het Brussels Hoofdstedelijk Gewest (Cornerstones for specific SME policies in the Brussels region)*, Small Business Research Institute, Brussels, 1994.

³ For details see KVK Amsterdam (Chamber of Commerce Amsterdam); *Reconstructie: Regulatorsbreestraat Rembrandtsplein evaluatie-onderzoek*; April 1989.

condition for economic development. Infrastructures by themselves are not enough to generate wealth if there is no pre-existing social and productive fabric able to exploit it. A large literature warns of this¹. Furthermore, it is not difficult to find examples of how infrastructures have been used in ways other than intended due the fallacy of infrastructure led developments. For example, the creation of a high speed rail link was supposed to generate enterprises and employment in the areas between Paris and Lyon, but instead it resulted in more commuting to work in Paris from these areas. Also, the analyses carried out to analyse the estimated impact of The Great Belt Link (a combined motorway and rail system between Eastern and Western Denmark that will soon be complete) shows that the largest gains will occur in Greater Copenhagen, while smallest benefits will be experienced by the peripheral counties like West Zeeland, Bornholm, and Southern Jutland, which were supposed to benefit. This said, the conjunction of an advantageous geographical position, good infrastructure, and with an availability of high quality human capital provides the seed for the creation of important and attractive zones. Flanders has a very high concentration of foreign investment which reflects its geographical, infrastructural, and human assets: it is located at the heart of Europe with a dense railway network and three major international highways cutting through the region, these are complimented by the important seaports of Antwerp, Gent and Zeebrugge, and by Brussels international airport, a European hub for many international freight couriers².

10.4 INFORMATION TECHNOLOGY AND SMEs³

A strategic and future vision of the infrastructure framework can not be based on the physical infrastructure alone. We are now in the midst of a technological revolution based on information technologies which is changing, and it will change further, our society in all its aspects: education, the way of life, and the methods of production⁴. It is no longer a nonsense to speak of information super-highways as these exist, have welfare and wealth creation implications, and provide a new vehicle for entrepreneurial activities unknown or unthinkable just a few years ago. It is no longer rare to see teleworking with geographically distant research groups working together, or small enterprises collaborating on a common product and communicating by information technologies.

From a broad perspective there is not a great conceptual difference between traditional infrastructures and information technology. Even the name 'information superhighways' recalls the terminology of traditional infrastructures. Telecommunications is a transport mode for information, a 'good' with increasing strategic value: 'What telecommunication

¹ See for example Bielh, D. (ed) 'Infraestructuras y Desarrollo Regional'. Papeles de Economía Española, 35, pp 293-310, 1988, or Ryntveit, L., 1993. Study by Transportøkonomisk Institut who asserted that there is not a significant connection between improved infrastructure and regional economic structure and creation of new firms.

² Among the 4 more frequent determinant factors named for establishment of new industries - market proximity, quality and availability of workers, adequate infrastructures and quality of life - one is the infrastructure itself and other, market proximity, depends upon and is clearly connected to infrastructure.

³ Useful comments to this section have been made by mr. Leo Pennings, NBBI Project Bureau for Information Management, The Hague, The Netherlands.

⁴ 'Throughout the world, information and communications technologies are generating a new industrial revolution already as significant as far reaching as those of the past'. Europe and The Global Information Society (known as the Bangemann Report, 1994).

does is to transmit information, making possible flows of information exchange and treatment of information, regardless of distance, at lower cost with shorter transmission times.¹ Furthermore, telecommunications can be considered to be more than an additional mode of transportation, they also provide an alternative mode to the traditional means. The clear advantage of this new mode is its great ability to manage enormous quantities of information in very small periods of time.

In all countries the telecommunications sector, the starting point and base of the information revolution, is undergoing dramatic structural changes. The telecommunications sector has been largely dominated by public or semi-public companies which operated monopoly or highly protected markets within their own countries. The premier service was voice telecommunications based in analogue circuits. With the diffusion of micro-computers, electronics developments, the penetration of fibre optics, satellite and microwave communications, mobile and cellular telephony, and cable television, a vast array of new services have been developed. These have disrupted the traditionally monopolised and highly protected nature of the sector.

Following the guidelines of the EU there is a requirement that the telecommunications sector moves towards liberalisation, this will speed up the creation of an information society capable of improving the life quality of European citizens². Countries have to deregulate their telecommunications markets and repeal protective legislation, with a commitment to fully liberalise the voice telephony market by 1998 (with a longer period for Greece, Ireland, Portugal, Spain and Luxembourg) and a Trans-european Telecommunication System will be established in the spirit of the Delors White Paper, which will encourage the development and use of the most advanced telecommunications services to improve competitiveness.

Enterprises, and SMEs in particular, face new challenges and new opportunities through the developments of the telecommunications sector and the new services and products based around it. These new technologies have implications for companies' competitiveness through improvements to their final products or services, reductions in their internal costs, and the greater availability of strategic information that enables more efficient management.

Advantages are not limited to individual enterprises, the new information technologies open the door to new and modern modes of production in which the value chain is much more decentralised. This offers opportunities to SMEs through greater subcontracting where the flexibility of smaller firms combines with the market potential of the larger enterprises. These longer production chains are only possible with a developed and flexible communications systems which includes both telecommunication and the physical infrastructure.-

The relationship with the public sector, a particular problem for SMEs³, will improve through using advanced telecommunications, firstly, through reduced duplication on bu-

¹ Castell, M. *The Informational City: Information Technology, Economic Reestructuring, and The Urban-Regional Procces*. Basil Blackwell, 1989.

² COM/94/347/fin, 1994/07/19/21p. *Europe's way to the Information Society. An action plan. Communication from the Commission to the Council and the European Parliament and to the Economic and Social Committee and the Committee of Regions.*

³ See also Chapter 14: Administrative Burdens.

reaucratic forms, secondly, through better access to public services, and through better and broader information provision by the selected diffusion of information using electronic mail or electronic tendering.

The importance of information technologies to enterprises appears to be obvious. However, their adoption by SMEs has progressed very far. The reasons for this are SME's internal weaknesses, linked to their small size. SMEs often do not have the human resources to comprehend and benefit from the new technologies, and many SMEs lack the financial resources to pay the high costs of some of the new services. It should be stressed that costs of purchasing hardware and software are not high, and neither are the costs of transmitting messages. What could be high are the extra labour costs for SME's own personnel, especially the initial costs (training, re-organisation of the work, etc.). In some cases it might be more efficient to make use of information intermediaries. A new technology such as the mobile telephone has potential benefits for enterprise but it will only be incorporated if these additional benefits outweigh the additional costs. Apart from the internal factors there is also external factors which directly influence the use of advanced telecommunications by SMEs: these include the infrastructure's own deficiencies and the lack of services specifically designed for SMEs.

In general it is large enterprises that benefit first from organisational and process innovations, but SMEs can still gain through the diffusion of information technologies. However many SMEs are not sufficiently aware of the availability of all the various electronic information services and products. There is also a lack of insight into the possibilities and means exploiting these services and products¹. The effect of these developments on an individual SME will depend on its attitude and ability to adapt, but the public sector can play a role by stimulating adoption through offering instructions to entrepreneurs about the possibilities of these new technologies, and by establishing standardised connection criteria of networks, services, and applications.

In the northern countries of the EU a lot of experience has been gained in developing information infrastructure, including these for SMEs. It would be worth exploiting these experiences to speed up the development of information infrastructure in southern countries.

¹ See for instance: EIM Small Business Research and Consultancy/NBBI Project Bureau for Information Management: *De informatiebehoefte van het MKB in de toekomst (Future information needs of SMEs)*, Zoetermeer, December 1991.

As a simple illustration, the table below presents the potential of information technologies and telecommunications in a variety of sectors in which SMEs play an important role (The strategies mentioned are specifically related to SMEs). Clearly almost any economic activity can use these valuable tools to improved their competitiveness:

<p>Leather, shoes, wood, furniture, textile and ceramic products</p> <ul style="list-style-type: none"> . CAD (Computer Aided Design) . Electronic quality systems. . Automation of productive systems. . Electronic system for warehouses control and its integration with production and commercialisation. . Computer terminals for data transmission to suppliers and sales points. . Electronic mail to improve subcontracting. 	<p>Freight Transportation</p> <ul style="list-style-type: none"> . Automatic captures systems about orders and fleets . Telecontrol of vehicles and merchandise. . Planning and path automation. . EDI. . Teleaction for stock control and management.
<p>Tourism enterprise</p> <ul style="list-style-type: none"> . Increasing participation on electronic reservation (access, promotion, reservation and invoicing of services) . Electronic money (extensively used in the sector) . Teleaction for building security and control. . Mobile communications and services of personal localisation. 	<p>Distribution</p> <ul style="list-style-type: none"> . Electronic money. . EDI with suppliers and clients . Electronic bar reading. . Integrated management (identification of sale products, automatic warehouse and stock control, sales forecasting, etc.)
<p>Car and Aeronautic Industry suppliers</p> <ul style="list-style-type: none"> . Productive systems automation (Automatic control of quality parameters, CAD and its integration within the productive system, Electronic mail and EDI to improve technical and commercial relations). 	<p>Engine tools</p> <ul style="list-style-type: none"> . Electronic mail to improve subcontracting relations. . EDI . CAD/CAM and video-conferencing.
<p>Electronic Components</p> <ul style="list-style-type: none"> . EDI, video conferencing, electronic mail and other electronic exchange systems which allow a better integration of the production system. 	<p>Printer and graphic industries</p> <ul style="list-style-type: none"> . Computer edition and electronic exchange of information (files exchange, electronic mail, EDI) with clients . automatic management of the production system.

Source: Own elaboration from Tirado, C. 'Las tecnologías de la Información y la Competitividad de las Pequeñas y Medianas Empresas', Fundesco Noviembre de 1994.

Of the ten applications proposed in 'Europe and The Global Information Society'¹ as the most effective for the stimulation of the Information Society, a number were specially designated to suit the needs of SMEs: teleworking (20 million teleworking jobs are forecast by the year 2000), distance learning (10% of SMEs and the public sector using this

¹ Bangeman Report, op. cit.

by 1996), electronic tendering (10% of awarding authorities using electronic procedures for their procurement needs in the next two to three years)

Distance learning

SMEs make more use of external training than large enterprises do¹. The new information and telecommunication technologies therefore offer a useful instrument to assist SMEs with their training needs which can help prepare the enterprise for a fast changing world. The flexibility and efficiency of the training are the two key factors as every SME is different and has different requirements, but distance learning also promises to be a means of lowering training costs, with access to ample, diverse and good quality teaching.

Teleworking

One of the major contemporary problems is an adequate physical infrastructure that avoids congestion in major cities. Teleworking, or decentralised work using telecommunications, is a new way to tackle this old problem². Teleworking is also a new tool for regional development and for increased flexibility in the labour market: it enables greater full and part-time work for people with disabilities or people with other responsibilities, such as child-care. Previously, the nature of the physical infrastructure, and the need to travel to work, barred many such people from participating in the workforce, but they can now work from home. Despite its attractions and opportunities, teleworking also posed potential problems through the threat of social isolation, the changing nature of labour relations, changes to the process of control over production, and other issues related to working conditions and wage discrimination.

In 1993 the estimated number of teleworkers in Europe and USA was 711,000, and it is expected that this figure will have more than doubled by 1995³. Teleurba is a teleworking project which will be carried out simultaneously in Madrid, Amsterdam, London, and Paris to study pilot centres with computers and telecommunications equipment. More than 2,000 people will work in these centres and will do their jobs without commuting to their work places⁴. In Madrid alone it is estimated that if 5% of the workforce employed in the tertiary sector used teleworking it would be possible to save more than 28,000 ECU transport costs, 3.7 MECU in energy costs, and to reduce the emission of pollutant gases by 800 tonnes over a year⁵. Smaller enterprises can benefit from teleworking from centres which provide equipment as they would have to invest in their own equipment or

¹ See The European Observatory for SMEs. Second Annual Report, 1994.

² Usually the enlargement or creation of new infrastructures is not a complete solution to the congestion problem: A new road, alleviates the obstacle in the short run, but at the same time it attracts new car users.

³ Data cited from Ovum Consultancy in Sánchez, F. 'Informática + Telecomunicaciones = Teletrabajo. La oficina virtual'. Mobile Computing (PC WORLD supplement), nº 105, Dec 1994.

⁴ For more information about actions and telework projects carried out in Europe, see Commission of The European Communities, DG XIII. 'Actions for stimulation of transborder telework and research cooperation in Europe. Accompanying measures and preparatory actions related to development of advanced communications' 1994.

⁵ Data cited in González, J.C. 'Companies sense oficines. El teletreball substitueix el desplaçament al lloc de treball per la connexió telemàtica' Tecno 2000, Nº 62, 1994.

human and technical resources required to run it. In Norway the telephone company's research institute started the Virtuel Bedrift (Virtual enterprise) project in 1994, the objective of this is to provide seamless integration between enterprises and units of enterprises. A fully operative system will make co-operation in geographically distributed organisations considerably easier, especially for SMEs.

Electronic tendering

Not only SMEs but enterprises in general can benefit from a more flexible way of accessing public sector tendering. The public sector will also save resources by accessing a larger and more competitive set of tenders. At Union level a pioneering example is DG XIII's 'TED' data base which contains information about public contracts in the Union, Member States, from GATT, EFTA, Japan, projects financed by the EDF (European Development Fund), and countries in Africa, the Caribbean, and the Pacific area.

National initiatives also exist. In Greece EOMMEX has recently established a National Information Network for Public Procurement with the objective of providing not only information, but also organisational support, and to follow up Greek SMEs participation in national and foreign public tendering. Another example is in Spain where the official State Bulletin (BOE; Boletín Oficial del Estado) which contains information about public tendering is now supplied on line.

Telematic networks

Telematic networks offer greater possibilities to the entrepreneur. The idea is that by the personal computer, a progressively more universal writing and calculating tool, individuals can contact each other by electronic mail, seek co-operation from other enterprises, seek for new clients, send orders to suppliers, consult their bank accounts, seek information on public tendering, get information from data bases, and all without geographical limitations.

Case A

One illustrative case is the well-known French MINITEL system. The range of services for enterprises and persons is impressive 'almost anything is possible with a MINITEL'. For example, SMEs can manage their bank accounts, buy train tickets and edit their wage bills (fiche de paie). They also have access to lots of information services such as data bases on public and regional support, information on new regulations, and on the Internal Market. SMEs can also consult public procurement tenders, the trade mark register, and the register of enterprises (SIRENE). They also have access to several data bases on French and other European enterprises from which they can realise their commercial mailing. Some of these data bases include financial information such as annual accounts and the main financial ratios.

Source: APRODI.

Case B

In the Basque Country of Spain the SPRI (Sociedad para la Promoción y Reconversión Industrial; Industrial Promotion and Reconversion Society), is using the SPRITEL programme which is an example of how information technology can provide regional support to SMEs. Since its creation in 1989 SPRITEL's main objective has been to encourage the use of telematics among enterprises, particularly SMEs. It offers its own services like electronic mail (amongst the SPRITEL members and, through the INTERNET, to the rest of the world), discussion groups and conferences on various subjects, and telex and fax services are also available. Besides this, SPRITEL operates as a gateway to other services like databases (connections to the world's main information brokers like DIALOG or BRS), tele-banking (the principal Spanish banks offer their services through SPRITEL), stock market information, access to other telematic networks such as COMPUSERVE with practically world coverage, and the access to public services (mainly databases and information about public services and subsidies for enterprises). In 1994 the service was used by about 1,100 enterprises and had more than 1,700 individual users. It has helped advance networking as a means of doing business.

11 TECHNOLOGY AND INNOVATION

Co-ordinated by Bocconi University, Centro Studi sull 'Imprenditorialità' Furio Cicoqna

MAIN POINTS

- The development and adoption of new technologies are increasingly important for the competitiveness of SMEs. However, traditional industries follow an innovative path which is different from that followed by SMEs in high-tech industries. Whilst, the former rely on technological change embodied in new machinery and capital equipment as a source of innovation, the latter display a significant commitment to autonomous R&D activities.
- Analysis of the sectoral distribution of product innovations developed and marketed by SMEs demonstrates that these enterprises, although still lagging behind larger ones in terms of technological capability, appear to be more innovative than is suggested by their R&D activities alone.
- Location factors affects the innovativeness of SMEs. SMEs located in areas of industrial agglomeration, or 'industrial districts', seem to benefit from easier access to relevant technological information and the presence of high-skilled workers specialised in the industry that dominates the area. The finding applies to both traditional and high-tech industrial districts.
- Regional policies aimed at stimulating or subsidising technology in SMEs can enhance the favourable environmental conditions which are likely to improve the technological ability of smaller enterprises.
- Participation in European RTD programmes represent an important incentive to the direct undertaking of R&D activities. In this respect, such programmes are likely to improve the autonomous capability of SMEs, which in general is low.

11.1 INTRODUCTION

This year the chapter on innovation deals with the technological performance of European SMEs and with the environmental factors which affect the innovative activities of SMEs. It will be argued that the level of innovation in small enterprises from different industries (with a different approach to innovation) will vary according to the indicator used in the analysis. For instance, the 'traditional' R&D indicators underestimate the innovative activity of SMEs in consumer goods industries, but whereas they provide reliable figures for Small Technology Based Enterprises¹ (STBEs). It is therefore suggested

¹ STBEs: Those innovative start-ups and established firms mostly in high-technology industries with their own autonomous R&D activities.

that policy makers pay attention to the specific features of innovative activities in different industries, in order to design the policies which provide the most effective support.

This chapter builds on the Innovation chapter in the Second Annual Report, by paying more attention to inter-industry differences, and to the industry-specific and location factors which affect the actual organisation of innovative activities. The chapter starts by (in section 11.2) summarising the pattern of innovative activity as suggested by the 'traditional' R&D indicators, In section 11.3 the results arising from direct innovation output indicators in a selected group of European countries are analysed, which allows a comparison of the innovative performance of traditional and high-tech SMEs. Section 11.4 deals with the influence of the business environment on SMEs innovative activities within some European regions, and section 11.5 describes national and regional policies and programmes aimed at creating an environment favourable to innovative activities in SMEs. This section also provides information on SMEs' participation in European RTD programmes.

11.2 R&D AND THE INNOVATIVE ACTIVITY OF SMEs

Typically, results arising from international comparisons of aggregate R&D figures imply that the autonomous innovative capability of SMEs varies between countries, and this finding therefore suggests that the ratio of R&D expenditures to GNP is an indirect indicator of sectoral specialisation within countries. This indicator therefore shows¹ that SMEs located in countries which specialise in consumer goods industries are less committed to R&D, a proxy for autonomous innovative activities, than those located in countries which specialise in high-tech industries.

Of the six largest countries in the EU (France, Germany, Italy, Spain, the Netherlands, and the United Kingdom), Italy and Spain have a relatively low R&D to GNP ratio. This contrasts with the higher ratios of France, Germany, the Netherlands, and the United Kingdom. However, this variation can be explained by the fact that, among the six largest EU countries, Italy and Spain are more specialised in the production of traditional consumer goods which are characterised as having low R&D requirements. By contrast, France, Germany, the Netherlands, and the United Kingdom, are more specialised in the production of chemicals and electronic & communication equipment, these industries are characterised by a higher propensity to undertake formal R&D activities. Similar conclusions can be drawn from a comparison of the six smallest countries in the EU (Belgium, Denmark, Greece, Ireland, Luxembourg, Portugal). Amongst these Greece, Ireland, and Portugal all have a low R&D to GNP ratio, which reflects their greater concentration of traditional consumer goods industries.

These findings suggest that, due to differences in countries' industrial composition, national R&D indicators disaggregated only by firm size classes will reflect the relative weight within countries of those industries which rely most heavily for innovation on autonomous capabilities (as represented by R&D), rather than the total innovative capacity of industry, and SMEs in particular, within each country². Consequently, R&D ex-

¹ Second Annual Report of the European Observatory for SMEs, see Table 7.1.

² Cf. Santarelli, E. - A. Sterlacchini, 'Embodied Technological Change in Supplier Dominated Firms. The Case of Italian Traditional Industries', *Empirica*, Vol. 25, No. 2, 1994.

penditures underestimate the innovative capacity of SMEs belonging to traditional industries which derive innovations from suppliers of capital equipment and machinery instead of through in-house R&D¹. Data from the Spanish Ministry of Industry relating to 1991 and from a sample of 1,950 enterprises belonging to 18 industrial sectors broken down by 6 size classes supports this argument. Once enterprises are identified by size class and industry, it turns out that enterprises with less than 20 employees and belonging to two traditional consumer good industries (leather & shoes and timber & wooden furniture) are characterised by an R&D intensity which is between four and nine times below that of firms of the same size and belonging to the office machinery, chemicals, and other industries which rely upon their own innovative capability as the main source of technology.

11.3 THE CONTRIBUTION OF SMEs TO THE INNOVATIVE OUTPUT

The direct measurement of innovation outputs at a sectoral level is required to accurately assess the contribution to innovation of SMEs in industries and countries that do not rely heavily on formal R&D activities. A direct measure of innovation output is a proxy of the overall innovation process, and not just those that arose through R&D. It also identifies those ideas for new or improved products, perhaps represented by a patented invention, which have some economic value. There are two sources of information that directly measure innovative outputs: the 'literature-based counting of innovations method', and the self-assessment by managers of the innovations introduced by their enterprises.

The literature-based counting method is based on the selection of innovations reported in trade journals. It assumes that enterprises have an incentive to publicise their novelties, and that the editors of the relevant journals make a thorough selection of the new products which they consider to be of interest to their readers. Self-assessment by managers of significant innovations introduced by their enterprise is based on the assumption that managers have a precise knowledge of the innovations developed by their enterprise. They are therefore able to specify whether these represent real novelties in either the domestic or world markets².

Table 11.1 reports the sectoral distributions of the 'domestic' innovations identified through the literature-based method for Ireland, Italy, the Netherlands, and the United Kingdom³. These are the only countries for which data is available, and due to aggrega-

¹ These enterprises are Supplier Dominated Firms (SDFs) as defined by Pavitt, K., 'Sectoral Patterns of Technical Change. Towards a Taxonomy and a Theory', *Research Policy*, Vol. 13, 1984.

² Cf. Kleinknecht, A. - J.O.N. Reijnen - W. Smits, 'Collecting Literature-based Innovation Output Indicators. The Experience in The Netherlands', in A. Kleinknecht - D. Bain (eds.), *New Concepts in Innovation Output Measurement*, London, Macmillan, 1993; Santarelli, E: - R. Piergiovanni 'Analysing Literature-based Innovation Output Indicators: The Italian Experience', Università di Bologna, Dipartimento di Scienze Economiche, Working Paper Series #197, 1994; Coombs, R. - P. Narandren - A. Richards (1994), 'An Innovation Output Indicator for the United Kingdom Economy', Manchester School of Management, Working Paper Series; Cogan, D.J., 'The Irish Experience with Literature-base Innovation Output Indicators', in A. Kleinknecht - D. Bain (eds.), *New Concepts in Innovation Output Measurement*, London, Macmillan, 1993. A slightly modified literature-based procedure has been applied to Austria by Fleissner, P. - W. Hofkirschner - M. Pohl, 'The Austrian Experience with Literature-based Innovation Output Indicators', in A. Klein-knecht - D. Bain (eds.), *New Concepts in Innovation Output Measurement*, London, Macmillan, 1993. These authors scanned a huge amount of journals for editorial material on product and process innovations, thereby identifying 1,355 innovations presented in 400 Austrian periodicals during 1989.

³ For the United Kingdom the analysis has been carried out limitedly to the first three months of 1989.

tion differences the results cannot be compared between countries, but provide useful information on innovation within countries. The gross figures provided by this comparison can however be used to emphasise the peculiarities of each country. Ireland and Italy appear to have a relatively high share of their total innovations in the textiles, clothing, footwear, and wood processing (furniture) industries, whereas the Netherlands has much of its innovation in the electronic & communication equipment industry¹. The Netherlands also appears to have a relatively high share of its innovations in iron and metal products, and it is probable that most of these innovations were introduced by SMEs with a limited commitment to formal R&D activities, instead relying on informal R&D activities and on R&D incorporated within their production machinery and capital equipment as sources of innovation².

The figures for the United Kingdom are more difficult to explain as none of the industries studied, with the significant exception of mechanical engineering, emerges as more innovative than the others. However, although the total contributions of the various sub-sectors is fragmented, that of the instruments industry (i.e. medical equipment, testing equipment, process control, and optical instruments) is the most significant and this suggests that Small Technology Based Enterprises (STBEs) have played a significant role in the overall innovation process within the country.

More dramatic results arise from an examination of the size distribution of the enterprises which introduced these innovations (Table 11.2). Here, the supremacy of SMEs over large enterprises appears extremely marked in Ireland, where SMEs with fewer than 20 employees were responsible for 61% of total innovations. From the Italian data the strength of Italian SMEs in terms of innovative output also appears to be very significant: 14.4% of the domestic innovations were introduced by enterprises with fewer than 20 employees, and enterprises with between 20 and 99 employees accounted for another 48.5% of all the innovations.

¹ However, the innovative output of this industry in the Netherlands can be mostly attributed to NV Philips, although small technology based enterprises are likely to have provided a significant contribution.

² In a previous study, Kleinknecht had in fact demonstrated that, in the Netherlands, informal R&D carried out in the production and marketing departments rather than the R&D departments contributes in a very significant manner to the total innovative output of Dutch SMEs. cf. Kleinknecht, A., 'Measuring R&D in Small Firms: How Much are We Missing?', *Journal of Industrial Economics*, Vol. 36, No. 2, 1987. Similar results are obtained with respect to Italy by Santarelli, E. - A. Sterlacchini, 'Innovation, Formal Vs. Informal R&D, and Firm Size: Some Evidence from Italian Manufacturing Firms', *Small Business Economics*, Vol. 2, No. 3, 1990.

Table 11.1 Sectoral distribution of domestic innovations in 1989 - Ireland, Italy, the Netherlands, the United Kingdom (column percentages)

Industry of origin	Ireland ^a	Italy	Netherlands	United Kingdom
Food & beverages	3	3.6	3.4	9.9
Textiles	3	3.4 ^d		0.2
Clothing & footwear		1.5		0.6
Wood processing	2	2.3		1.0
Paper & publishing			2.3	0.4
Chemicals	16	6.7	7.1 ^f	7.7
Plastics & rubber	12 ^b	3.4	3.9	1.6
Glass, brick, etc.				1.5
Iron and metal products		3.8	7.0	3.3
Mechanical engineering	29	46.2	25.6 ^g	19.7
Weapons				0.1
Office equipment	14	10.3		8.2
Electrical equipment	9			8.8
Electron. & commun. equipment		9.4 ^e	22.5 ^e	4.4
Medical equipment	12 ^c	5.4 ^c		3.1
Testing equipment				4.7
Process control				5.5
Computing activities			5.0	7.1
Optical instruments				1.0
Motor vehicles		3.8	2.3	1.3
Aerospace				0.3
Furniture				1.1

a. Refers to 1991.

b. Comprises paper & publishing.

c. Comprises testing equipment, process control equipment & optical instruments.

d. Comprises clothing (therefore the row 'clothing and footwear' comprises only footwear).

e. Comprises also electrical equipment.

f. Comprises also plastics (therefore the row 'rubber & plastics' comprises only rubber).

g. Comprises machine building & engineering.

Source: Ireland: Cogan (1993); Italy: Santarelli - Piergiorgio (1994); Netherlands: Kleinknecht et al. (1993); United Kingdom: Coombs et al. (1994).

Table 11.2 Percentage distribution of domestic innovations by employment size category (Ireland, Italy, the Netherlands, the United Kingdom)

Size class	Ireland ^{a, b}	Italy ^c	Netherlands ^d	United Kingdom ^e
1-19	61	14.4	35	22.4
20-49	21	21.3	18.4	14.7
50-99	9	27.2	10.9	26.7
100-499	8	14.1	21.1	15.6
500-999	1 ^f	5.5	14.7 ^f	7.1
1,000 and more		17.5		13.0
Total	100	100	100	100

a. Refers to 1991.

b. Source: Cogan (1993).

c. Source: Santarelli - Piergiovanni (1994).

d. Source: Kleinknecht et al. (1993).

e. Source: Coombs et al. (1994).

f. Innovations introduced by enterprises with more than 500 employees.

For the Netherlands the percentage distribution of Dutch innovations by the size of the innovating enterprise reveals that SMEs were responsible of a very high share of the innovations: enterprises having less than 20 employees introduced 35% of all innovations, whereas those between 20 and 99 employees accounted for 29.3%.

Similar figures emerge for the United Kingdom (see Table 11.2). with SMEs having introduced a very significant share of the innovations: enterprises with fewer than 20 employees were responsible for 22.4 % of domestic innovations, and those with between 20 and 99 employees accounted for another 41.4%.

For Austria, Belgium, Denmark, France, and Germany, information collected through the self-assessment procedure described above, and relating to the early 1990s initially suggests (Table 11.3) that large enterprises are on average stronger than SMEs with regard to both product and process innovations. However, analysis of the distribution of innovations by the size category of the innovating enterprise shows that SMEs with fewer than 50 employees are more innovative than is usually indicated by assessments based on R&D activities.

Table 11.3 Percentage of innovating enterprises in manufacturing industry (Austria, Belgium, Denmark, France and Germany - 1990/91)

Size	Austria		Belgium ^a		Denmark		France		Germany	
	Product	Process	Product	Process	Product	Process	Product	Process	Product	Process
20-49	49.0	22.8	54.06	48.79	24	36	47.0	39.7	27.1	29.1
50-99	47.5 ^b	28.3 ^b	55.87	47.75	44	50	57.4	48.9	54.7	54.9
100-199					51	59	61.9	53.3		
200-999	71.8 ^c	47.1 ^c			63 ^c	71 ^c	71.5 ^d	64.9 ^d	62.3	58.3
1,000+							82.6 ^e	77.7 ^e	79.3	72.8
Total					46	54	52.5	45.1	66.6	62.5

a. Flanders region.

b. Includes a sample of enterprises with between 50 and 199 employees.

c. Includes a sample of enterprises with more than 200 employees.

d. Regards enterprises with between 200 and 499 employees.

e. Regards all enterprises with 500 and more employees.

The figures for Belgium, for instance, although limited to firms with fewer than 100 employees, and those for France are notable as 54% percent of Belgian, and 47% of French firms with between 20 and 49 employees have introduced product innovations.

Although significant differences among countries remain, the direct measurement of innovation outputs demonstrates that SMEs' capacity to innovate, particularly in product innovation, is very important. The next sections will discuss some of the factors which determine these innovative capabilities.

11.4 SMEs, INNOVATION, AND THE BUSINESS ENVIRONMENT

This section assesses the role of the business environment as one of the factors which determine the innovative capability of SMEs.

Smaller enterprises, in particular those in traditional consumer goods industries, are sometimes geographically concentrated in areas, usually referred to as 'industrial districts'. These districts offer environmental conditions that positively influence innovative capabilities and activities. Industrial districts are characterised by easy access to relevant technological information and the presence of high-skilled workers, specialised in the activities which prevail in the area. Informal communications between firms is also much easier within industrial districts than it is elsewhere, and this assists the rapid development and introduction of incremental innovations (minor product improvements) in response to changes in consumer demands. Although industrial districts are usually specialised in traditional consumer goods productions, their features are sometimes found in areas (of the Silicon Valley type) of high-technology activities where STBEs dominate.

The formation of an industrial district is in most cases caused by increasing returns which arise through agglomeration economies whereby an enterprise entering the industry in which the area is specialised benefits from the presence of other enterprises belonging to the same industry. Through this, a predominant share of an industry 'may cluster in a single region, district, or location ... not necessarily because of any intrinsic advantage of that particular location, but because a 'historical accident' placed certain firms there initially and this concentration of firms in turn attracted a high proportion of subsequent entrants¹. Whilst industrial districts emerge as a consequence of cultural and environmental conditions in the case of traditional consumer goods industries, in technologically advanced industries such 'districts' are usually created by policy interventions, such as the development of Science & Technology Parks (S&TPs), or Innovation Centres, or Technopoles (henceforth S&TPs). These are designed to attract STBEs.

Table 11.4 summarises the existence in European countries of either traditional industrial districts: areas characterised by the widespread presence of SMEs belonging to traditional consumer goods industries, or S&TPs: areas characterised by a prevalence of STBEs which operate in high-tech industries, these industrial districts are usually created artificially by policy actions.

It is notable that there are relatively few traditional industrial districts across Europe as compared to those created artificially by S&TPs policy instruments. Although an expla-

¹ Arthur, W.B., Silicon Valley Locational Clusters: When Do Increasing Returns Imply Monopoly?, *Mathematical Social Sciences*, Vol. 19, No. 3, 1990.

nation would probably include the different specialisations of the various countries in 'traditional' or 'advanced' industries, a fuller understanding of the features and importance of both types of district can be provided through illustrative case-studies.

Case A

An example of a traditional industrial district is that of the toy industry in the Valencia region of Spain, the origins of which date back to the beginning of this century. Until the 1950s the local toy industry was characterised by a process of concentration which took place through mergers and acquisitions. However, increasing concentration ratios were not sufficient to lower the labour costs and a reduction in the average size of enterprise was apparent. This process of concentration and retraction, in terms of employment, had two complementary processes. First, many redundant workers started their own businesses as sub-contractors to larger toy manufacturers, and also to enterprises belonging to other industries. The toy industry is in effect subject to seasonal variations in demand and production and it was therefore very important for sub-contractors to serve also the demand for intermediate goods coming from other industries. And second, those enterprises which had survived the difficulties of the initial period began to externalise, through subcontracting, those parts of their manufacturing processes which could not be maintained in house as a consequence of diminishing returns to scale. As a result, toy production in the Valencia area is now a prosperous industry, employing around 15,000 workers and generating a total annual turnover of more than 615 MECU.

Moreover, although the Valencia region has a poor technological tradition, the toy industry has adopted a strategy of solving its technological problems by adapting and improving technology mostly imported from other areas. Therefore, while SMEs in this industrial district are very weak in terms of their commitment to R&D activities, they nonetheless maintain a favourable orientation toward technology by using up to date process technologies which transfer into the final product technological knowledge embodied in the industry's capital goods.

Table 11.4 Significant presence of traditional SMEs and advanced STBEs localised in industrial districts and Science & Technology Parks or Innovation Centres

Countries	Traditional SMEs in		Prevalent industries in S&TPs
	industrial districts	STBEs in S&TPs	
Austria	-	X	n.a.
Belgium	-	X	Pharmaceuticals
Denmark	n.a.	n.a.	n.a.
Finland	-	X	n.a.
France	-	X	Electronics
Germany	-	X	Data & commun. tech.
Greece	-	X	n.a.
Ireland	n.a.	n.a.	n.a.
Italy	X	X	Electronics
Luxembourg	-	-	-
Netherlands	-	X	Pharmaceut., Software
Norway	X	X	n.a.
Portugal	X	X	n.a.
Spain	X	X	n.a.
Sweden	-	X	Electronics
United Kingdom	X	X	Biotech., Electronics

n.a.: Information not available. X : Significant preference, -: not significant presence.

The United Kingdom is particularly notable in relation to STBEs industrial districts: there are more than thirty Science Parks which have been developed by universities and local authorities, usually in co-operation with industry and commerce, to encourage the development of high-technology activities in local areas. A much larger area of high technology industries is the 'M4 Corridor', running from West London to Bristol and South Wales along the M4 motorway. The existence of this concentration of high-technology developments is perpetuated by locational advantages such as excellent communications infrastructure, an attractive physical environment, and a highly-skilled workforce, however, while these advantages help explain the continued growth in the area, a 'historical accident' explains the origins of the M4 Corridor phenomenon. This 'historical accident' was the location in the area of government research laboratories employing skilled workers and engineers. Many of these individuals identified potential commercial applications for their work¹ and started their own enterprises producing electronic hardware and computer software. In addition, the presence of research centres and skilled workers attracted immigrant enterprises from other areas, which, like the newly established enterprises, became specialist sub-contractors that benefited from government contracts and grants.

A similar situation to the United Kingdom's M4 Corridor can be found in the French regions of Ile de France (in the Paris area) and Provence (on the Mediterranean coast), in the German Länder of North Rhine-Westphalia, Lower Saxony and Baden-Wurttemberg,

¹ Cf. Breheny, M. - P. Cheshire - R. Langridge, *The Anatomy of Job Creation? Industrial Change in Britain's M4 Corridor*, in P. Hall - A. Markusen (eds.), *Silicon Landscapes*, London, Allen & Unwin, 1985.

in the Swedish region of Linköping, in the Greek regions adjacent to the largest cities, and in North-Eastern Italy.

In France nearly 40% of STBEs are created by researchers, but whilst researchers have established enterprises across the country (see Table 11.5) it is clear that in the northern and southern regions the process of new high-tech enterprises formation has been much stronger than in the central regions. In general, French STBEs started by researchers have emerged in industries like biotechnology, electronics, opto-electronics, robotics, data processing, and telecommunications, which play a significant role in the technological development of the country. Furthermore, according to a recent study¹, the role of such enterprises in the dissemination of high-quality technological capabilities is expected to increase further in the future.

In Germany, the Länder of North Rhine-Westphalia, Lower Saxony, and Baden-Württemberg have experienced a permanent increase in the number of STBEs since 1986, largely through the favourable environmental conditions created by Innovation Centres which offer a number of advisory services². In these areas, nearly two third of total STBEs, which are mostly founded by a scientific entrepreneur, are specialised in data & communications technology, consumer electronics, engineering, and control technologies.

In Sweden the Linköping region is mostly specialised in data processing. Enterprises here benefit from close connections to the local university and easy access to the relevant technical information.

Table 11.5 Mapping of STBEs started by researchers in France (by administrative region - 1988 and 1992)

Region	1988	1992	Region	1988	1992
Alsace	4	7	Limousin	2	3
Aquitaine	3	1	Lorraine	3	5
Auvergne	1	1	Midi-Pyrénées	7	7
Bourgogne	3	3	Nord-Pas-de-Calais	6	1
Bretagne	3	9	Provence-Alpes-Côte d'Azur	20	10
Centre	1	1	Pays de Loire	1	4
Franche-Comté	1	3	Picardie	2	2
Haute Normandie	2	1	Poitou-Charentes	3	2
Ile de France	26	29	Rhône-Alpes	11	8
Languedoc Roussillon	1	5	Total	100	102

Source: P. Muster, Science et Innovation, Paris, 1995.

S&TPs are also likely to become increasingly important in Greece, where the creation of local clusters of STBEs in areas adjacent to the major technological universities of Athens, Thessalonike, Patra, and Heraklion, are already being encouraged. In these areas, universities and SMEs co-operate in a number of activities, including research and tech-

¹ Muster, P., Science et Innovation, Paris, 1995.

² Cf. R. Sternberg, The Impact of Innovation Centres on Small Technology-based Firms: The Example of the Federal Republic of Germany, Small Business Economics, Vol. 2, No. 2, 1990.

nology projects, student industrial training, short courses and seminars. These Greek universities prefer to co-operate with SMEs in the S&TPs which have their own in-house R&D activities.

In Italy, a Science Park has existed in the Trieste area (in the Friuli Venezia Giulia region) since 1981 and has successfully attracted STBEs in the biotechnology and new materials industries. But similar instruments have been much less successful in Southern Italy (for example, the Technopolis in the Puglia region), mainly because of a shortage of entrepreneurial talent in the area, and policy measures aimed at disseminating an industrial culture to a still rural area are required.

Co-operative activities involving enterprises belonging to traditional industries and specialised research centres are also an important factor in creating the environmental conditions favourable to innovative activities. Such co-operative arrangements generate environmental externalities when joint R&D influences the partners' ability to co-operate in other activities and gives rise to broader non-R&D related commitments between them. A good example of this can be found in the Austrian textile industry.

Although held to be a traditional industry, textiles is a scale intensive industry¹ which therefore relies more than other traditional industries on its own autonomous innovative capability as a source of technology. Consequently, SMEs in this industry, although they usually do not perform in-house R&D, have to internalise basic knowledge through channels which are different from the technological change embodied in their machinery and capital equipment. To achieve this, a small number of Austrian textile SMEs pursue product developments by co-operating with the Institute of Textile Chemistry and Textile Physics in Tyrol. This co-operation includes mainly basic research on the technical processes in the industry, but also includes special projects dealing with ecology and recycling, treatment of waste water from textile plants, and control quality systems aimed at testing the robustness of textile fabrics. The scientific council of the Institute works with representatives of an association of enterprises to carry out R&D activities in the textile industry. Through this mechanism, the SMEs' technological knowledge and know-how requirements are satisfied, so the enterprises do not have to undertake their own R&D activities. This example shows that in a traditional but scale intensive industry like textiles, the technological input of SMEs does not necessarily depend on their own autonomous innovative capability, and cannot be identified by assessing the enterprises' commitment to R&D.

Product innovations introduced by STBEs have been shown to be heavily dependent on external finance, through venture capital or bank loans². For example, a study in the Netherlands showed³ that on average 44% of all the innovation costs faced by a sample of 60 manufacturing SMEs were externally funded. The same study found that in most cases a lack of external funding is identified by firms as a major determinant of delays in the innovation process. Since a large proportion of European SMEs resort to bank loans

¹ I.e. an industry the main technological strategy of which consists in the extensive exploitation of scale economies.

² Cf. Santarelli, E., 'Asset Specificity, R&D Financing, and the Signalling Properties of the Firm's Financial Structure', *Economics of Innovation and New Technology*, Vol. 1, No. 2, 1991.

³ Docter, H.J. - J. Snijders, 'Financing Product Innovations', in H. Geschka - H. Hubner, *Innovation Strategies*, Amsterdam, 1992.

as their preferred source of external funds¹, it seems plausible that SMEs located in industrial districts have easier access to this source of finance than their counterparts outside the industrial districts because local banks in industrial districts will in effect specialise in financing enterprises belonging to the industry that dominates the area. Consequently, the banks should possess all the relevant information to select from the various SMEs those which are most likely to undertake profitable innovative activities.

11.5 NATIONAL POLICIES TOWARDS INNOVATION AND SMEs PARTICIPATION IN EUROPEAN RTD PROGRAMMES

Most European countries have national and regional policies or programmes aimed at fostering the development of innovative SMEs, and adoption of new and improved technologies by SMEs. Public subsidies and financial incentives to SMEs which carry out R&D, or adopt process innovations, are the most popular type of national SME technology policy (see Table 11.6), and a variety of tax incentives have been introduced in different countries. Government funded institutions for technology transfers into SMEs are becoming a common policy instrument. These institutions are aimed at promoting skills transfer, knowledge, and advanced machinery from universities or other actors in area.

Regional policies towards innovation in SMEs are less developed, but they are more common amongst the larger countries in the Union, often implementing the same policy instruments described above, but on a local or regional basis.

Table 11.6 National/regional policies specifically aimed at stimulating or subsidising technology in SMEs

Countries	National policies			Regional policies		
	Subsidies	Tax incentives	Tech. transfer	Subsidies	Tax incentives	Tech. transfer
Austria	X	-	X	X	-	X
Belgium	-	X	-	X	X	X
Denmark	X	X	X	-	-	-
Finland	X	-	X	X	-	-
France	X	X	X	X	-	X
Germany	X	X	X	X	-	X
Greece	X	-	X	X	-	-

France and Germany are particularly notable in the field of national technology policies, as their governments have granted special advantages to SMEs

German SMEs get support from national policies when they adopt new technologies. This support is to overcome diffusion barriers which are perceived to exist for those SMEs which are potential adopters of the new technologies. In Germany widespread use is made of tax incentives for innovative investments. There are two particular instruments that are intended as incentives for investments in innovative activities: a tax incentive represented by an R&D investment grant; and possible tax reductions in the form of a special R&D depreciation rate.

¹ Among European countries, only in the United Kingdom financing of the venture capital type is instead more likely to be sought than bank loans.

In France several measures have been adopted to promote technological development. These include financial support to SMEs that recruit researchers, technology transfer institutions, incentive schemes for venture capitalists, subsidies to innovating enterprises, and the introduction of specific initiatives to promote the widespread diffusion of information technologies, electronic components, and advanced materials in the French industry (ATOUT programme).

Participation in European RTD programmes is becoming increasingly popular among SMEs, particularly because of their financial impact. According to recent data¹, the financial importance of RTD programmes is much greater for SMEs than for large enterprises, this is also true for industries in the less favoured regions compared with those in the most advanced regions. For example, the percentage of the total R&D budget of participating R&D units financed through RTD programmes was significantly higher in Greece (47% in 1990), Ireland (43% in 1991), and Spain (31% in 1990) than in Germany (13% in 1991), and the Netherlands (4% in 1992). However, studies aimed at assessing the impact of EC research activities on SMEs found that RTD programmes were relevant to only a small minority of SMEs, notably those in high-technology industries and/or heavily involved in formal R&D activities. In particular, these enterprises gained significant internal advantages from the application of the knowledge gained by the involvement in their activities of PhD students who were supported by the research programme. On the other hand, SMEs which belonged to traditional consumer goods industries were found to have been stimulated to perform direct R&D activities only by more flexible programmes aimed at promoting the adoption or upgrading of new or existing technology.

The European Commission's series of Framework Programmes for RTD have targeted selected fields over specific periods of several years. In particular, the framework programmes have included cost-sharing which stimulate R&D projects on the basis of contracts between the European Commission and contractors within the various member countries. A comparison of the distribution of EC contractual funding for projects in the Second (1987-1991) and the Third (1991-1993) Framework Programmes shows that SMEs' (with fewer than 500 employees) increased their share of the funding at the expense of large enterprises (Table 11.7).

Table 11.7 EC contractual funding of projects: per cent distribution of funds by type of participants

	2nd Framework Programme	3rd Framework Programme
SMEs	18.7%	21.1%
Large Enterprises	41.1%	30.0%
Public or Private Research Centres	20.8%	23.2%
Higher Education Establishments	18.9%	21.8%
Others	0.6%	3.9%

Source: European Commission services.

Among the interventions funded by the European Union, is support for R&D in SMEs provided by the structural funds. The principal policy instrument in this area is the STRIDE (Science and Technology for Regional Innovation and Development in Europe)

¹ Cf. European Commission, The European Report on Science and Technology Indicators 1994, European Commission, DG XIII, Brussels-Luxembourg, Chapter 8, 1994.

programme which aims to strengthen the capacity of assisted regions for research, technological development, and innovation. The STRIDE programme has in particular had an important impact in Portugal, where it supported the creation of an innovation agency which promotes technological innovation through closer links between the scientific and the business communities. However, STRIDE is mostly designed for enterprise with in-house research capabilities, and traditional SMEs therefore participate more frequently in the CRAFT initiative under the BRITE-EURAM programme. This permits them to contract out research to third parties such as research institutes, universities or other enterprises.

12 EDUCATION AND ENTREPRENEURSHIP

Co-ordinated by Small Business Research Institute (KMO-Studiecentrum), K.U. Brussels

MAIN POINTS

- The Northern part of the EU has a larger number of higher educated people than the Southern countries, but this difference will be reduced in the future. Today, students in all the countries have similar educational opportunities.
- Most of the students participating in education at the tertiary level aim to get a university degree. Female participation at the university level remains below the male participation rate, and more men than women receive degrees in scientific and engineering fields.
- There is a relationship between the educational level of the entrepreneur and the characteristics and behaviour of the SME. For example, innovative start-ups are established by people with a higher educational level than ordinary start-ups. Persons with a solid educational background prepare themselves better for the start of their enterprise, which increases the chances of its survival. Entrepreneurs with a higher level of education are more growth-oriented, have a wider external network, and are more export orientated.
- Educationalists recognise the socio-economic importance of SMEs, and acknowledge that education can stimulate entrepreneurship by, amongst other things, the developing entrepreneurial skills. In addition, students and graduates have shown explicit interest in entrepreneurship itself and education relating to it. Co-operation between institutions of education and SMEs can improve the attention to, and quality of, education relating to entrepreneurship.
- A number of barriers to the encouragement of entrepreneurship in education exist. Education has become too academic and theoretical, it puts too little emphasis on the development of practical and personal skills, and is often too narrow, that is not sufficiently multi-disciplinary. That business related education that does exist, concentrates on large enterprises and wage earning, rather than on entrepreneurship. Furthermore, teachers are generally unfamiliar with entrepreneurship and SMEs.

12.1 INTRODUCTION

It is generally recognised that entrepreneurship can not be taught; but is instead 'in the blood'. This said, education can still perform important tasks to ensure that potential entrepreneurial talents do not disappear. After all, entrepreneurship is a vital part of the socio-economic fabric of each country. This importance explains this chapter, and its

focus on the role of education in entrepreneurship. With respect to this the following questions will be addressed:

- What is the current state of education?
- Why is education important to entrepreneurship?
- How is entrepreneurship approached in education?

Education here refers to all official education from early childhood, through primary, lower secondary, and upper secondary, to the tertiary level¹. Secondary education can consist of general and vocational education. Vocational education includes apprenticeships and technical programmes within the official education system. This chapter does not refer to training programmes undertaken within or outside enterprises.

12.2 WHAT IS THE CURRENT STATE OF EDUCATION?

A quantitative picture can be drawn of the state of education in fourteen countries², but a clear distinction between upper secondary and tertiary education, and between non-university and university education, is difficult, even impossible, in some countries, particularly Austria, Germany, the Netherlands, and the United Kingdom. This section will first discuss the educational level of the population, followed by the participation rate of students in education, and the gender differences in these rates. The analysis concludes with an analysis of the education of potential SME owners, business founders, and existing entrepreneurs.

12.2.1 The educational level of the population

Almost half of the population (49%) aged between 25 and 64 in the fourteen countries have attained no more than a lower secondary education. Germany (18%), Norway (21%), Austria (32%), Sweden (33%), the United Kingdom (35%), Denmark (39%), Finland (40%) and the Netherlands (43%) all have a smaller proportion of their populations with only this low levels of education, whilst Portugal (92%), Spain (78%) and Italy (72%) have significantly more people with only this level of education.

On average, for all the countries, upper secondary education is the highest level achieved by 36% of the population, whilst 15% have completed tertiary education. Portugal (4%) and Italy (6%) have the smallest proportions with a tertiary education.

In all countries there are large differences in the educational attainment of the different age groups. Younger people have benefited from the post-1960s expansion of education, and, on average, young people have a higher level of education than their parents and

¹ General definitions according to the International Standard Classifications of Education (ISCED): early childhood (ISCED 0) refers to pre-primary education, primary education (ISCED 1) is first level education that begins at age five, six or seven and lasts for five or six years, secondary education (ISCED 2/3) relates to second level that can consist of general and vocational education. The upper secondary education may prepare students for direct entry into working life or may prepare students for education in the university or non-university sectors. Tertiary education (ISCED 5/6/7) covers programmes that are offered outside the university (non-university) and which lead to a final qualification or programmes offered at the university degree. For France, the Grandes Ecoles are classified at the tertiary university level.

² The fourteen countries are the EU-12 members (without Greece and Luxembourg), Austria, Finland, Norway and Sweden. Greece and Luxembourg are not included, as there were no figures available for these countries. If not mentioned otherwise, the figures are derived from OECD, *Education at a Glance*, Paris, 1993 and they refer to 1991.

grand-parents. This means that a better qualified work-force and pool of potential entrepreneurs are now available.

12.2.2 Participation rates in education

The overall participation rate for students aged between 5 to 29 in official education is similar for all the fourteen countries. In 1991, an average 57% of this age group were participating in official education.

In particular the percentage of students participating at the primary and the secondary level differs little between the fourteen countries. The largest differences are at the tertiary level. Finland¹ (10%), Austria (9%), and Norway (9%) have the highest tertiary rates, relative to the average of 7%, whilst Portugal (4%) has the lowest rate.

In most of the fourteen countries (the Nordic countries, Austria, Germany, the Netherlands, and the United Kingdom) a greater proportion is engaged in apprenticeships or vocational programmes than on general educational programmes. The reverse is true in Ireland and Spain. In the other countries, similar numbers participate in general educational programmes and in vocational and apprenticeship schemes.

12.2.3 Gender differences in education²

Gender differences are also most marked at the tertiary level. In most countries, more women than men are involved in tertiary non-university education, with the opposite being true for university education. Programmes at the tertiary non-university level are often short and may lead female-dominated occupations. However, this difference is diminishing as the proportion of women amongst university graduates is increasing. For instance, during the 1977-1987 period, the percentage of women university graduates in Austria rose from 31% to 41%³. But, major disparities still exist in the education received by men and women, with more men than women receiving degrees in science and engineering. More than four times as many men gain engineering degrees as do women in most countries.

12.2.4 Education at universities and business schools for potential SME owners

Courses offered by business schools and universities concentrate on issues affecting large firms rather than small firms, and the courses primarily educate managers for larger firms⁴. This helps to explain why their students are more attracted to employment in large enterprises. The few studies that exist on activities of graduates from business schools and universities provide some evidence as to the employment of their students. Of the students who graduated between 1965 and 1967 from INSEAD (a Business

¹ In Finland, both new entrants into tertiary-level programmes and persons who have previously been enrolled at this level are counted.

² No figures by gender available for Greece, Ireland, Italy and Luxembourg.

³ OECD, *From higher education to employment*, Paris, 1992.

⁴ CEDEFOP, *Management Education for Small and Medium-sized Enterprises in the European Communities*, Berlin, 1989.

School in France), as many as 36% became active owner managers¹. About 20% of 1970 graduates of the London and Manchester Business Schools were working in small enterprises in 1977.

12.2.5 Education for starters and existing entrepreneurs

National figures for Portugal and Denmark show that, in comparison with the educational level of the labour force, the level of education of entrepreneurs is high. Also, business starters in Germany, Ireland, the Netherlands, France and Sweden had achieved a higher level of education than the labour force as a whole, and starters in services had a higher level of education than those in the trade and industrial sectors (also see chapter 2)².

Most business starters and existing entrepreneurs have no specific education for entrepreneurship³, instead enterprises tend to be started or taken over by individuals with a technical and practical, highly as well as non-highly, education⁴. It can be assumed that the level of general education amongst future entrepreneurs will be higher as the level of education in society increases, but enterprise creation requires an ever more professional approach, as illustrated by the higher failure rate amongst entrepreneurs who do not have any appropriate management education⁵. Having a good business idea and being well motivated are necessary, but not sufficient factors, in the successful creation and development of a business. Initial skills must exist, and learning or training must continue after the establishment of the business.

12.3 WHY IS EDUCATION IMPORTANT TO ENTREPRENEURSHIP?

This section examines the relationship between the educational level of the entrepreneur and the characteristics and performance of the SME, and thereby illustrates the importance of education to entrepreneurship. The following characteristics and behaviour of SMEs are considered: innovative and non-innovative start-ups, the survival rate, growth, networking, and internationalisation.

¹ Research done by the St. Gall Graduate School of Economics, Business, and Public Administration in Switzerland found that 38% of their students who graduated in 1978 were working in enterprises with less than 100 employees at the time of the survey.

² Donckels, R., J.P. Segers, A. Courtmans, J. Lambrecht, *Onderwijs en Ondernemerschap (Education and Entrepreneurship)*, Brussels, 1991.

³ CEDEFOP, European conference: Training for start-ups: Existing programmes and policies in the twelve Member States of the EC, CEDEFOP flash, 8, Berlin, 1991.

⁴ Viennet, H., *Créations et reprises d'entreprises en 1985: les acteurs et leurs projets (Start and take-over of enterprises in 1985: The actors and their projects)*, Paris, 1989.

⁵ Dekimpe, M., D. Morrison, A Modeling Framework for Analyzing Retail Store Durations, *Journal of Retailing*, Spring, 1991; Larson, C.M., R.C. Clute, The Failure Syndrome, *American Journal of Small Business*, October, 1979; Wichmann, H., *Accounting and Marketing - Key Small Business Problems*, *American Journal of Sociology*, Spring, 1983.

12.3.1 Education and innovative and non-innovative start-ups

A Belgian study found that the educational level of entrepreneurs differed significantly between those who established technology-based and ordinary start-ups¹. Entrepreneurs of technology-based start-ups were better educated: 81.3% of them had a tertiary degree (non-university or university), compared with 32% of the entrepreneurs that started ordinary firms.

In Denmark, entrepreneurs with an innovative new business idea or concept were also found to have a higher level of education². Of the innovative entrepreneurs, 62% had attended tertiary education, whereas this was true of only 21% of entrepreneurs in general.

12.3.2 Education and survival rates

From the Danish figures, it appears that the higher the educational level, the higher the survival rate³. On average, 57.1% of the businesses started in 1985 survived to 1990, but of the entrepreneurs with further education, 65.5% survived to 1990. However, when the survival rates were studied by educational level of the entrepreneur and industrial sector of the business, the pattern became more complicated. For instance, within the hotel and catering, and transport sectors, the survival rate did not vary with the level of the entrepreneur's education, and in retail and wholesale, entrepreneurs with a skilled vocational education had the highest survival rates. A Danish survey⁴ found that among people who started their business from unemployment, those with the highest levels of education were the best prepared when starting the business. These findings suggest that the higher survival rate among people with good educational backgrounds may be directly due to their choice of business and good preparation, and only indirectly related to their level of education.

12.3.3 Education and business growth

A study in Spain characterised new entrepreneurs as being of four 'types' (risk oriented, craftsman, security, and managerial) and a relationship was discovered between the educational level of the entrepreneur and the performance of the enterprise⁵. It was found that the best prospects for future growth, measured by increased sales, were amongst the 'risk oriented' entrepreneurs. These also had a higher level of education than the other types. The group with the highest proportion of 'fast growth' enterprises

¹ Donckels, R., J.P. Segers, *New Technology Based Firms and the Creation of Regional Growth*, Small Business Economics, 2, 1990.

² Jakobsen, L., *Nye Innovative Virksomheders behov for Rådgivning - Erfaringer fra Etableringsordningen (New innovative firms and their needs for consultancy services - Experiences from the start-up scheme for entrepreneurs)*, Taastrup, 1994.

³ Danish Statistical Bureau.

⁴ Hægeland, J., K. Langager, L. Jakobsen, L. Jagd, *Iværksaetterydelsen (The enterprises' allowance)*, Taastrup, 1992.

⁵ Lafuente, A., V. Salas, *Types of Entrepreneurs and Firms: The Case of New Spanish Firms*, Strategic Management Journal, 1989.

(those which had achieved a real sales growth between 1980 and 1984 of over 50%) was also the enterprises owned by 'risk-taking' individuals, and thus by entrepreneurs with the highest educational level.

The results of a survey among SMEs (enterprise with less than 50 employees) in the Brussels metropolitan area also indicates a relationship between the educational level of the entrepreneur and the growth orientation of the enterprise¹. Entrepreneurs with a tertiary education expect more expansion in their business area (52.7% compared with 41.2% of the entrepreneurs with low education), and such entrepreneurs tend to be more growth orientated (61.7% compared with 40.9% of the entrepreneurs with low education)²

12.3.4 Education and networking

Networking is the extent of the relationships between the entrepreneur, or the SME, and the outside world. In Belgium, it has been argued that network formation contributes to the growth of the enterprise, and that among other factors the educational level of the entrepreneur has an impact on the networking of the SME (amongst enterprises with less than 100 employees)³. Entrepreneurs with a tertiary education have been shown to have wider networks⁴. This can be illustrated in three ways. First, these entrepreneurs are attending more seminars (the probability of an entrepreneur with a tertiary educational level attending a seminar is 60% compared with 43% for the less educated), second, the level of education has a direct influence on the geographical diversity of the contacts, entrepreneurs with a tertiary education are significantly more likely to have international contacts (32% versus 24% probability for those with a lower level of education), and third, entrepreneurs with a higher education tend to be less dependent on members of their family for business advice (they have a 61% probability that they will discuss business decisions with relatives, compared with 70% for those with a lower education). This difference is probably attributable to the fact that highly educated entrepreneurs have wider networks, allowing them to rely less on the judgement of relatives.

12.3.5 Education and internationalisation

The results of a survey among business start-ups in the United Kingdom have shown that entrepreneurs of exporting firms are generally better educated (three times more likely to have a university degree)⁵ than non exporters. Empirical findings in Belgium have shown that the educational level of entrepreneurs (those with an enterprise with less than 100

¹ Donckels, R., M. Cottyn, J. Lambrecht, Hoekstenen voor een Specifiek Middenstands- en KMO-beleid in het Brussels Hoofdstedelijk Gewest (Cornerstones for a Specific SME Policy in the Brussels Region), Brussels, 1994.

² A growing enterprise is then defined as an enterprise which has witnessed an increase in turnover over the last three years and expects a similar trend over the next three years too.

³ Donckels, R., J. Lambrecht, Networks and Small Business Growth: An Explanatory Model, Small Business Economics, forthcoming.

⁴ Networking has been measured by the following variables: consultation of external consultants, attendance of seminars, participation in trade fairs, contacts with other entrepreneurs and discussion of important business decisions with relatives.

⁵ See the National Westminster Bank start-up tracking exercise of start-up businesses in 1988.

employees) affects the decision to undertake activities in a developing country (in Africa, Asia, or Latin America). As their educational level increases entrepreneurs are more likely to deal with a developing country (51.1% of the entrepreneurs with tertiary education had a business link with a developing country, compared with 41.8% of the entrepreneurs with a lower level of education)¹. The establishment of a joint venture in a developing country was also associated with the entrepreneur's level of education: of the entrepreneurs having or planning a joint venture, 80.2% had a university degree, while 62.4% of those excluding the possibility of such a joint venture has followed university education²

12.4 HOW IS ENTREPRENEURSHIP APPROACHED IN EDUCATION?

Table 12.1 shows the opportunities and barriers in the development of an entrepreneurial spirit within education.

Table 12.1 Opportunities for and barriers to an entrepreneurial spirit in education

Opportunities	Barriers
Recognition of socio-economic importance of SMEs	Education is an inadequate mirror of reality
Ability of education	Too little emphasis on developing personal skills
Interest of students	Insufficiently multi-disciplinary approach
Enthusiasm of graduates	Too much attention is paid to large institutions and to the wage earning culture
Co-operation between institutes of education and SMEs	Insufficient familiarity amongst the teaching staff of entrepreneurship and SMEs

Source: KMO-Studiecentrum, K.U. Brussels, 1995.

12.4.1 Opportunities for the development of an entrepreneurial spirit in education

Recognition of socio-economic importance of SMEs

On the whole, the socio-economic importance of SMEs is recognised in education. In a survey of Belgian teachers from 562 educational institutes (secondary and tertiary education) 93.8% considered the enterprise to be the most important creator of wealth in society³ (6.2% did not agree with this thesis), and 91% of the respondents agreed that entrepreneurship is the cornerstone of a wealthy society (9% did not agree).

¹ Lambrecht, J., Cooperation agreements between entrepreneurs from developed and developing countries: theoretical considerations and empirical evidence from Belgium, *Southern African Journal for Entrepreneurship and Small Business*, 1, 1993.

² Donckels, R., J. Lambrecht, Joint ventures: no longer a mysterious world for SMEs from developed and developing countries, *International Small Business Journal*, forthcoming.

³ Donckels, R., J.P. Segers, *Onderwijs en Ondernemerschap: Mist Vlaanderen een kans? (Education and Entrepreneurship: Is Flanders missing a chance?)*, Brussels, 1989.

Ability of education

The educationalists acknowledge the important role of education in the stimulation of entrepreneurship. In the survey of teachers mentioned above, 76.5% agreed that education can develop a large number of entrepreneurial skills, especially the development of independence, problem solving, the taking of initiative, and work efficiency.

Graduates are also of the opinion that education can stimulate entrepreneurship. A Belgian survey of 558 economics and 538 civil engineering graduates whose studies included the development of entrepreneurial characteristics¹ found that both groups ranked as most important the ability to process information, the ability to work independently, and a capacity to solve problems.

The 'Mini-Enterprises' programme in several countries (see Case A) and the Development Engineering Programme in Sweden (see Case B) prove that education can develop an entrepreneurial spirit.

Case A

Mini-Enterprises

Several countries (e.g. Belgium, Denmark, France, Norway, Sweden, the Netherlands) have introduced the 'Mini-Enterprises' programme. This programme is for young people, especially those in their last year of upper secondary education, which has pupils establish their own enterprise and manage it for one school year in which they try to sell a product or service. Through 'learning by doing', the pupils become familiar with the human, technical, commercial, financial and administrative aspects of managing an enterprise. At the end of the school year, the mini-enterprise is liquidated, the shareholders repaid, and the pupils report their experiences.

Source: ENSR.

¹ Donckels, R., A. Courtmans, J. Lambrecht, *Universitair Onderwijs en Ondernemerschap (University Education and Entrepreneurship)*, Brussels, 1991.

Case B

Development Engineering Programme at the University of Halmstad, Sweden

This programme integrates technical studies, marketing, and economics, to provide broad general knowledge, rather than specialist skills in one field. Theoretical courses are interwoven with four major projects: product improvement; product planning; market planning; and new product development. These projects are carried out by a small group of students (2 to 4) in close co-operation with a company. The students have their own work places where they can carry out their project assignments. The final part of the course is a project in which a new product is developed from conception to a completed prototype. The course participants therefore have to work on their idea in a real-life situation, they have to deal with financing, market analysis, design, patent applications, create contracts, etc. Of the 440 people who have completed the course, 100 have started their own business.

Source: NUTEK.

Interest of students

The Small Business School in Haarlem, the Netherlands, illustrates the interest of students in entrepreneurship education (see Case C). This interest is also apparent from empirical studies.

According to a survey of 394 final year applied economics students from three universities in Belgium, 75% have considered entrepreneurship¹. In a repeat survey of 176 university applied economics students (81 students in the third year and 95 in their last year), 53.5% of the third year students and 71.2% of the final year students envisaged becoming entrepreneurs². And, 69% of the students in both years were prepared to follow optional courses on SME problems and entrepreneurship.

Case C

Small Business School in Haarlem, the Netherlands

This school, established in 1984, is aimed specially at students who want to become entrepreneurs. The course takes four years, during the second and third years the students follow traineeships. Those who have become entrepreneur refer to being forced to work under time pressure, being taught to take advantage of unexpected situations, the development of self-confidence, perseverance, and social capabilities as being positive aspects of their training at the school.

Source: EIM Small Business Research and Consultancy.

¹ Moyson, F., N. Seghers, R. Vuerings, Zin voor ondernemerschap: empirisch onderzoek bij studenten-TEW (Sense of entrepreneurship: empirical research with students-applied economics), Leuven, 1985.

² Donckels, R., J.P. Segers, Onderwijs en Ondernemerschap: Mist Vlaanderen een kans? (Education and Entrepreneurship: Is Flanders missing a chance?), Brussels, 1989.

Enthusiasm of graduates

Of the graduate economists and civil engineers referred to above, 60% had had the notion of starting their own business at least once. Their interest in entrepreneurship is also reflected in their positive attitude towards entrepreneurship courses. Of the economists, 89% said that university education should pay explicit attention to entrepreneurship, and 79% of the civil engineers shared this view.

Co-operation between institutes of education and SMEs

Different forms of co-operation exist between institutes of education and SMEs, including: traineeships in SMEs, provision of advice by education establishments about projects in SMEs, and training courses for new and existing entrepreneurs. Such interrelations are important, as they can show the shortcomings of both the institutes of education and SMEs to each other, and a familiarity with the specific characteristics of SMEs may act as a stimulus for the introduction and improvement of entrepreneurship courses in the institutes of education.

12.4.2 Barriers to the development of an entrepreneurial spirit in education

Education is an inadequate mirror of reality

To enterprises, students, and graduates the education experienced may be too theoretical. A Spanish survey of university students and enterprises points to a gap between the nature of the education and the skills required for jobs¹. Enterprises complained of a lack of realism and of an inadequate practical content in education. The fact that the courses are not updated and that the theories do not match enterprises' own practices was especially heavily criticised. In a general review of the educational system in Ireland, businesses stated that too few young people possessed the technical skills required for today's industry². And the survey of Belgian graduate economists and civil engineers found that more knowledge of practical management techniques was needed when in employment than was provided by education. The dominance of theory in education does not foster entrepreneurship as the entrepreneur's world is a very practical one.

Too little emphasis on developing personal skills

The study of the educational system in Ireland concluded that there is a need for an enterprise culture to equip students with the ability to think and to solve problems, rather than with to accumulate knowledge. The Irish enterprises studied perceived that too many young people lacked communication and other interpersonal skills, furthermore young people were generally not critical thinkers with a problem solving ability and individual initiative. When asked about their educational needs, both the graduate economists and civil engineers from Belgium referred to the need to development interpersonal skills, like communication, leadership and risk taking. In Spain, a survey of 400

¹ Ministerio de Trabajo y Seguridad Social, Encuesta para el Desarrollo de los Recursos Humanos en España (Questionnaire for the development of human resources in Spain), 1987.

² Department of Education, Education for a Changing World, Dublin, 1992.

university graduates has shown that they are averse to jobs which involve leadership functions¹. In another Spanish survey, university students were dissatisfied that their education does not favour teamwork².

Insufficiently multi-disciplinary approach

The absence of an interdisciplinary synthesis is considered a weakness in education and in the cultivation of an entrepreneurial spirit³. Students are often too narrowly focused: in accounting for example, students must know what book-keeping entries go into the accounts but may have little understanding of their economic meaning or importance. For the stimulation of entrepreneurship, eclectic knowledge is necessary as entrepreneurs do not follow the same track.

Too much attention is paid to large organisations and to the wage earning culture

The emphasis in the courses offered by business schools and universities on large rather than small firms is not conducive to entrepreneurship⁴. Consequently, it is not surprising that the majority of graduates from business schools and universities opt to work for big business or large organisations. In a survey of 95 final year economics students at the university in Belgium, 59.5% expressed a preference for a career in a big enterprise or a large organisation⁵. Moreover, the wage earning culture prevails in education, at the secondary as well as the tertiary level. The opportunities to start enterprises are rarely if ever highlighted.

Insufficient familiarity amongst the teaching staff of entrepreneurship and SMEs

The lack of small business teachers is a last obstacle⁶. Many teachers, including those teaching business, do not have a thorough knowledge of SMEs and consider small businesses as miniature big businesses. The survey of Belgian teachers mentioned above found that 89.5% of teachers considered themselves insufficiently prepared to inform their students about entrepreneurship. Consequently, it is not surprising that 80.1% contend that education does not stimulate the entrepreneurial spirit of young persons.

In addition, in business schools and universities, teaching and research on SMEs sometimes has a poor image, which can mean that these areas have less respected staff than those working in specialised departments on big enterprises. Lastly, small business teaching requires specialised staff who do not exist in the traditional, functionally oriented faculty structure.

¹ Ibeas, J.C., *Actitud de los Licenciados ante los Puestos de Mando (Attitude of the University Licentiatees regarding the Managerial Posts)*, 1992.

² Ministerio de Trabajo y Seguridad Social, *Encuesta para el Desarrollo de los Recursos Humanos en España (Questionnaire for the development of human resources in Spain)*, 1987.

³ Mentha, D., *L'Entreprise à l'Ecole (The Enterprise at School)*, Objectif PME, 10, 1993.

⁴ CEDEFOP, *Management Education for Small and Medium-sized Enterprises in the European Communities*, Berlin, 1989.

⁵ Donckels, R., J.P. Segers, *Onderwijs en Ondernemerschap: Mist Vlaanderen een Kans? (Education and Entrepreneurship: Is Flanders missing a change?)*, Brussels, 1989.

⁶ CEDEFOP, *Management Education for Small and Medium-sized Enterprises in the European Communities*, Berlin, 1989.

13 LEGAL ENVIRONMENT

Co-ordinated by l'Association pour la Promotion et le Développement Industriel (APRODI)

MAIN POINTS

- Legal forms of enterprises have the same broad characteristics in all European countries.
- The Sole Trader form is in most countries most commonly used by the self-employed and by enterprises, exceptions to this rule being Luxembourg and Sweden. Nevertheless, statistics on legal form display important differences amongst European countries.
- In particular, while Sole Traders predominate in Portugal, Spain, Greece and Germany, Companies are very numerous, even amongst small firms, in Sweden, Luxembourg, Norway, the United Kingdom, France, Finland, Belgium and the Netherlands.
- The share of Sole Traders is inversely related to firm size. Above 10 employees there are relatively more Limited Liability Companies and Public Limited Liability Companies.
- In addition to the average size of enterprises and sector specialisation, the two domains in which there exist important differences between European countries, namely tax rates on profits and capital requirements of companies, are with no doubt key factors which also explain these statistical differences.
- In particular, a differential between income tax rate and corporation tax rate favourable to the corporate form will influence recourse to that form. Other factors, such as differences in social security systems, may also explain the observed preference for corporate form.
- Although the implementation rates for European standards are quite impressive in most countries, SMEs are still sceptical and misinformed about the harmonisation process and its advantages. It should be borne in mind, of course, that the process might in fact be more favourable to LSEs, particularly those located in large advanced countries.
- A significant proportion of European SMEs remain reserved about, or reluctant to engage in, quality certification. SMEs are more often 'pushed' to get an ISO certificate rather than having freedom but positive encouragement to do so. Furthermore, costs can constitute a barrier for SME certification.

13.1 INTRODUCTION

The remit of this chapter is to present an analysis of legal forms of enterprises on one hand (section 1) and a discussion of the issue of norms and quality assurance on the other (section 2). It is the first time that the European Observatory for SMEs has dealt with the topic of legal forms¹. Obviously, both subjects play a role in the framework of harmonisation and of competition within Europe. Furthermore, these themes have links with other chapters of this report, namely business dynamics, access to financing, administrative burdens, technology and international orientation.

13.2 LEGAL FORMS OF SMEs

13.2.1 A brief recall

In each of the 16 countries of the ENSR a business start-up has the choice between several different legal forms for establishing the enterprise. Nearly all countries in fact offer the same choices. Within the range of the Observatory sectors (i.e. private and commercial non-primary sectors) a business start-up will therefore usually choose between the following²:

- Sole Trader,
- Partnership (general, simple or limited),
- Limited Liability Company (or private limited company),
- Public Limited Company³.

We shall not recap at this stage on the broad characteristics of each form since these differ little between countries. In Table 13.1 the main characteristics which must be considered when choosing a legal form are outlined. Broadly speaking one can summarise the criteria for choice as follows :

- The Sole Trader format is adapted to small size projects leaded by one person and which do not need important capital neither external financing
- The Partnership form implies a great deal of trust between partners as they are free to define rules for functioning and for sharing profits and because they possess joint liability
- Companies (Limited Liability Companies and Public Limited Companies) are to be considered when the activity concerned is 'risky', when it implies important financing needs, and when relatively high profits are expected. If the enterprise is 'small', the entrepreneur must be aware, however, that despite his/her limited liability, banks will often ask for personal guarantees in order to grant loans.

In fact, the Public Limited Company form is not of relevance for most SMEs due to the large capital requirements and heavy administrative 'burdens' implied. It is worth noting

¹ About norms and quality assurance, see also ENSR, 'The European Observatory for SMEs, Second Annual Report', Zoetermeer, 1994, chapter 7.

² Other forms are usually not very relevant for such activities. For example, Co-operatives are mainly developed in the primary sector, associations and foundations concern non-profit activities, civil societies are often founded to buy and rent apartments etc.

³ Public Limited Companies do not exist yet in Finland, Norway and Sweden. See appendix 1 to this chapter for a translation of the names of legal forms in the twelve European languages.

that European SMEs wishing to develop transnational activities in co-operation with SMEs from other European countries can constitute a European Economic Interest Grouping (EEIG). The progress of this European legal form is dealt with in chapter 5 Other European legal forms are also now developing. These include the European Co-operative Society, and the European Association.

Table 13.1 Comparison of legal forms according to the life cycle of the enterprise

	Start-up	Development	Transmission
Sole Trader	<ul style="list-style-type: none"> + No minimum capital required + Limited and cheap administrative formalities 	<ul style="list-style-type: none"> + Full freedom of the entrepreneur to run his business as he wishes - Full liability of the entrepreneur for debts of the enterprise - Possibilities of raising funds limited 	<ul style="list-style-type: none"> - Inheritance regulations and taxation may be a source of problems - The enterprise hardly ever survives the retirement or the death of the entrepreneur
Partnerships	<ul style="list-style-type: none"> + No minimum capital required + Relatively limited administrative formalities 	<ul style="list-style-type: none"> + Rules of functioning are defined by partners - Full joint & several liability of (general) partners for the debts of the enterprise 	<ul style="list-style-type: none"> - The enterprise often does not survive the retirement or the death of one member
Companies	<ul style="list-style-type: none"> - Heavy and costly administrative formalities - In general minimum capital required 	<ul style="list-style-type: none"> - Burdensome rules of functioning, especially regarding accounts + Liability of members limited to the amount of their shares + Easiest access to credit + Tax system on benefits in general more favourable 	<ul style="list-style-type: none"> + Easy transmission of capital

+ = Advantage.

- = Disadvantage.

Source: Analysis by APRODI from information provided by ENSR.

13.2.2 A statistical overview

Except in Luxembourg and Sweden, Sole Trader is the most common form of 'enterprise' in the European countries (see Table 13.2). Regarding sectoral distribution, Sole Traders are especially important in all countries in retail trade and services activities (this is not

surprising, given the characteristics of this legal form, see 13.2.1). Nevertheless, there exist great differences between countries¹.

- Sole Trader is really the predominant legal form in Portugal, Spain, Greece and Germany and is also dominant in Austria, France, Denmark, Belgium and Italy.
- Partnerships are very important in the United Kingdom, Italy, Finland, Austria, Greece and important in Sweden and the Netherlands, but are poorly developed in all other countries.
- Companies (and especially limited liability companies) are much 'used' in Sweden, Luxembourg, Norway, the United Kingdom, France, Finland, Belgium, the Netherlands.

In all countries where data exist for a sufficient time span (Austria, Belgium, Denmark, Finland, France, the Netherlands and Norway), one notes a downward trend in the share of Sole Traders.

In the five countries for which information is available by size-class (Austria, France, the Netherlands, Spain and Sweden, see Table 13.3) the share of the Sole Traders is inversely related to firm size. Companies, however, account for an important share of small and even very small enterprises in some countries, namely, the Netherlands, France and especially in Sweden. Here again, for the four countries where data on the distribution of SMEs by legal forms are available over a five year period (viz., Austria, France, the Netherlands and Sweden), there is a decreasing trend in the share of Sole Traders in the stock of SMEs²

In five countries the distribution of start-ups by legal form is available (Denmark, France, the Netherlands, Portugal and Norway, see Table 13.4). In Denmark the relative share of Sole Traders in start-ups remain stable, whilst the share increases in the Netherlands and Norway and decreases in France. Table 13.4 shows also that in France³ and Norway the birth rates of Sole Traders are below average birth rates. Denmark and the Netherlands are in the reverse position, and birth rates are constant in Portugal.

Regarding bankrupts by legal forms, by contrast, in all cases where data are available (Austria, Belgium, France, Greece, Norway, Spain and Sweden) bankruptcy rates of Sole Traders are below average bankrupt rates (see Table 13.5)⁴. This is not surprising. Because personal and enterprise patrimonies are 'confused' in this format the entrepreneur is induced to cease activity before bankruptcy occurs. Thus in Italy for example, in 1992, the cessation rate of Sole Traders was 9.4% against 4.9% for companies and 7.2% on average. In Portugal, it is estimated that Sole Traders account for 97% of total number of cessations (against 79% of total stock of enterprises). But legal form cessation can be

¹ Although statistical comparisons must be interpreted with caution because years concerned and sources used show some important differences.

² In Austria the analysis is based on data for SME dominated sectors, in the Netherlands on data for the size-class 10 to 100 employees.

³ In France changes in nomenclature and definition of start-ups have occurred in 1993 so that we prefer not to present data for several years, nevertheless according to INSEE there is no doubt that both number and relative share of Sole Traders in start-ups tend to decrease.

⁴ According to INSEE and BODACC, in France bankruptcy rate of Sole Traders was 2.0% in 1993 against 5.4% for companies and 3.4% on average.

indicative of other outcomes than failure; a Sole Trader can also change its legal form, or stop activity because the owner wishes to retire, etc.

Table 13.2 Distribution of self-employed and of enterprises by legal forms (as a percentage of total stock of self-employed and enterprises)***

	Sole Traders	Partnerships	LLC	PLC	LLC + PLC	Other forms
Belgium 1993	61.5		20.4	12.7	33.1	5.4
Denmark 1992	61.6	8.2			22.2	7.9
France 1994	61.9	1.3	27.7	6.9	34.6	2.7
Germany 1990	73.4	12.3	12.5	0.8	13.3	1.0
Greece 1988	73.8	17.4	2.1	3.8	5.9	2.9
Italy 1992	59.3	22.7			14.6	3.3
Luxembourg 1992		48*	33.1	13.4	46.5	5.5
Netherlands 1993	48.9	13.2	31.6	0.3	31.9	6.0
Portugal 1991	79.0		18.6	0.5	19.1	1.9
Spain 1990	75.9			10.6		13.5**
United Kingdom 1991	39.2	25.8			35.0	
Austria 1990	67.5	19.3	10.4	0.2	10.6	2.6
Finland 1992	42.1	22.9	33.5		33.5	1.6
Norway 1994	51.9	6.0	40.1		40.1	2.0
Sweden 1993	28.7	17.8	49.8		49.8	3.7

* Total Sole Traders + Partnerships.

** Includes Partnerships and Limited Liability Companies.

*** Agriculture, forestry & fishing excluded.

LLC = Limited Liability Company.

PLC = Public Limited Company.

No data for Ireland.

Source: Belgium	VAT Statistics, National Institute of Statistics.
Denmark	Statistical Yearbook.
France	INSEE, Fichier SIRENE.
Germany	Central Statistical Office.
Greece	Census of enterprises, National Statistics Institute.
Italy	Register of enterprises.
Luxembourg	CEPS/INSTEAD database.
The Netherlands	EIM.
Portugal	INE, National Institute of Statistics.
Spain	Las Empresas Españolas en las Fuentes Tributarias.
The United Kingdom	Business Monitor.
Austria	Kreditschutzverband von 1870.
Finland	Statistics Finland, register of enterprises.
Norway	Norwegian Statistics.
Sweden	NUTEK.

Table 13.3 Distribution of SMEs by legal form, by size-class in five countries (%)

Size-class	Legal forms	France 1994	Netherlands 1993	Spain 1990	Austria 1993	Sweden 1993
0-9	Sole Traders	65.7	52.7	80.1	80.4	37.9
	Partnerships	1.2	13.9		9.6	17.5
	LLC + PLC	30.3	28.3		9.7	41.3
	Other forms	2.8	5.1	19.9**	1.0	3.2
	TOTAL	100	100	100	100	100
10-19	Sole Traders	10.3			38.7	0.9
	Partnerships	1.6			22.6	2.0
	LLC + PLC	84.7			38.7	95.2
	Other forms	3.4			0.0	1.9
	TOTAL	100			100	100
20-49	Sole Traders	3.1	11.4	17.9	29.0	0.4
	Partnerships	2.0	6.7		29.9	1.4
	LLC + PLC	92.2	72.9		40.2	96.4
	Other forms	2.7	9.0	82.1**	1.0	1.8
	TOTAL	100	100	100	100	100
50-99	Sole Traders	1.5			6.3	0.1
	Partnerships	3.3			30.2	0.8
	LLC + PLC	93.1			63.5	96.9
	Other forms	2.1			0.0	2.1
	TOTAL	100			100	100
100-499*	Sole Traders	1.1	0.2	2.5	2.6	0.1
	Partnerships	4.9	1.1		15.6	0.8
	LLC + PLC	91.2	63.7		80.5	94.8
	Other forms	2.8	35.0	97.5**	1.3	4.3
	TOTAL	100	100	100	100	100

* The Netherlands = > or = 100.

** Spain: Other includes partnerships and incorporated companies, Sweden = agriculture, forestry and fishing included.

LLC = Limited Liability Company.

PLC = Public Limited Company.

Source: See Table 13.2 except Austria, sample, IFG.

Table 13.4 Legal forms of start-ups compared to legal forms of total stock of enterprises

	Sole Traders		Other forms		In which LLC	
	1	2	1	2	1	2
Denmark 1985	77.5		22.5			
Denmark 1991	77.5	61.6	22.5	38.4		
France 1993	56.7	61.9	43.3	38.1	35.8	27.7
Netherlands 1988	45.5	56.4	55.5	43.6	40.4	28.8
Netherlands 1993	66.5	48.9	33.5	51.1	17.3	31.6
Portugal 1993	80.0	79.0	20.0	21.0		
Norway 1988	33.6		66.4		58.3	
Norway 1993	41.1	51.9	58.9	48.1	53.9	40.1

1. As a % of start-ups.

2. As a % of total stock of enterprises.

Source: 1. Denmark: Danish Statistical Bureau & DTI.
 France: INSEE, Fichier SIRENE.
 The Netherlands: DMCD (Marktselect).
 Portugal: estimations by INE.
 Norway: The Register of Business Enterprises.
 2. See Table 13.2.

Table 13.5 Legal forms of bankrupted enterprises compared to legal forms of total stock of enterprises

	Sole Traders		Other forms		In which LLC	
	1	2	1	2	1	2
Belgium 1988	38.9	70.5	61.1	29.5	12.0	17.9
Belgium 1992	23.1	61.5	76.9	38.5	34.1	20.4
Germany 1990	9.5	73.4	90.5	26.6	57.0	12.5
Germany 1992	9.3		90.7		60.1	
Greece 1988	62.4	73.8	37.6	26.2		2.1
Greece 1992	45.0		55.0			
Spain 1990	10.6	75.9	89.4	24.1	12.9	
Spain 1993	6.2		93.9		24.8	
Austria 1993	33.9	67.5	66.1	32.5	46.5	10.4
Norway 1993	4.4	51.9	95.6	48.1	94.5	40.1
Sweden 1988	26.3	38.1	73.7	61.9	63.5	41.6
Sweden 1993	10.6	28.7	89.4	71.3	78.2	49.8

1. As a % of bankrupts.

2. As a % of total stock of enterprises.

Source: 1. Belgium: Kredietbank.
 Germany: Statistical yearbooks.
 Greece: National Statistical Service.
 Spain: Instituto nacional de Estadística.
 Austria: Kreditschutzverband von 1870.
 Norway: The Register of Business Enterprises.
 Sweden: Statistics Sweden.
 2. See Table 13.2.

13.2.3 Main differences amongst countries

Partly due to the work of harmonisation of company law of the EU (see in particular second, fourth, seventh, eleventh and twelfth Council Directives) legal forms of societies show little differences throughout the EU as far as legal nature, liability, registration formalities and accounting obligations are concerned.

There is one subject of importance for enterprises where harmonisation is not fully in action, which is the tax systems on benefits (income tax and corporation tax). Table 13.6 provides the details for 1994. Not only are the ranges of rates themselves relatively wide, but also the differentials between income tax rates (which affect Sole Traders and Partnerships) and corporation tax rates (which affect Companies) exhibit large differences.

Another area of country differences concerns the capital requirements of Limited Liability Companies. Significant differences in capital requirements and in tax rates on benefits could constitute barriers for SMEs wishing to establish in another European country, particularly because the Limited Liability Company is undoubtedly the form most adapted to SMEs for foreign direct investments. These differences could also contribute to an explanation of differences between countries regarding the 'use' of Limited Liability Companies. Table 13.7 provides an overview of the situation in the European 'sixteen'.

The German 'case' is a good example of this. Differences in the average size of enterprise and/or in sector specialisation of economies are not sufficient to explain the differences in distribution of enterprises by legal forms discussed in section 13.2.2. Considering Tables 13.6 and 13.7, one can establish the following :

- In Finland, the Netherlands, Denmark, France, Sweden and Norway the differentials between corporation tax rates and income tax rates are over 20% ; this is also the case in Belgium for enterprises with a taxable income of not more than 325,000 ECU to which a tax rate lower than the corporate tax rate of 40.17% is applied.
- In the United Kingdom, Norway, Belgium, France and Sweden minimum levels of capital required to constitute a Limited Liability Company are either nil (the United Kingdom) or relatively low (other cases)¹.
- In Germany, by contrast, the tax rate differential is low (2%) and capital requirements are amongst the highest.

Thus it seems clear that limited liability companies are likely to be more common in countries where the tax system is relatively more favourable to them and/or where capital requirements are low.

Other factors certainly also play a role in relative use of legal form. For example, in France craftsmen and shopkeepers often choose to constitute a Limited Liability Company rather than a Sole Tradership. This is partly because the tax rate on benefits of Companies have sharply decreased in the last few years (from 50% to 33.33%), but also because by doing so they can also become wage-earners of the enterprise and as such benefit from a better social security system (covering illness and retirement) than that available to the Sole Traders².

¹ In Sweden, until January 1995 minimum capital required was 5,500 ECU.

² To give a better social security to Sole Traders is one of the aims of the 'Lol Madelin' on Sole Trader (see chapter 7).

One important aspect of the harmonisation of company law has been the fact that all countries have been told to pass a law through national legislation allowing the formation of a Limited Liability Company with one member only (Twelfth Directive of the Council dated December 21st 1989). This is the case already in Belgium, Denmark, Finland, France, Germany, Luxembourg, the Netherlands, Norway, Portugal and Sweden (see Table 13.7), and had in fact been implemented before the directive in many countries. The objective of this policy is obvious, namely, to offer limited liability to individual entrepreneurs. In Belgium, France, Luxembourg and Portugal this has been done with the creation of a new legal form. However, it should be noted that there are delays in the adoption of a new legal form, and that it is possible that the one member Liability Company may not be perfectly adapted to the objective intended for it. In France where this form (Enterprise Unipersonnelle à Responsabilité Limitée (EURL)) has existed since 1985, one person Limited Liability Companies accounted in 1994 for only 0.2% of the total stock of enterprises, and for 6.0% of the total stock of Limited Liability Companies¹. In Belgium where such legal forms have existed since 1987, Sociétés Unipersonnelles à Responsabilité Limitée (SPRLUs) accounted in 1992 for 8.4% of total birth of companies (Sole Traders excluded) against 2.8% in 1987². In Portugal, this legal form is of negligible importance. Perhaps the administrative formalities linked with this form outweigh the advantages of the limited liability that it grants, as banks will still ask for personal guarantees in the event that external financing is required.

In conclusion, it should be stressed that there do not exist 'good' nor 'bad' legal forms. The problem indeed lies in the fact that the entrepreneur must have the possibility of choosing the legal form which is best adapted to his/her business and that this is not always available or is discouraged by the tax or social security system. Neither system should constitute an impediment to this choice. In particular, use of the Sole Trader form should not be discouraged when this is obviously the relevant form to be chosen. In some countries, policy makers are becoming aware of this problem. For example, in France the 'Loi Madelin'³ is aimed at restoring the image of Sole Traders by reducing inequalities between this legal form and that of the company. In Denmark, the Enterprise Tax Scheme was introduced in 1987 to give Sole Traders almost the same tax conditions as Companies. Under this scheme, retained profits (i.e. profits reinvested in the enterprise) are taxed at 34%, unretained profits remaining taxed at the income tax rate.

¹ INSEE, Fichier SIRENE.

² CEDRE, 1993.

³ For further details, see chapter 7 of this report.

Table 13.6 Comparison between income tax rates and corporation tax rates (1994, %)

	Income tax rates		Corporation	Differentials	
	Minimum rate (1)	Maximum rate (2)	tax rates (3)	(3)-(1)	(3)-(2)
	level of income	level of income	(maximum)**		
Belgium	25	55	40.17	+15.17	-14.83
	till 1,343 ECU	>61,307 ECU			
Denmark	45	68	34	-11	-34
	from 3,973 ECU	>31,520 ECU			
France	12	56.8	33.33	+21.33	-23.47
	from 3,370 ECU	>42,140 ECU			
Germany	19	47	45*	+26	-2
	from 2,956 ECU	from 52,778 ECU			
Greece	5	40	40	+35	0
	from 3,333 ECU	>23,333 ECU			
Ireland	27	48	40	+13	-8
	till 10,340 ECU	>10,340 ECU			
Italy	10	51	52.2	+42.2	+1.2
	<3,672 ECU	>153,000 ECU			
Luxembourg	10	50	33	+23	-17
	from 6,035 ECU	>34,468 ECU			
Netherlands	13	60	35	+22	-25
	<20,220 ECU	>40,435 ECU			
Portugal	15	40	39.6	+24.6	-0.4
	from 3,518 ECU	>30,428 ECU			
Spain	2	47	35	+33	-12
	from 6,200 ECU	>124,000 ECU			
United Kingdom	20	40	33	+13	-7
	from 4,361 ECU	from 34,361 ECU			
Austria	10	50	34	+24	-16
	<3,700 ECU	>51,800 ECU			
Finland	average 40	65	25	-15	-40
	?	?			
Norway	31	49.5	28	-3	-21.5
	2,723 ECU	28,253 ECU			
Sweden	average 30	51	28	-2	-23
	<22,000 ECU	>22,000 ECU			

* On retained profits.

** Only Belgium and the United Kingdom have two rates.

Source: Journal Officiel des Communautés Européennes & ENSR. Eventual municipality or other taxes as well as social contributions are not taken into account.

Table 13.7 Limited Liability Companies: Comparison of main characteristics (1994)

	Minimum capital	Min % of capital to be paid up	Number of members Min/Max	Corporation tax rate
Belgium	19,000 ECU	33.33% (6,333 ECU)	1/unlimited	Max 40.17% Min 28%
Denmark	26,000 ECU	100%	1/unlimited	34%
France	7,600 ECU	100%	1/50	33.33%
Germany	26,000 ECU	50% (13,000 ECU)	1/unlimited	45%
Greece	10,000 ECU	100%	2/unlimited	40%
Ireland	none	none	2/50	40%
Italy	10,200 ECU	100%	2/unlimited	52.2%
Luxembourg	12,700 ECU	100%	1/40	33%
Netherlands	18,000 ECU	100%	1/unlimited	35%
Portugal	2,000 ECU	50% (1,000 ECU)	1/unlimited	39.6%
Spain	3,100 ECU	100%	2/50	35%
United Kingdom	none	none	2/unlimited	Max 33% Min 25%
Austria	37,000 ECU	50%	2/unlimited	34%
Finland	2,500 ECU	50% (rest within a year)	1/unlimited	25%
Norway	6,025 ECU	50% (rest within a year)	1/unlimited	28%
Sweden	11,000 ECU	100%	1/unlimited	28%

Source: National sources provided by ENSR.

13.3 THE ISSUE OF NORMS AND QUALITY ASSURANCE

Although a common approach for norms and quality certification will in the long run have a positive effect on European SMEs by increasing their export potential, most European SMEs, especially those having weak international activity, do not yet feel the impact of the Internal Market in this area¹.

13.3.1 The harmonisation process of norms

The number of European standards (EN) ratified are 1698 for CEN (Comité Européen de Normalisation) and 755 for CENELEC (Comité Européen de Normalisation Electrotechnique) (at June 30, 1994). Despite the progress of the implementation rates of EN in most countries (see Table 13.8 for CEN standards implementation) it must be said that SMEs are still sceptical about the real extent of harmonisation within the EU.

¹ ENSR, 'The European Observatory for SMEs, Second Annual Report', Zoetermeer, 1994, chapter 7 pp.160/161.

Table 13.8 National implementation rates of European standards (EN) ratified by CEN as of May 1994 (%)

	Implementation rates	Non implementation rates
Belgium	95	5
Denmark	83	17
France	96	4
Germany	98	2
Greece	64	36
Ireland	92	8
Italy	98	2
Luxembourg	47	53
Netherlands	93	7
Portugal	95	5
Spain	83	17
United Kingdom	98	2
Austria	97	3
Finland	97	3
Norway	99	1
Sweden	99	1

Source: CEN Newsletter, June 1994.

In some cases, norms are still felt to constitute real non-tariff barriers, especially in the electronics, food and drink, and health industries¹. Although this perception often reflects both misinformation and misunderstanding by SMEs of the process of harmonisation, it is still possible to question whether the normalisation process is really intended to protect consumers and to improve product quality or whether it is simply a new form of protectionism.

This is especially relevant in the light of a Spanish study which stresses that in most cases norms have been developed by LSEs in the advanced industrialised countries which set rather difficult targets for SMEs and in particular those in the less developed countries of the Union². One of the reasons could be that SMEs are still underrepresented in the normalisation committees of CEN and CENELEC. Both the interests of SMEs and those of the less advanced countries should be given more consideration.

13.3.2 Quality assurance in European SMEs

All the countries of the Union (with the exception of Luxembourg) have implemented public support to promote and foster quality assurance in SMEs, but an important section of the Union is still reluctant, or at least reserved, about ISO 9000 certification. In fact,

¹ See for example a survey of the Danish Ministry of Industry, 1993.

² Naz Pajares, 'AENOR y la calidad. Reflexiones en torno a la normalización y la certificación en España', in *Economía Industrial*, July/August 1990.

both the main characteristics and the barriers to ISO certification are very similar in all the countries where studies or surveys have been conducted¹.

In most cases SMEs are involved in ISO certification because they feel it is compulsory, either because they are asked to do so by main contractors/buyers, or because they think it is an obligation to enter certain markets because of competition pressures. Therefore, SMEs often do not see what quality management will really bring to the enterprise. ISO 9000 certificate is seen as some kind of diploma you have to get. In this sense, as the entrepreneur too often has a misunderstanding of, or even a 'negative approach' to quality, it is not surprising that the motivation and involvement of employees, a key success factor for implementation of the quality assurance process, appears to be one of the most, perhaps the most difficult aspect of the process to implement.

Criticisms of the ISO certification process focus on the following :

- it is too bureaucratic and implies too many administrative burdens;
- it is too time-consuming;
- it is too expensive;
- it reduces flexibility.

Furthermore, quality experts stress the point that ISO certification is too static for SMEs.

Certification costs are of three kinds :

- Direct external costs or 'administrative' costs to be paid to the certification authority;
- Other external costs or fees of the consultants;
- Internal costs or time spent within the enterprise itself to set up the quality procedures.

As shown in Table 13.9 the cost of ISO 9000 certification tends to increase with the size of the enterprise. However, when divided by the number of employees cost of ISO 9000 certification is higher for SMEs than for LSEs. Although data are not fully comparable amongst countries, there is no doubt that there exist cost differences throughout Europe.

¹ See for example : France, CEGOS survey, 1994 ; Germany, IFM, Survey on quality assurance, 1994 ; Netherlands, Kwaliteitsnormen Midden-en Kleinbedrijf, Interview research, 1994.

Table 13.9 Average cost of ISO 9000 certification by size-class (in ECU)

Size class	<50	50/99	100/199	200/499	500/999	1,000 & +
France TC			138,460	171,538	184,615	284,615
Greece TC	1,667	1,750		1,917		2,167
Luxembourg DC	12,500			12,500		
Luxembourg EC	37,500			62,500		
Netherlands EC		75,936		146,031		75,936
Portugal TC			70,000	125,000		160,000
Norway EC			8,440	11,150	13,560	16,270

TC = Total internal + external costs.

EC = Total external costs only (Direct external costs + other external costs).

DC = Direct external costs only.

Source: France: CEGOS, 1994.

Greece: ELOT, 1993.

Luxembourg: Chambre des Métiers, 1994.

The Netherlands: Van Mierlo, J., Timmers, J.G., Van der Wiele, T., Inspanningen bij de invoering van ISO 9001 of 9002, SIGMA, Nr. 5, 1994.

Portugal: IAPMEI, 1993.

Norway: Agderforskning, 1994.

Moreover, as we saw last year, ISO certificates do not yet prevent large main contractors from doing their own quality audits¹, so that small sub-contractors do not see the value of ISO certification in practice and bear the risk of heavier costs.

¹ ENSR, 'The European Observatory for SMEs, Second Annual Report', Zoetermeer, 1994 chapter 7, p. 160.

Appendix to Chapter 13

Appendix 1 Names of the main legal forms in the twelve European languages.

English	Sole Trader	General Partnership/ Limited Partnership	Limited Liability Company/ Public Limited Company
German	Einzelunternehmen	OHG/KG	GmbH/AG
French	Entrepreneur individuel	SNC/Société en commandite	SARL/SA
Dutch	Eenmanszaak	Maatschap/Commanditaire Vennootschap	Besloten Vennootschap/ Naamloze Vennootschap
Danish	Enkeltmandsfirma	Interessentselskab	Anpartsselskab/ Aktieselskab
Greek	Atomiki Epichirissis	Omorythmi Etairia/ Etérorrythmi Etairia	Etairia périorisménis efthinis/Anonimi étairia
Italian	Ditte individuali	SNC/SAS	SRL/SPA
Portuguese	Empresária em nome individual	Sociedade em nome colectivo/ Sociedade em comandita	Sociedade por quotas/ Sociedade anónima
Spanish	Empresario individual	Sociedad colectiva/ Sociedad comanditaria	Sociedad Limitada/ Sociedad anónima
Finnish	Yksityinen tiiminimi	Avoin yhtiö/Kommandiituyhtiö	Osakeyhtiö
Norwegian	Enkeltmanns foretak	Ansvarlig selskap/ Kommanditteskap	Aksjeselskap
Swedish	Enskild näringsidkare	Handelsbolag/ Kommanditbolag	Aktiebolag

PART III THEME STUDIES

14 ADMINISTRATIVE BURDENS

Co-ordinated by EIM Small Business Research and Consultancy

MAIN POINTS

- In this chapter we have defined the activities that enterprises undertake in order to comply with the legislative obligations as administrative burdens on enterprises. These administrative burdens can be measured in terms of the time that must be spent, the number of forms that must be completed, the number of obligations that must be met, or the financial costs.
- Estimates indicate that obligations that result from being in business ('being an enterprise') cause between 60 and 70% of all administrative burdens. The areas of corporation tax, tax on dividends and revenue tax, annual accounts, VAT and excise levies cause most of administrative burdens.
- Obligations that result from having employees cause between 30 and 40% of the burden. Here the levying wage taxes and social premiums causes the greatest burden.
- The key to reducing administrative burdens lies both in Brussels and in the individual Members States. In areas like VAT, excise levies and annual accounts, which lead to a lot of the administrative burden on enterprises, a lot of European legislation exists.
- In other areas that impose a burden the amount of European legislation is limited (for example in areas of corporation tax, taxes on dividends and revenues, wage tax and social premiums). In these areas, national legislation is the primary source of administrative burdens.
- In the opinion of entrepreneurs the main causes for administrative burdens are the complexity, the number, and the frequency of the forms and/or obligations, and the number of changes in the forms and/or obligations.
- The total annual costs of administrative burdens for enterprises in Europe has been estimated at between 180 and 230 billion ECU. This is between 3 and 4% of the GDP.
- The total costs of administrative burdens on each enterprise are higher amongst large enterprises than amongst smaller ones. The costs per employee are higher amongst small enterprises.

continued

continued

- At European level the most important strategies, policies, and measures to reduce administrative burdens are the actions regarding the improvement of information and advice, the replacement and simplification of existing laws, and attention to the possible administrative burdens connected to new legislation.
- At the national level different strategies, policies, and measures are being used to reduce administrative burdens in the different countries. In some countries the reduction of administrative burdens has only just started.

14.1 INTRODUCTION

Aim of this chapter

In many countries, as well as at European level, the issue of administrative burdens on enterprises due to legislation is receiving more and more attention. Everywhere it is acknowledged that it is important to reduce and minimise these administrative burdens as far as possible, because they can hinder the development of enterprises and the growth of employment.

The aim of this chapter is to present an inventory of current state of administrative burdens on enterprises in the different European countries. Section 14.1.2 deals with the size and causes of administrative burdens, and the policy areas that cause the most burdens on enterprises. In section 14.1.3 the policies, strategies and initiatives that are being used to reduce the administrative burdens on enterprises are discussed. Besides, some case studies are presented.

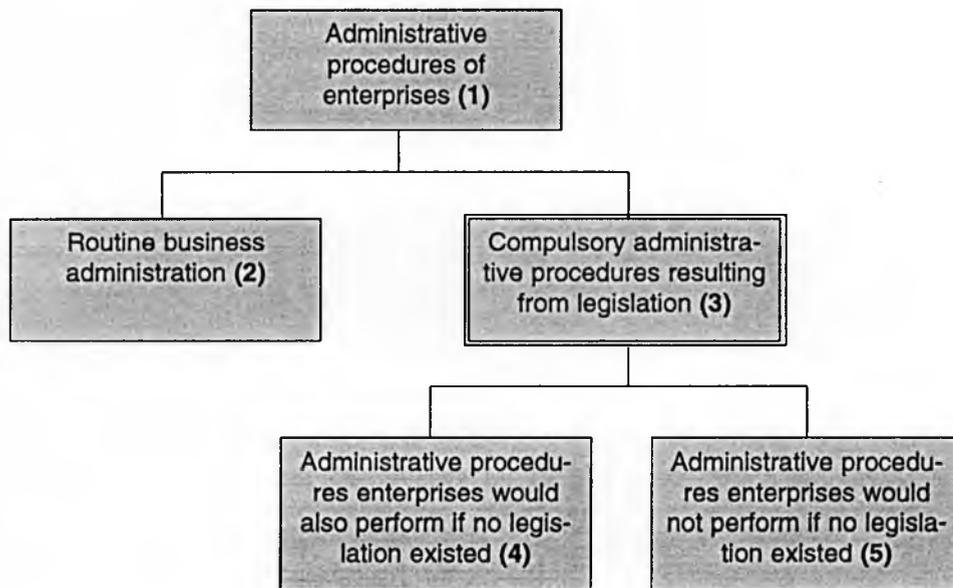
Administrative burdens: theoretical framework and definitions

Both enterprises and citizens have to carry out a number of administrative procedures. An administrative burden on citizens is, for example, the tax declaration. This chapter only deals with administrative procedures and administrative burdens on enterprises.

In theory, the administrative procedures that enterprises are carrying out can be divided into several kinds. Figure 14.1 gives a theoretical framework for these different types of administrative procedures.

Figure 14.1

Theoretical framework of types of administrative procedures for enterprises



Part of all administrative procedures that enterprises carry out (block 1 in Figure 14.1), they do for their own needs, because it gives them specific and valuable information about the enterprise (block 2). These procedures belong to the routine business administration. Examples of these administrative procedures are warehousing, procurement and sales administration, and records of debts.

The rest of the administrative procedures enterprises carry out to meet obligations that result from national and international legislation (block 3). *These procedures are compulsory for enterprises and in this chapter, we define the efforts that enterprises have to make in order to comply with these legislative obligations as administrative burdens.*

It is important to note that compulsory administrative procedures do exist for their own sake, some give specific and valuable information and enterprises would also carry them out if no legislation existed (see block 4). An example is the annual account. It is however possible that if no legislation existed, enterprises would undertake these procedures in a different way, and for instance less frequently than at present. The rest of the administrative procedures (block 5) enterprises would not do if legislation did not exist. These procedures are of no immediate value to the individual enterprise. This does not mean, however, that the obligations themselves are without value: they provide information that is used by enterprises and by society as a whole. Essential is however that the individual entrepreneur does not see a direct benefit from carrying out these procedures, That is why they are called a burden.

Administrative burdens can be measured in terms of the time that they take, the number of forms that must be filled in, the number of obligations that must be met, or in terms of their financial costs. In terms of financial costs, the administrative burdens consist of the labour costs (or parts of it) of those employees involved in getting the information that is

necessary to fulfil the legislative obligations, the costs of training and educating these employees, the labour costs (or parts of it) of self-employed who do their own administrations, the costs (or parts of it) of machinery like computers, that are being used to meet the legislative obligations, and the costs of external advice and assistance.

Some of these costs, like the labour costs of self-employed who do their own administrations, are more hidden than others, for example, the costs of external advice.

In the data on the costs of administrative burdens in section 14.2, all of these types of costs are included. The costs of administrative burdens do not include the taxes and premiums that enterprises have to pay in order to fulfil their legislative obligations.

So, in Figure 14.1 a distinction is made between several kinds of administrative procedures and some of them are defined as administrative burdens on enterprises. Although this a theoretical framework, it can be very useful in practice. In the Netherlands research has been done to make estimates of the financial costs of the different types of administrative procedures that enterprises carry out. In section 14.2.4 some of those results will be presented.

14.2 AREAS, CAUSES AND THE SIZE OF ADMINISTRATIVE BURDENS

14.2.1 Introduction

Administrative burdens result from legislation which exists in different policy areas. In section 14.2.2 the policy areas where enterprises experience most administrative burdens are discussed. In section 14.2.2 we will also look at the kinds of legislation in these policy areas: such as whether this is national or European legislation, or indeed both. This makes clear at what level the key to reducing the administrative burdens can be found.

Section 14.2.3 deals with the causes of administrative burdens through the perceptions of entrepreneurs. Finally section 14.2.4 gives information about the size of the administrative burdens on enterprises.

14.2.2 The administrative burdens and kinds of legislation by policy area

Classification system of policy areas

This section examines which legislative areas give the most administrative burdens on enterprises in the different European countries. Also attention will be paid to the kind of legislation that exists in these areas: is it national or European legislation, or both?

For this, a classification system of legislative areas is used:

- Those applicable to all existing enterprises (burdens applicable 'for being an enterprise'):
 - corporation tax, tax on dividends and revenue tax;
 - VAT and excise levies;
 - annual accounts;
 - environmental legislation;
 - community levies (local levies);

- operating licences¹;
- statistical information for (national) statistical offices;
- import/export, and transport tariffs.
- intellectual property;
- legislation dealing with the quality of products and services²;
- Those dealing with employment:
 - levying wage tax and social premiums;
 - the prevention of absenteeism because of illness³;
 - quota regulations targeting special groups⁴;
 - employment contracts and employee participation;
 - working conditions (including health and safety of employees).

ADMINISTRATIVE BURDENS WHEN STARTING UP AN ENTERPRISE

The administrative procedures that must be undertaken when starting up an enterprise depend on the legal form of the new enterprise. If one wants to start up a firm as a self employed, the procedures that in general must be done are:

- register for a general licence to start up a firm. This is needed in countries like Austria, Belgium, Germany, and the Netherlands. To get such a licence, very often a tradesman's certificate and/or a certificate of proficiency for the specific activity is needed;
- register for special licences. These special licences often relate to environmental legislation, the health and safety at work act, or to food legislation. They can also be required in areas involving financial risks, for example with activities as banking and insurance. Some of these special licences can be linked to an activity, while others relate to all activities;

continued

- ¹ Operating licences are special licences, needed for operating a business. Some of these licences count for all branches, while others can be linked to a specific branch (for example the catering business) or activity (for example if one wants to build something).
- ² Within this area legislation concerning norms, standards and standardisation of goods, health and safety of buyers of these goods and legislation dealing with the responsibility for defective products can be mentioned. Here, the legislation in these areas is only relevant if it leads to administrative procedures for enterprises. Legislation concerning for example norms and standards of products will usually lead to investments and adjustments in enterprises, but not necessarily to administrative procedures and administrative burdens. Because there is no information available on the administrative burdens that legislation in these areas causes, no further attention will be paid to them. The same counts for the legislation dealing with intellectual property.
- ³ Some countries (the Netherlands for example) maintain legislation that aims at reducing absenteeism because of illness. When an employee falls ill, enterprises have to pay for instance the first few weeks of absenteeism. After that period, the industrial insurance board takes over. For this reason, enterprises have to register sick-leave of employees.
- ⁴ In some countries enterprises have the obligation to hire a certain number of people who belong to special groups, for instance disabled people.

continued

- register in a Trade Register. This is not always compulsory. In Ireland for example, this is only necessary if someone wants to operate under a name other than his/her own personal name;
- register at the tax office for a VAT-number. In countries like Denmark, Ireland and Norway this is not necessary if turnover does not exceed a certain amount;
- register at the tax office for a tax number. In Denmark registration for a tax number also depends on the turnover of the enterprise. In the Netherlands registration for a tax number has to be done when the first employee is hired;
- register with the industrial insurance board;
- register with the national health service.

Not all of these procedures are necessary in all European countries when starting up a new enterprise (Ireland for example), while in other countries some further procedures are required (Belgium, Denmark, Norway; sometimes these extra procedures are only necessary in special cases).

The administrative burdens by policy area

Because of the lack of specific research in most of the European countries, it is only possible to give rough information about the administrative burdens by legislative area in the different countries. The main conclusions are:

- obligations that result from being an enterprise cause more administrative burdens than obligations that result from having employees. For example, research in Germany shows that the obligations concentrating on being an enterprise cause about 56% of all administrative burdens enterprises face, while 44% are caused by obligations arising out of having employees¹. In the Netherlands these figures are estimated at 71 and 29%²;
- of those applicable to all enterprises (or 'for being an enterprise'), most administrative burdens are experienced through corporation tax, taxes on dividends, revenue taxes, the annual accounts requirement, and VAT and excise levies. The least burdens are experienced through environmental legislation, operating licences, and community levies (local levies). The order of these may differ by country;
- of those burdens only applicable to enterprises with employees, the levying wage taxes and social premiums causes the greatest administrative burdens. Quota regulations, the targeting of special groups, and the prevention of absence through illness cause little or no burdens on enterprises in most countries. An exception to this is the Netherlands.

¹ See 'Kosten der Bürokratieüberwälzung', Prof. Dr. Wolfgang Kitterer, Institut für Finanzwissenschaft, Universität Kiel, 1989.

² 'Administratieve lasten bedrijven 1993' (Administrative burden in Enterprises 1993), EIM Small Business Research and Consultancy, Zoetermeer, 1994.

ADMINISTRATIVE BURDENS WHEN HIRING EMPLOYEES

The most common administrative procedures that are necessary when hiring an employee are:

- the preparation of an employment contract (usually a written one);
- to inform the employee of the collective agreement (if there is one);
- to register the new employee with the tax office;
- to register the new employee with the industrial insurance board;
- to register the new employee with the national health service;
- to register the new employee with the pension fund (if there is one).

As with starting up an enterprise, differences exist between countries. For example, the preparation of a written employment contract is not necessary in all countries. Another difference is that in some countries (Luxembourg and Sweden for example) the registration at the tax office, the industrial insurance board, the national health service, and the pension fund, can be done in one registration.

National and European legislation

In this part it is discussed whether the legislation that exists in the different policy areas is national or European¹. This makes clear, where, in each legislative area, the key to reducing administrative burdens lies.

Table 14.1 gives information to what extent European legislation exists in the different areas.

As Table 14.1 shows, the burdens from VAT and excise-duties, and those that relate to imports, exports and transportation, are completely based on European legislation. On VAT there are about 20 EU-directives. In the import/export area, there were necessary 35 documents, but this has been reduced to one (although this is a document of some 70 pages; but only one stamp is needed). Further European legislation in this area exists for trade with countries outside the European Union, and special European legislation exists for the trade in textiles and endangered species.

¹ There are different kinds of European legislation:

- regulations, which have general application and are binding in its entirety and are directly applicable in all Member States. Every year more than 4,000 regulations are being issued. Some 70% of those relate to agriculture;
- directives, which are binding, as to the result to be achieved, upon each Member State to which it is addressed, but leaves to the national authorities the choice of form and methods. In the period between 1958 and 1992 there have appeared about 1,700 EU-directives. Every year there appear 150 to 200 new directives, including changes to already existing directives;
- decisions, which are binding in its entirety upon those to whom it is addressed.

The Council and the Commission also make recommendations and deliver opinions, but these have no binding force.

Table 14.1 Amount of European legislation in the different policy areas

Area	None	Not much	Much	Complete
<i>Obligations concentrating on being an enterprise</i>				
Corporation tax, tax on dividends, revenue tax		X		
VAT and excise duty				X
Annual accounts			X	
Environmental legislation			X	
Community levies	X			
Operating licenses		X		
Statistical information			X	
Import/export, transport etc.				X
<i>Obligations concentrating on having employees</i>				
Levying wage tax and social premiums		X		
Prevention of absenteeism because of illness	X			
Quota regulations	X			
Employment contract, employee participation			X	
Working conditions			X	

In five areas: annual accounts, environmental legislation, statistical information for national statistical offices, employment contracts etc. and on working conditions, a lot of European legislation exists. The area of annual accounts is largely based on three European directives. In the area of environmental legislation, European directives apply, for example, to maximum emission standards and to the processing of waste. The increasing environmental legislation is becoming more and more of a problem for enterprises. At European level the Fifth Action Programme is relevant¹. This programme aims to achieve a sustainable balance between socio-economic development and the protection of the environment. In the area of statistical information for national statistical offices, European directives oblige Member States to make specific kinds of statistical information available at the European level. How the countries get this kind of information is a matter for the individual countries themselves. In the area of employment contract and employee participation there is a directive on the proof of an employment relationship and there are several directives which contain provisions regarding employee information and consultation. In the area of working conditions, European directives are dealing with specific products and goods, for example the VDU-directive², stipulates the maximum time that one can work behind a computer screen.

In three areas, some European legislation exists. In the area of 'corporation tax, taxes on dividends, and revenue taxes'. European directives concerning corporation tax exist. For example, one directive deals with the fiscal consequences of mergers of enterprises from

¹ 'Towards sustainability, A European Community programme of policy and action in relation to the environment and sustainable development', Commission of the European Communities, Directorate-General XI, Nuclear Safety and Civil Protection, Brussels, 1993.

² VDU stands for Visual Display Unit.

different Member States. Further legislation in this area is in preparation, but is not yet effective. Examples are the European tax treaty and legislation dealing with tax on dividends and revenue tax. In the area of levying wage tax and social premiums, there is almost no European legislation. Attempts are being made to harmonise the direct taxes. Taxes on capital are already harmonised and based on European directives. European legislation is only limited in the areas of operating licences (needed for operating a business).

In the remaining three areas (community levies, prevention of absence because of illness and quota regulations targeting special groups), no European legislation exists at all. European level quota regulations targeting special groups is not dealt with in European directives but through the European Social Fund: from this fund special projects can be financed.

In the area of employment contracts and employee participation it is important to note, that collective agreements do not exist in every Member State.

In the area of employee participation some European directives have been adopted and some others are in preparation.

The administrative burdens and kinds of legislation by policy area combined

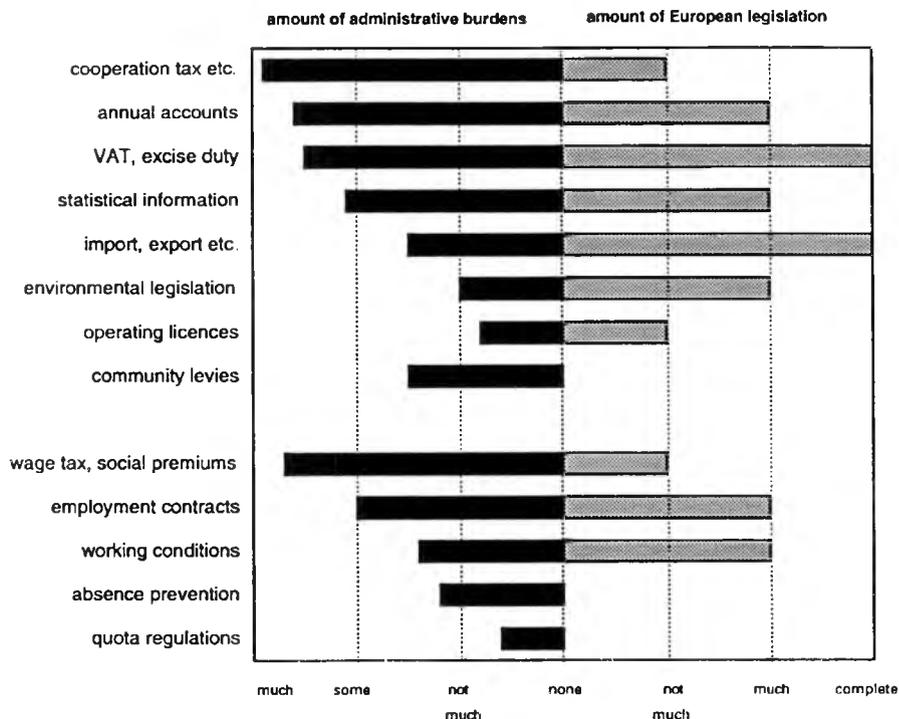
If one combines the information on the areas where enterprises experience the most administrative burdens with the information on the level of legislation (national or European), it is possible to get an idea of where the *keys to reducing administrative burdens* in the different policy areas might be found. This information gives *no* indication of the *source or origin* of administrative burdens. It might well be the case that introduction of European legislation has led to a decrease of administrative burdens. This information therefore only indicates the keys to reduce administrative burdens.

The results are shown in Figure 14.2. One must bear in mind that this figure gives only rough information, it is not based on specific research, but is largely based on the opinions of experts in the different European countries.

The conclusion can be drawn that the key to reducing administrative burdens lies both in Brussels and in the individual Member States. In some areas where enterprises experience administrative burdens a lot of European legislation exists (for example the areas of VAT, excise levies and the annual accounts). In other areas the amount of European legislation is only limited (for example in corporation tax, tax on dividends, revenue taxes, wage taxes and social premiums).

At the same time there are areas where a lot of European legislation exists, but where enterprises face only some administrative burdens (for example in the areas of imports, exports, and transportation, environmental legislation and working conditions).

Figure 14.2 The administrative burdens enterprises face by policy area and the amount of European legislation that exists, exists in this areas



A last remark concerns the new Member States. Before 1995, Austria, Finland, and Sweden were not member of the European Union so until recently European legislation was not effective in these countries. This means that in these countries existing administrative burdens could only arise from national legislation. However, in these countries European legislation has already influenced the national laws and regulations: although these national laws and regulations will have to be adjusted and adapted to a certain degree. This adaptation of national laws to the European legislation is important in these countries. In Sweden for example, a committee of inquiry has been appointed to investigate the adaptation of the country's rules concerning VAT to the European rules on VAT. It is possibility for these countries will ask for more time to adapt or for special transitional arrangements.

14.2.3 The perceived causes of administrative burdens amongst entrepreneurs

In several countries entrepreneurs share the opinion that administrative obligations give problems, take too much time, and cost too much money. The reasons for these problems are basically the same in most of the countries:

- the forms and/or obligations are too complex;
- there are too many forms and/or obligations;
- the frequency of the forms and/or obligations is too high;
- the frequency of changes in the forms and/or obligations is too great.

Research from Finland and Portugal shows that entrepreneurs see administrative burdens as an important barrier for entrepreneurship: they are seen as a barrier to business, to investment, to increasing employment, and to internationalisation. Entrepreneurs in

Portugal consider administrative burdens as one of the major threats to their competitiveness (together with labour relations, the acquisition of technology, access to finance, the cost of energy, and computers and software)¹.

The perception of entrepreneurs on administrative burdens is closely connected to the extent that the companies are informed of the use of the information, and whether they receive feedback. Furthermore, the administrative burdens are perceived differently depending on the extent of the use computers in the companies. If companies have good tools for dealing with the various obligations, the administrative procedures are easier to conduct. But when the obligations change because of changes in the legislation, problems arise despite the use of good computer systems.

Other criticism by entrepreneurs concentrates on the long processing times and the delays related to administrative procedures, the lack of industrial experience among officials at state agencies, the lack of transparency of administrative procedures, and the poor performance of public services. These criticisms relate to the quality of the services of public organisations.

The reporting procedures to the national statistical institutions are considered especially costly, time-consuming, and unnecessary.

A last point of criticism deals with the penalty system. In some countries, penalties are being imposed on enterprises if they do not comply with certain administrative obligations. In general this is not unjust, but sometimes punishments are imposed for 'accidental errors' that are made because entrepreneurs are not familiar with, or don't understand, all the rules. In these cases, entrepreneurs feel that penalties are unjust.

Individual entrepreneurs do not usually provide viable solutions when asked in what ways the problem of administrative burdens can be best solved,. They experience and see the problems, but do not have the answers (which is of course not their job).

14.2.4 The measurement of administrative burdens

The total costs of administrative burdens

It is not easy to give an overview of the costs of the administrative burdens on enterprises in the different countries. There are two reasons for this:

- the first is that research into the size of the administrative burdens on enterprises has not been done in all the countries;
- the second is that in countries where research has been carried out (Germany, Finland, the Netherlands) the research findings are not comparable because of differences in definitions and the research findings usually relate to different years.

Table 14.2 gives an overview of some estimates of the size of the administrative burdens for enterprises in some European countries.

These estimates indicate that the administrative burdens on enterprises are between 1 and 3% of GDP in the different countries.

¹ See for Finland: Malinen, 1994. The information for Portugal is based on a survey carried out in 1992 for the Managing Board of the PEDIP-Programme.

Table 14.2 Estimates of the yearly costs of administrative burdens for enterprises in some European countries (in MECU)

Country	Total
Finland	843
France	2,000-38,000
Luxembourg	76
Netherlands	6,100
Norway	838-1,700

These estimates are based on the following sources:

- Finland: Malinen, Pasi, (1994), 'PK-yritysten hallintomenettely', Turun Kauppakorkeakoulu, Yritystoiminnan tutkimuskeskus, Discussion, Turku;
- France: The estimate made by Mr. Prevost, chairman of the National Institute for Simplification, of 250 billion francs is based on a reasoned appraisal on the basis of a valorization of the time spent by 2,5 million entrepreneurs;
- Luxembourg: 'Etude analytique des obligations et formalités administratives imposées aux chefs de petites et moyennes entreprises', 1987;
- The Netherlands: 'Administratieve lasten bedrijven 1993', EIM Small Business Research and Consultancy, Zoetermeer, 1994;
- Norway: Dyrhaugh et al., 'Bedriftenes oppgaveplikt - generelle samordningstiltak', En utredning for Næringslovutvalget fra Arbeidsgruppen for bedriftenes oppgaveplikt, Oslo, Norway, 1991.

Most of the figures given in Table 14.2 are based on very rough estimates. The estimate for the Netherlands is based on specific research. This study gives detailed information about the average costs of administrative burdens on enterprises by size class and economic sector. It shows that¹:

- the total costs of administrative procedures for enterprises in the Netherlands are estimated at 16,5 billion ECU in 1993 (block 1 in Figure 14.1);
- 63% of these costs (10,4 billions ECU) result from routine business administration (block 2 in Figure 14.1). The rest (37% or 6,1 billion ECU) is compulsory and results from legislation. In this chapter, these costs are defined as administrative burdens (block 3 Figure 14.1);
- 41% of these administrative burdens (2,5 billion ECU) have to do with procedures firms would also carry out if no legislation existed (block 4 in Figure 14.1). So, 59% of administrative burdens (3,6 billion ECU) have to do with administrative procedures firms would not do if no legislation existed (block 5 in Figure 14.1).

Based on the information that is available for the Netherlands, a very rough calculation has been made to get an indication of the total costs of administrative burdens on enterprises in Europe. This calculation is based on:

- the number of enterprises in the 16 European countries by sector and size class;
- the average costs of administrative burdens by firm size and sector in the Netherlands.

Because these average costs depend on the time spent on administrative procedures and labour (and other) costs per hour, a correction was made in the average costs per firm for differences in labour costs between the countries.

¹ In this study, the entrepreneurs were asked how much time they needed in a year in their enterprise to deal with the administrative procedures in the different areas, as well as the average labour costs per hour. Also the costs of external help were asked. Based on this information, the administrative burdens of the enterprises could be calculated, as well as the average costs per enterprise, size class and branch.

Based on this information, the annual costs of administrative burdens on enterprises in Europe is estimated at between 180 and 230 billion ECU¹. This is between 3 and 4 per cent of the Europe's GDP².

The administrative burdens by size class

The administrative burdens on each enterprise and for each employee differ greatly between size classes. Table 14.3 gives information about the average costs of administrative burdens in the Netherlands.

Table 14.3 The average costs of administrative burdens per size class, enterprise and employee in the Netherlands, 1993 (in ECU)

Number of employees	Costs per enterprise	Costs per employee
0	2,800	0
1-9	12,100	3,500
10-19	20,500	1,500
20-29	47,100	1,400
50-99	62,000	900
100 or more	171,000	600
All size classes	9,800	1,800

Source: 'Administratieve lasten bedrijven 1993' (Administrative Burdens in enterprises 1993), EIM Small Business Research and Consultancy, 1994.

Table 14.3 shows that the costs of administrative burdens on each enterprise are higher in large enterprises than in smaller ones. The reason for this is that larger enterprises face more administrative obligations than smaller ones. In France it is estimated that enterprises with no employees receive on average 25 forms and compulsory statistical surveys each year, whereas enterprises with 1 to 10 employees receive on average 46 forms a year, and enterprises with 100 or more employees receive some 560 forms³.

Although the total cost of administrative burdens is higher in larger enterprises, the relative cost (the costs per employee) is higher in small enterprises. Surveys and research done in Austria, France, Germany and Greece lead to the same conclusion.

Research in several countries (Belgium, Finland, Germany and the Netherlands) also shows, that small enterprises make more use of external help to deal with the administrative obligations. Large enterprises usually deal with the administrative obligations within their own organisation. In Germany for example, 46 percent of the total costs of

¹ Because it is very well possible that the administrative burdens in The Netherlands do not equal the average burdens in Europe, three estimates have been made. The first with the average costs per enterprise, branch and size class per enterprise in The Netherlands, the second with 90 percent and the third with 110 percent of these average costs. This results in the minimum and maximum estimate.

² The estimates we made in this way correspond pretty good with the upper estimates made in France and Norway. Compared with the estimates of Finland and Luxembourg, our estimates are higher. The estimates refer to all compulsory administrative procedures (block 3 in Figure 14.1).

³ These figures are based on a estimate made in 1987 by the French Ministry of Industry. According to ANCE (1994), a French enterprise receives on average about 300 forms and compulsory statistical surveys each year. In Luxembourg 155 forms exist for SMEs.

administrative burdens in enterprises with less than 10 employees were external costs. In enterprises with 1,000 to 5,000 employees this was only 14 percent¹.

In order to measure the size of administrative burdens some studies assessed the time that enterprises spend complying with their legal obligations. Several studies indicate that, on average, an enterprise needs about 300 hours a year to deal with its administrative obligations². The differences by size class are the same: large enterprises spend more time than small enterprises, but per employee, small enterprises use much more time.

The administrative burdens by sector

The size of the administrative burdens on each enterprise and employee also differ greatly between sectors. Table 14.4 gives information from Germany.

Table 14.4 The average costs of administrative obligations per sector, enterprise and employee in Germany, 1989 (in ECU)

Sector	Costs per enterprise	Costs per employee
Industry	20,900	140
Trade	8,700	350
Craft	9,700	350
Services	12,300	260
All sectors	11,300	250

Source: Kitterer, 1989.

Table 14.4 shows that the costs per enterprise are highest in industry and the lowest in trade and craft activities. It is important to note, however, that the average enterprise in the industry is larger than that in trade and craft trades. If one looks at the average costs per employee then administrative burdens are felt most in the trade and craft activities. Research from the Netherlands leads to the same conclusions.

¹ See:

- or Belgium: Donckels, R., Degadt, J. and Uyttebrouk, 'KMO en administratieve verplichtingen - empirisch onderzoek voor Vlaanderen', Brussels, Small Business Research Institute, 1983;
- for Finland: Malinen, Pasi, (1994), 'PK-yrittysten hallintomenettely', Turun Kauppakorkeakoulu, Yritystoiminnan tutkimuskeskus, Discussion, Turku;
- for Germany: 'Kosten der Bürokratieüberwälzung', Wolfgang Kitterer, Institut für Finanzwissenschaft, Universität Kiel, 1989;
- for The Netherlands: 'Administratieve lasten bedrijven 1993', EIM Small Business Research and Consultancy, 1994.

² The estimates for Finland (Malinen), Luxembourg ('Etude analytique des obligations et formalités administratives imposées aux chefs de petites et moyennes entreprises', 1987) and Germany (Kitterer) are 290, 300 and 333 hours per company per year.

14.3 STRATEGIES, POLICIES AND MEASURES TO REDUCE ADMINISTRATIVE BURDENS

14.3.1 Introduction

In this part the strategies, policies, and measures to reduce the administrative burdens on enterprises are discussed. Section 14.3.2 deals with a classification system of possible strategies, policies, and measures to reduce these burdens. In section 14.3.3 it is investigated which of these are being used at European level, while section 14.3.4 deals with the strategies, policies, and measures in the different European countries. Section 14.3.5 discusses the preconditions that must be met to make measures and policies aimed at reducing administrative burdens successful.

14.3.2 Classification system of strategies, policies and measures

Measures to reduce administrative burdens usually take place within the framework of policy aimed at deregulation. This kind of policy aims at reducing all kinds of burdens for enterprises (not only administrative burdens) and to improve the way that markets are functioning.

To reduce administrative burdens several strategies, policies, and measures can be developed:

- in countries where there is little known on the subject of administrative burdens the gathering of information through research about the size of the administrative burdens, and the areas that create most of the burdens, is usually the first step;
- secondly, it is possible to improve the information for enterprises about administrative obligations, or to increase the possibilities for enterprises to get advice on the subject of administrative obligations. The obligations themselves remain the same;
- thirdly, it is possible to improve and simplify the forms enterprises have to complete. The information that enterprises have to give remains the same but the questions are asked as simply as possible and the lay-out of the forms is as neat as possible;
- fourthly, it is possible to simplify the administrative procedures themselves. Sometimes it is possible to reduce the frequency with which enterprises have to give information, to make it possible for enterprises to send information that is needed by several authorities to one central authority or by linking databases. In this case, the use of new technologies can be of importance;
- fifthly, it is possible to make special rules for those enterprises that are most affected by the administrative burdens. These enterprises, usually smaller enterprises, can be given privileges, for example, more time to comply with certain obligations;
- sixthly, it is possible to reduce administrative burdens by replacing existing laws with new ones¹. In these cases, a large number of laws and rules can sometimes be replaced by one new law, or complicated laws by much simpler laws;
- seventhly, it is possible for policy makers to take into account the possible administrative burdens new laws might cause. Law makers usually do not think about the trouble new laws will cause to enterprises, as a result administrative procedures often tend to be too highly detailed. In some countries new legislation do not come into

¹ Or by abolishing laws.

force before the probable administrative burdens they will cause are estimated, and the costs to enterprises are compared with the benefits (cost/benefit analysis). Also policymakers can strive to keeping the administrative burdens of new legislation to a minimum.

The above mentioned strategies, policies, and measures have an increasing impact on administrative burdens. In practise they can be closely connected to each other. For example, if the aim is to make legislation more transparent and simpler with the replacement of existing laws with new ones, this can also mean changes in the administrative procedures themselves and a reduction in the number of institutions to which enterprises must send information.

In some countries, new measures to reduce administrative burdens are sometimes first tested in the form of special projects. These projects usually aim at reducing the administrative burdens in specific cases by testing new methods, or new technologies, for example.

14.3.3 European activities to reduce administrative burdens¹

The general philosophy at the European level

At European level the problem of administrative burdens on enterprises receives a lot of attention. There is special interest regarding SMEs. The European Council holds the opinion that SMEs make an important contribution to growth and the creation of jobs in the European Union. In the opinion of the Council this is due to their flexibility and adaptability to changing circumstances, and this flexibility and adaptability is hampered by legal and administrative hurdles, especially at the three key moments in the life of an enterprise (creation, growth and transfer). So in the opinion of the Council a simple, logical and coherent legal framework is essential to SMEs, their growth, and the creation of jobs.

In the opinion of the European Council, the best policy at European level to reduce the administrative burdens for SMEs is to concentrate on setting objectives and to create a commonly defined, general framework. Part of this general framework is the need for consistency between domestic and Community regulations. It is left to the Member States to choose the means most appropriate to their specific circumstances (institutional, legal, and contractual) to achieve the objectives set by the Community.

The different actions at European level

At European level, most of the strategies, policies, and measures to reduce administrative burdens that are mentioned above are being used. The most important of these are the actions regarding the improvement of information and advice, the replacement and

¹ This section is mainly based on two sources:

- 'Report by the Commission on administrative simplification work in the Community in favour of enterprises, in particular SMEs', SEC (92) 1867, 27-10-1992;
- the Council Resolution of 10 October 1994 (94/C Z94/04).

simplification of existing legislation, and the assessment of possible administrative burdens connected with new legislation¹.

Regarding the improvement of information and advice to enterprises about administrative procedures, the provision of up to date information services for business has become increasingly necessary. This need is met across the Union by the Euro Info Centres (EICs) which is now an established computerised network providing up-to-date information to business, particularly in respect to the Internal Market.

Another action in this area is the stimulation of co-operation and consultation between Member States through the exchange of experiences and best practice regarding enterprise-support measures. Regarding this, the Commission has established a Committee consisting of expert representatives from the Member States. Its aim is to organise intensive exchanges of experience between Member States and to address both national and Community legislation by means of a series of forums concerning the objectives, structure, and efficiency of national measures at every level².

Also, in the Commission, consultations with business organisations at a European level are vitally important when considering legislation.

In addition, the replacement and simplification of existing laws at European level is important. An objective of the Commission is to make legislation more transparent and understandable. To achieve this aim a number of pieces of legislation on one subject are replaced with one comprehensive regulation without changing the substance of the directives being consolidated. In the cases of fertilisers, agricultural tractors, units of measurement, public procurement of works, dangerous substances, cosmetics, and doctors diplomas, nearly one hundred separate measures have, or will be, replaced by less than 10 new directives. Similar codification work in other areas is in progress (including fruit juices, detergents, machinery safety, and public procurement of supplies). Other examples of simplification procedures in the last years are the Customs Code³ and the abolition of tax frontiers in the Union⁴.

Furthermore, there is at present much attention on the simplification of current Community legislation. The Council has set up a group of independent experts⁵ charged with examining (in mutual consultation with the Member States) the effects of existing Community and national legislation on employment, and competitiveness, with the aim of reducing legal and administrative constraints on enterprises.

¹ See for example: *Interne markt en B.T.W. (Internal market and VAT)*. Deloitte en Touche and VAT across the European Community. Deloitte Touche Tohmatsier International, 1993.

² This committee had its first meeting on 9 December 1994.

³ This was adopted by the Council on 12 October 1992 and gives a single tool to those working in the import/export business: it regroups and organises all the Unions customs regulations which were dispersed in 30 different texts.

⁴ The new regulations in respect of indirect taxation (VAT and excise-duty; into effect since 1 January 1993) represent for business (and particularly for SMEs) a substantial simplification of the administrative formalities in Intra-Union trade. Despite these simplifications, the area of VAT and excise-duty remains an area that gives firms a lot of administrative burdens, as is shown in section 14.2.2. Changes in legislation and the implementation of these changes is also a source of administrative burdens on enterprises.

⁵ This group is called the Molitor-group, named after the president of the group, Dr. Bernard Molitor. The report of this group must be finished before June 1995.

There is also specific attention on administrative burdens connected with new legislation. A basic principle at European level is that the application of environmental legislation must be accompanied by measures co-ordinated with the objective of avoiding or minimising the administrative, financial, or legal burdens, which might impede the creation or development of SMEs. The Commission is encouraged, when making new legislative proposals and in appropriate cases, to carry out consultations, cost/benefit analysis and impact assessment studies. Both the Commission and the Member States agree that this area needs further improvement.

Other actions are also taken at European level. An example of the simplification of forms and reporting requirements is, that the Commission has been active in relation to reporting requirements under environmental directives: these must also be kept as simple as possible.

Furthermore, the Commission supports studies and research to improve commercial software capability for enterprises in order to help them develop and produce the information required by administrations and government.

Last but not least, special rules for SMEs exist at European level. As far as control measures in connection with environmental legislation are concerned, it is possible in appropriate circumstances to provide for some variations in the time frames for SMEs for adaptation or implementation or to outright exemptions for specific enterprises.

14.3.4 Strategies, policies and measures at national level

In most of the European countries the problem of administrative burdens on enterprises is recognised and policies to reduce these burdens are being developed. Table 14.5 gives an overview of the most important strategies in the different countries.

Table 14.5 Strategies, policies and measures to reduce administrative burdens in the different European countries

Country	Strategies, policies and measures to reduce administrative burdens						
	1	2	3	4	5	6	7
Austria	X	X		X	X		X
Belgium	X		X	X			
Denmark		X	X	X	X	X	X
Finland	X			X		X	
France	X	X	X	X	X		X
Germany	X	X				X	
Greece			X	X		X	
Ireland			X		X		X
Italy				X	X		
Luxembourg	X	X	X	X			
Netherlands	X	X		X	X	X	X
Norway	X	X	X	X			
Portugal	X	X		X		X	X
Spain		X					X
Sweden	X		X			X	
United Kingdom	X	X	X	X	X	X	X

Explanation:

1. Research.

2. Information and advice.

3. Forms and reporting requirements.

4. Administrative procedures.

5. Special rules for SMEs.

6. Replacement of existing laws.

7. Possible burdens connected with new legislation.

As Table 14.5 shows, in different countries different strategies, policies, and measures to reduce administrative burdens have been chosen. The rest of this section gives more detailed information on the policies used by the different European countries.

Austria

To reduce the administrative burdens on enterprises the Austrian government employs various strategies. Information to enterprises (SMEs in particular) about requirements and administrative procedures has been improved, and the number of institutions to which enterprises have to give information has been reduced. An example of this sort of initiative is the revision of the tax law, which took place in 1994.

Special measures have been taken for SMEs (especially in the area of taxation) and on the evaluation of new legislation proposals have been made but have not yet been implemented.

Some research in the field of administrative burdens has been done¹.

Belgium

In Belgium the most important strategy aims to simplify the content and lay-out of administrative forms. To achieve this, two commissions were formed: the first, the Commission 'Conform', was not successful and has been replaced by the 'Auditform'. The 'Auditform' consists of public servants from several Ministries, the commission thereby directly involves those design and use the administrative forms.

This strategy of simplifying the administrative forms has two effects: it made clear what information must be sent to the different institutions and where overlaps exist, it also made public servants more aware of the problem of administrative burdens on enterprises. Some research on administrative burdens has been done in Belgium².

Denmark

In Denmark a new committee operates under the supervision of the Ministry of Business and Industry and is charged with monitoring the impact on enterprises of all new legislation. This includes an assessment of the administrative burdens on enterprises.

This policy has led to growing attention in Denmark on the problem of administrative burdens.

Another strategy used to reduce administrative burdens in Denmark is the existence of special rules for SMEs.

¹ Schmidt, 'Personalverrechnung', Schriftenreihe des KMB-Institutes, Wien, 1989.

² Donckels, R., Degadt, J. and Uyttebrouk, 'KMO en administratieve verplichtingen - empirisch onderzoek voor Vlaanderen', Brussels, Small Business Research Institute, 1983.

Bragard, L., Donckels, R., Michel, P., Demarche, M.P. and Dupont, B., 'De nieuwe ondernemer', Brussels, Liège, Intercollegiate Center for Management Science, 1987.

Donckels, R., Cottyn, M. and Lambrecht, J., 'Hoekstenen voor een specifiek middenstands- en KMO-beleid in het Brusselse Hoofdstedelijk Gewest', Brussels, Small Business Research Institute, 1994.

Finland

In Finland the problem of administrative burdens is a concern of the national SME-programme¹. As a consequence of a study² which estimated the costs of administrative burdens on enterprises, various ministries (Ministry of Finance, Ministry of Social Affairs and Health, Ministry of Trade and Industry, Ministry of Environment) launched projects which aim to streamline administrative procedures. This may mean changing or replacing existing laws.

The results of these projects will possibly be implemented in 1995, and further measures are in preparation.

Case A

A SMALL BAKERY IN FINLAND

In Finland a small bakery with 3 owners and 2 employees produces ginger bread for the local market. In 1994, approximately 6,000 kg was produced, which resulted in a turnover of almost 58,000 ECU (VAT excluded).

One of the owners deals with the administrative matters. This job takes about half his time. The enterprise also had external help in dealing with these administrative matters. The cost of this help in 1994 was about 500 ECU, and the total cost of dealing with administrative procedures was almost 5,700 ECU. About 45% of these costs (2,600 ECU) resulted from administrative procedures that were compulsory. This is about 4% of the turnover of the enterprise.

There are three areas that take most of the time: the annual account (35% of the time the owner must spend to meet administrative obligations), the wage tax and social premiums (25%), and corporation tax, revenue tax, VAT and excise duties (15%).

The entrepreneur names two specific administrative burdens. The first is that every month the enterprise buys industrial butter. The price of this butter is between 20 and 30 percent below the consumer price, but every month the enterprise has to apply for a licence to buy this butter from the government, who fixes the price level of the industrial butter. In the opinion of the entrepreneur, this procedure is time consuming and unnecessary.

A second example is that every month the enterprise has to fill in a form for customs concerning excise on foodstuffs. The enterprise is always exempt from these duties, but still this administrative procedure must be fulfilled (since 1994, only twice a year).

¹ 'SME Report 1994', Ministry of Trade and Industry, Business Development Department, Studies and Reports 52/1994, Helsinki.

² Malinen, 1994.

France

In France, several organisations at governmental and professional level are involved in reducing the administrative burdens on enterprises. Within government the COSIFORM¹ is the most important organisation. It comprises representatives of different Ministries and 'qualified persons', and operates under the authority of the Prime Minister. COSIFORM has a liaison officer in each Ministry, and 20 regional commissions also (CORESIFORM) exist.

At professional level 'Confédération Générale des PME' (CGPME) and 'Conseil Supérieur de l'Ordre des Experts Comptables' are the most important organisations.

Recent (1993-1994) measures to reduce administrative burdens have been incorporated into two new laws: the 'Loi Madelin sur l'Entreprise et l'initiative individuelle' and the 'Loi quinquennale sur l'emploi'. Almost all the strategies have been used:

- enterprises can get information and advice by telephone, Minitel and 'vis à vis' services. There are also books for start-ups, mainly produced by ANCE and the Chambers of Commerce;
- great efforts are made to simplify administrative forms (their length and language);
- special rules exist for SMEs;
- proposed new legislation has to go to the COSIFORM with a so-called 'fiche d'impact'. This gives information on the expected administrative impact of the new legislation. COSIFORM, however, complains that it has received very few new laws;

Case B

AN INDUSTRIAL ENTERPRISE IN FRANCE

A French enterprise with 70 employees produces electronics and robotics. In 1994, the turnover of the enterprise was 3 MECU excluding VAT. Of all the time spent on administrative procedures in this enterprise, 20% is spent to meet legal obligations. Furthermore, in 1994 the enterprise paid 30,000 ECU for external support and advice in the area of administrative procedures; 85% of these costs were connected to compulsory administrative procedures.

As a result, in 1994 the administrative burdens of this enterprise were about 7% of its turnover. The annual account especially took a lot of time: 10% of the entrepreneur's time had to be spent on compulsory administrative procedures. Also 50% of the external help dealt with administrative procedures in this area.

Other areas where administrative burdens are felt are the social premiums (the formalities must be frequently repeated) and surveys (there are too many).

In France, there are also a lot of pilot projects. One deals with the creation of a central institution that would take charge of collecting all forms concerning social contributions. Other pilot projects deal with the further use of computerised data exchange.

¹ In 1990, COSIFORME (Commission pour la Simplification des FORMalités incombant aux Entreprises), which exists already since 1983, was changed in COSIFORM.

Germany

In 1983 the 'Waffenschmidt Kommission' was established by the German home office. Its task was to look for ways of reducing administrative burdens. Since then they have collected 1.800 proposals from various institutions, not only related to administrative burdens for forms, but to society in general. The commission reported in October 1994, and some proposals have been implemented. For example the procedures required when establishing a new plant have been simplified, especially in order to facilitate the building of plants in the new 'Bundesländer'. Furthermore, the number of administrative regulations regarding income taxes has been reduced. As a result the new tax handbook on income tax is only half the size of its predecessor.

The recommendations of the commission are presently being discussed, and it is expected that more of the recommendations will be implemented in the near future.

Apart from this, measures have been taken to foster the development of the new 'Bundesländer'. For example, 'hotlines' have been established for new entrepreneurs who want information.

Greece

The most important Greek strategy for the reduction of administrative burdens is the reduction and standardisation of required documents. An example of this is that enterprises can deliver information on computer discs or present their own computer printouts (for example in VAT-declarations).

Ireland

Irish efforts have evolving with renewed impetus since early 1994 in response to the findings of a Government Task Force on Small Business which dealt in detail with the issue of reducing burdens. Three important strategies are being used and are co-ordinated by a new policy unit (the Small Business and Services Division) at the Department of Enterprise and Employment.

The first strategy aims at reducing the reporting requirements through a general policy of simplifying the language and detail of forms. A recent innovation is the introduction of simplified forms relating to health and safety legislation for micro-enterprises.

The second strategy is the development of special rules for small enterprises. Moves are being made to shorten and simplify procedures required of small enterprises in areas of company law and tax administration. Progress is already evident in regard to non-legislative rules and appropriate legislative changes are being examined.

The third strategy focuses on the assessment of the impact of new legislation. Although this has been happening in various ways since 1983, there has been an increase in this activity over the last year. It is envisaged that a Joint Oireachtas Committee (a committee of both houses of parliament) will be established in early 1995 with specific responsibilities in relation to the scrutiny of existing and prospective administrative burdens on small business.

Italy

Most of Italy's policy regarding administrative burdens is based on the so-called 'Tremonti Decree', which became law on 8 August 1994¹. This law aimed in particular to reduce the burdens of taxation and the bureaucratic obligations on new enterprises. The simplified administrative requirements from new enterprises will exist for three years, this will, for example, mean that one fixed tax will replace six different taxes.

Luxembourg

Following a study carried out in 1987² the Ministry for SMEs installed a commission that dealt with the simplification of administrative burdens. All relevant ministries and professional organisations were represented in this commission. The work of this commission, which existed until 1989, resulted in the publication by the Ministry for SMEs of a 'Guide for the entrepreneur', and to some simplifications of certain administrative forms.

However, the most important proposals of the commission, those dealing with the reducing the amount and the redundancy of information, were partly blocked by the ministries. They argued that the information they requested was vital for their activities and could not be shared with other ministries for reasons of confidentiality and/or definitions of the concepts that were used. Only the Statistical Bureau was open to change.

Following the recommendations of the European Commission, and the wish of professional organisations, the new government's programme states that it will make new efforts to reduce administrative burdens on enterprises.

The Netherlands

In the Netherlands one of the most important strategies to reduce administrative burdens on enterprises aims at the burdens that result from new legislation. In 1985 the Dutch government decided that government bills should be tested for their consequences on enterprises. The Ministry of Economic Affairs was made responsible for the co-ordination of the test. A problem was that no unambiguous and manageable system existed through which to conduct such a test. Instruments were developed through co-operation between EIM Small Business Research and Consultancy and the Ministry of Economic Affairs, and two methods of assessment now exist:

- a simple test that can be done by the different ministries themselves, if necessary with the help of the Ministry of Economic Affairs. This simple test consists mainly of an analysis of documents and existing information;
- a more complex test, conducted by a specialist research institute. Whether or not this test is necessary becomes clear on completion of the simple test. To execute this test it is often necessary to undertake fieldwork within enterprises to determine the size of its administrative impact. The MISTRAL instrument is useful for this purpose³.

¹ Act no. 489.

² 'Etude analytique des obligations et formalités administratives imposées aux chefs de petites et moyennes entreprises', 1987.

³ Which stands for 'instrument to measure administrative burdens'. In Dutch: MeetInSTRument Administratieve Lasten.

In August 1994 a new ministerial committee was formed to make sure that these tests on the consequences of proposed measures on enterprises are actually being done by the different ministries. It is intended that proposed new legislation that has not been tested will not be dealt with by the Dutch Parliament¹.

Case C

A WHOLESALE TRADE BUSINESS IN THE NETHERLANDS

A wholesale trades in the Netherlands with an entrepreneur and 38 employees had a turnover of between 2.3 and 4.6 MECU in 1994 excluded VAT. Besides the entrepreneur himself, 2 employees deal with administrative procedures. In 1994, the total labour cost spent on all administrative procedures was 138,000 ECU. Furthermore, almost 40,000 ECU was spent on external help and advice on administrative matters, so the total cost of the administrative procedures was 178,000 ECU.

About 20% of these costs had to do with administrative obligations that result from legislation. This equals around one percent of the firm's annual turnover.

In this enterprise, the entrepreneur only deals with the routine business administration. The 2 employees deal with the procedures that result from legislation. The obligations like the annual account, VAT and excise levies, and the prevention of absenteeism due to illness take most of their time.

External help and advice is mainly needed for the obligations required for the annual account.

Most of the other strategies are also used in the Netherlands. In the last few years specific research in the field of administrative burdens has been done, together with special projects. These are aimed especially at the simplification of correspondence between enterprises and the industrial insurance boards. Important initiatives are, for example, aimed at promoting the use of electronic mail when reporting absence through illness of employees.

Only recently has the Dutch Government started to look at the administrative burdens that are caused by existing laws and to try to increase the transparency of existing legislation.

Norway

In Norway the issue of reducing the administrative burdens for SMEs has been on the agenda for at least 15 years. It is recognised that difficult administrative procedures can hinder the operations of enterprises.

The most important strategy aims at simplifying the administrative procedures themselves. There is special attention on the problem of different authorities asking enterprises for the same information. To reduce administrative burdens projects have been

¹ It is also the intention that the Ministry of Economic Affairs agrees on targets with the other ministries aimed at the actual reduction of administrative burdens for companies, which result from the legislation concerning those ministries.

initiated and carried out by the Ministry of Industry and Energy, the Ministry of Finance, and the Confederation of Norwegian Business and Industry. One of the most important results is the establishment of the Unity-Register ('Enhetregisteret') which begins in 1995 and in which all the general information about enterprises will be located. Some research has also been conducted¹.

In order to simplify and reduce administrative burdens on SMEs, special rules have been introduced. Since 1992 small enterprises with less than 10 employees have had to give less information for official industrial statistics.

Portugal

In Portugal a Business-Administration Commission was established in 1987 as part of the Secretariat for Administrative Modernisation. This is a commission of eight representatives of the most relevant business associations, eleven General Directors of public institutions related to business activities, and some other experts in the area of administrative burdens.

One of the first actions of the Commission was a study called the 'Interministerial Programme for Debureaucratisation'. This was adopted by the Portuguese Government in 1988 and contained about 90 proposals for administrative simplifications in areas such as the registration of new enterprises, fiscal, statistical obligations, and obligations related to international trade.

The Programme also paid attention to the possible administrative burdens related to new legislation. Procedures were introduced to assess several issues relating to the preparation of new legislation, such as need, opportunity, efficiency, adaptation to requirements of the users, transparency and cost-benefit optimisation.

More recently the Commission has worked on improving information to enterprises on administrative procedures. Measures have been taken which aim to simplifying these procedures. An example is the establishment of the 'Public Notary Pivot' as an innovative 'one-step-shop' for several administrative obligations.

New legislation has also been introduced. Examples include the new 'Regulation for the Installation and Functioning of Industries' (adopted in 1991, this simplified the licensing procedures in industry), and a new 'Code Law for the Recovery of Companies and Bankruptcies'.

In the programme of the Commission for 1994/1995, special attention is given to the simplification of administrative procedures and improving the transparency of legislation, information and the interaction between the public and private sectors.

¹ Dyrhaug et al., 'Bedriftenes oppgaveplikt - generelle samordningstiltak', 'En utredning for Naeringslovutvalget fra Arbeidsgruppen for bedriftenes oppgaveplikt', Oslo, Norway, 1991.
Sletten, J., 'Fra etablerenopplaering til bedrift?', FOU-rapport 142, Agder Research Foundation, Kristiansand, Norway, 1993.

Case D

A CIVIL CONSTRUCTION COMPANY IN PORTUGAL

In Portugal there is a civil construction company with 1 entrepreneur and 55 employees (5 permanent and 50 non-permanent). In 1994, the turnover of this enterprise was 1.2 MECU excluding VAT. In this enterprise, three people deal with administrative procedures: the entrepreneur and 2 of his (permanent) employees. Of all their time spent on administrative procedures, 20% is spent on compulsory procedures. Furthermore, in 1994 the enterprise spent 2,755 ECU on external help on administrative matters; 45% of this help had to do with administrative procedures that result from legislation. As a result, the administrative burdens of this firm were between 1 and 2% of the turnover in 1994.

The entrepreneur spends time on almost all of the areas in which legislative obligations must be met. The 2 employees who are dealing with administrative procedures mainly deal with procedures like corporation tax and revenue tax, VAT and excise levies, the wage tax, and social premiums.

In the opinion of the entrepreneur, most of the administrative burdens are connected with taxes (the administrative obligations in this area are too complicated) and community levies (too time-consuming). Another reason for the administrative burdens are, in his opinion, the frequent changes in legislation.

Spain

In Spain efforts to reform public administration are not specifically focused on enterprises, but on all citizens. In the last two years the Government¹ has developed a plan to reform public administration. This has led to a new law for Legal Regimen of Public Administration and Administrative Procedures, which came into force on August 27, 1994. This law covers the general ways to develop new administrative procedures. Efforts have also led to improvements in the area of information and advice to enterprises regarding administrative procedures.

Sweden

From 1991 to 1994 the Swedish government carried out a programme of deregulation. The programme mainly aims to create a better business climate and to stimulate new enterprises. Some fifty reforms have been introduced to facilitate entrepreneurship and to improve the conditions for companies.

In 1993 a Deregulation Commission was appointed by the Swedish government. This Commission proposed a rolling review of rules affecting companies. Simplification of legislation is one of the most important strategies in Sweden. Reforms have been carried out in areas such as the registration of new enterprises, tax deductions for entrepreneurs etc.

¹ Plans have been developed by both the national and regional authorities.

At the moment a study is being undertaken (which was initiated by the government) to investigate the problems of SMEs in dealing with administrative obligations. This study will be completed at the end of January 1995 and will result in proposals for changes in the information requirements and changes in administrative forms.

The United Kingdom

The UK government has placed a great deal of attention on the need to reduce administrative burdens on all enterprises, and in particular, on SMEs. The major product of this attention is the 'Deregulation Initiative', outlined in the government's recent White Paper 'Competitiveness: Helping Business to Win' (May 1994).

The UK government has adopted a twin strategy of reviewing existing regulations, and a rigorous evaluation of all new regulations. These are equally important.

In its review of the existing regulatory system (in close consultation with business), the government has just completed the first stage of the process, over 500 measures have been identified requiring action, and a process of rolling reviews of regulations will be established in the future. These measures concern, for example, health and safety legislation, environmental legislation.

To avoid possible burdens caused by new legislation, all new regulations which are likely to impose a burden on enterprises are subject to a compliance cost assessment and, where appropriate, an assessment of risk. This will ensure that future regulations are kept to a minimum and that all regulations enforced will be cost-effective¹.

Other important strategies in the United Kingdom are the simplification of administrative procedures, for example the payment of taxes has been streamlined, and special attention has been paid to SMEs their forms and reporting requirements.

Strategies, policies and measures at national level: summary

An examination of the different strategies, policies, and measures taken to reduce administrative burdens on enterprises in the different countries reveal clear differences:

- in countries like Belgium and Greece, the focus is on the forms and the reporting requirements;
- in countries like Finland and Norway, the focus is on the administrative procedures and the institutions to which enterprises have to send their information;
- in countries like Portugal, Sweden, and the United Kingdom, existing laws are being replaced by new, more transparent and simple laws;
- in countries like the Netherlands and (again) the United Kingdom, attention is being paid to the administrative burdens that arise from new legislation.

It is also clear that in some countries (France, the Netherlands, the United Kingdom) an array of measures have been taken, while in others (Belgium, Italy) only a limited number of strategies are being used. Lastly, it is clear that some countries (Sweden, the

¹ Cost-benefit analysis and assessments have been made in the United Kingdom in relation with specific laws. Examples are:

- 'Single market business cost/benefit analysis, An assessment of the costs and savings to British Business resulting from compliance with the changes in customs requirements brought about by completion of the single market', Single Market Unit, HM Customs & Excise, October 1992;
- 'EC directive on packaging and packaging waste, Compliance cost assessment', Final Report, Department of Trade and Industry, December 1992.

United Kingdom) are further advanced than others (for instance Luxembourg) where initiatives have only recently begun.

14.3.5 Preconditions to reduce administrative burdens

To be successful, policies to reduce administrative burdens on enterprises must meet some conditions¹:

- all those involved in the legislative process must be committed to the policies. Political commitment is vital, but business and social organisations must also assume a degree of responsibility. Close co-operation between public and private institutions, and consultations with social organisations, are important;
- existing laws and regulations should be systematically and frequently evaluated for their negative effects;
- there should be procedures in the legislative process that guarantee that attention is given to undesirable side-effects of new legislation and any associated regulations. These procedures must be given a formal status, which means that attention must be given and that sanctions may be imposed if a review does not take place. In these procedures, four questions must be asked:
 - the need for government regulation must be evaluated. In other words: how far should government extend its responsibilities?
 - if it is felt that the government should play an active role, alternatives to regulation (such as information campaigns and self-regulation) should be considered;
 - once it is decided that government regulation is the best form of intervention, the lightest form of regulation must be chosen;
 - the possible side-effects of the regulation should always be evaluated independently.
- both the evaluation of existing legislation and the evaluation of the possible side-effects of proposed new legislation and instruments are needed. Adequate knowledge amongst all those involved in the legislative process is vital, and a range of different instruments (like checklists, databases and measuring instruments) is needed to collect practical, preferably quantitative, information about the effects of legislation.

¹ 'Best practice in SME policies', Presentation 'Reducing the regulatory Burden on Business, How can this be achieved?' by the Delegation of the Netherlands to the Working party of the Industry Committee on Small and Medium sized Enterprises (SMEs), Best practice in SME Policies, OECD, Paris, 2-4 May 1994.

15 PRODUCER SERVICES

Co-ordinated by Bocconi University, Centro Studi sull 'Imprenditorialità 'Furio Cicogna'

MAIN POINTS

- SMEs are involved in a highly competitive environment. The use of producer services is a crucial factor for competitiveness of SMEs promoting the access to technological information, the development of product and process innovation, the growth of exports, and for market access. However, demand for modern services amongst SMEs still seems to be relatively low, the main reason for this being the low formal competence of many managers and entrepreneurs.
- The use of producer services as a percentage of gross production seems to be higher for LSE dominated sectors and less for SME and micro-enterprise dominated sectors.
- Business services are the most heavily purchased services by micro-enterprises and SMEs, while LSEs are most dependent on banking and financial services.
- An important issue is the externalisation of service sourcing by enterprises. The kind of business service and the firms' size are among the variables which influence the choice of internalising or seeking external service provision.
- Small firms are characterised by a high degree of internal service provision, while the demand of external producer services is higher for medium size enterprises. Large firms are capable of internalising a large number of their services which they tailor to their specific needs, but they also use specialist external services, so the degree of combined internal and external provision is higher for large enterprises.
- Alongside the trend of using more external service providers there has also been an increase in the number of tertiary jobs in manufacturing. This indicates the high degree of complementary between internal and external services.
- Producer services are dominated by SMEs in every country.
- Producer services have the highest average annual growth rate in terms of employment, a slightly below average annual growth rate in terms of value added, and the lowest performance in terms of productivity, relative to the other sectors of industry.
- There is a high degree of concentration of services in the central regions and major urban areas, but some decentralisation is apparent in some countries.

continued

continued

- Despite their low share of international trade there is evidence of an increasing internationalisation in producer services.
- There does not seem to be an explicit public policy toward the development of service activities in any country, but several programmes have stimulated the provision of these services. In Portugal the PEDIP programme which has made SMEs aware of their own needs and of the importance of contracting external services. In Italy, France, Ireland, and Sweden financial subsidies to stimulate the demand of services by SMEs are available. In Spain and other countries the co-operation network programmes have been launched.
- Public authorities are designing new policy schemes aimed at assisting SMEs through the development of technology and service providers; these aim to improve the quality of the local environment in which SMEs operate.
- Other kinds of policies may be needed to increase the formal competence of managers and entrepreneurs and to make them aware of the opportunities that arise through the use of services.

15.1 INTRODUCTION

Producer services are a growing sector, in which most of firms are SMEs, but they are also a diverse set of activities that are increasingly important to the competitiveness of industrial or service SMEs. This chapter therefore investigates both the supply of these services and the demand for them from SMEs.

Economic analysis demonstrates that the use of services, such as consulting or marketing services, is crucial to SMEs access to technological information, the development of product and process innovations, growth in exports, and access to markets; but difficulties arise when assessing the demand of producer services.

External experts may be better able to evaluate the quality of services needed by SMEs than measurements of their use by SMEs. In fact, the demand of producer services is often only latent as many industrial SMEs have no experience in the use of producer services, they do not perceive a need for them, and often consider them too expensive. Empirical studies of the analysis of the demand for producer services by SMEs in various countries demonstrate that it is difficult to fully understand the demand for services, because some aspects, such as the quality of services perceived by the users, and the willingness to pay for them, are elusive subjective concepts, which depend on the persons interviewed. On the contrary, empirical studies on the structure of service firms allow to found the analysis on quantitative or more objective measures.

An analysis of the supply of services has a crucial importance for SMEs as their availability in the business environment is a means through which they can reduce their disadvantage relative to large firms.

15.1.1 Research methodology and definitions

First, producer services must be given a precise definition.

As elsewhere¹ producer services are here defined as service activities whose outputs are, in the main, purchased by enterprises. Producer services are intermediate or auxiliary to production processes in other industries; they support these activities which are based on a transfer of knowledge and information. The demand for producer services is largely governed by the output and investment decisions of other enterprises. Producer services include business and professional services, financial services, insurance services, and real estate services. The expression 'business services' is often used, and normally refers to a sub-set of 'producer services', that is services such as: consulting, advertising, engineering, and software. Business services represent the highest proportion of the employment and total value added amongst producers services, and they are of particularly importance in providing an external support environment for SMEs. It is also easier to find information on business services than on producer services, so the discussion in this chapter will sometimes be confined to business services.

Producer services do not include distributive services (retail and wholesale trades, transport and communication services) which are used to take the product to market, and are necessary only after a product has been produced. Producer services are also different from personal services, these are used by individual consumers and the social services. Therefore, in this report the following activities are considered to be producer services (NACE 70 classification):

- NACE 81 banking and finance;
- NACE 82 insurance and pension funds, except compulsory social security;
- NACE 83 activities auxiliary to banking, finance, and insurance; real estate transactions (except letting of real estate by the owner, see NACE 85), and business services;
- NACE 84 renting, leasing and hiring of movables;
- NACE 85 letting of real estate by the owner.

The sub-sector NACE 83 is considered here as 'business services', which includes activities auxiliary to banking, finance, and insurance; real estate transactions, legal consultancy, accountancy, tax consultancy, auditing, technical services, advertising, market research, management consultancy, data processing and other services to enterprises.

Precise statistical information on each of these activities is often lacking in many countries and an international comparison at the European level is difficult. While the NACE classification has been accepted in almost all the countries, statistical information has not necessarily been collected at a very detailed sectoral level in each country, and all national reports stress the lack of adequate quantitative and qualitative information on the supply and demand of producer services. The lack of consistent statistical information gathered on a regular basis has necessitated the use of ad hoc studies on the service sectors of different countries. As these studies vary in their classifications of service activities, the period of analysis, and the geographical area covered, there are obvious difficulties in making comparisons. Furthermore, the lack of official statistics that identify

¹ Elfring T., An International comparison of service sector employment growth, United Nations Economic Commission for Europe, Geneva, 1992.

and describe the changes in the supply and demand of these services has meant that much of the existing work is based on the opinions of experts.

This chapter uses the Eurostat/EIM data to present comparisons at European level on the use and supply of producer services. This is the first time that information of this kind has been made available regarding producer services, and it enables a description of the sector's structure.

15.1.2 Structure of the chapter

The second section examines the demand for producer services with reference to their role in SMEs' competitiveness. The use of producer services will be assessed through input-output data, trends in the internalisation and externalisation of these services will be examined, as will be the process of the increasing service orientation (also called 'tertiarisation' of employment) in industrial firms.

The third section will analyse the supply side of producer services through the available statistical data and empirical studies. This will focus on the growth of services, regional concentrations of services; their internationalisation, and the impact of the internal market on the business services.

The fourth section will analyse policies relating to the supply and demand of producer services.

15.2 SMEs AND PRODUCER SERVICES

15.2.1 The increasingly important role of services in SMEs' competitiveness

Producer services are a crucial facilitating factor in the business environment, they are the interface between individual enterprises and their local environment, their market, and their suppliers. They represent a 'soft' infrastructure for enterprises, which is becoming increasingly important in the competitive process.

SMEs are involved in highly competitive markets, where the role and accessibility of information and services is increasing as a factor of comparative advantage between various countries and regions. Moreover, market demand is becoming more differentiated and customer service is becoming a crucial factor in competitiveness within international markets¹. The increase in the use and availability of services reflects this more competitive business environment.

Demand for producer seems to be also influenced by the following factors²:

- the production technology;
- the size of client enterprises;
- the nature of the input flows and degree of vertical integration;
- the extent and differentiation of markets;
- the public regulations in countries or regions concerned.

¹ Formica P., Rapporto sul terziario industriale in Emilia Romagna (Report on producer services in Emilia Romagna), in 'Quaderni di analisi', Bologna, 1982.

² A. Paula Delgado, 1994.

15.2.2 SMEs' need for producer services

The size of the enterprise is one factor which influences the demand of services. There are micro-economic indications that the demand for producer services initially rises with increasing enterprise size such that demand for them is normally found to be higher amongst medium sized firms than amongst small firms¹, but after firms reach a certain size their demand for producer services levels off, and indeed the use of these services appears to decrease slightly amongst the largest firms². There is, however, no evidence that this relationship holds for the use of external producer services at the macro-economic level. From the input-output data we know that LSE dominated sectors use more producer services than micro-dominated sectors (see 15.2.3).

The demand for these services is also affected by the technological level of the firm: the demand being higher in modern sectors than it is in traditional labour intensive sectors.

The demand for external services by SMEs is concentrated in the most mainstream services, such as accounting, tax accounting, and computer services. A Spanish study found that over 90% of the small firms analysed uses these kind of services, and in Belgium a survey found that 76% of SMEs used accountants³. These patterns of demand are explained by the mandatory regulations that necessitate their use and underpin the demand. Nonetheless, a new trend is now visible in many European countries with an increasing demand for other services such as marketing, advertising and education and training.

In the southern countries such as Spain and Italy the supply of mainstream services for SMEs is sufficient, the availability of new or innovative services may be poor⁴.

The demand for producer services by SMEs is generally low and one of the main reasons for this is that managers and entrepreneurs are often unable to identify problem areas which could benefit from the use of external services; and they are often unaware of the extent of the services available. According to a survey on Italian SMEs⁵, and some academic experts, other reasons for the low use of external producer services by SMEs include: the fact that the services have been developed to meet the requirements of large firms so they may not be well designed or appropriate for smaller firms; the inability of SMEs to identify a service and assess the quality available; and the lack of internal

¹ Mañas E., La demanda de servicios a empresas según tamaño, actividad y localización (the demand of producer services by size, activity and localisation), *Papeles de Economía Española* N. 50, 1992.

Barbieri G., Rosa G., Terziario avanzato e sviluppo innovativo (producer services and innovative development), Il Mulino, Bologna, 1990.

² Bramanti A., Servizi alla produzione e politiche locali. La domanda delle PMI innovative (producer services and local policies. The demand of innovative SMEs), *Quaderni del Consorzio Milano Ricerche*, Milano, 1989.

³ FEDEA, Los servicios en España. Situación y perspectivas (Producer services in Spain), 1993. Confindustria, Cultura e comportamenti del piccolo imprenditore (Culture and behaviour of the small business' entrepreneur), SIPI, Roma, 1991.

Donckels R., Webben weven (weaving webs), Roularta Bodes, Brussels, 1992.

⁴ FEDEA, 1993.

⁵ Confindustria, 1991.

competencies with smaller enterprises may inhibit their ability to respond to the external services on offer¹.

A large scale survey on SMEs² suggested that the demand for services is often overestimated, as firms are reluctant to admit that they do not use services which are widely recognised as modern and crucial for their competitiveness. Demand therefore tends to be overstated. However, in many less developed regions a crucial problem is the low demand of services, despite SMEs need for modern services, and the surplus supply available from public and private service providers.

15.2.3 The use of producer services

The use of input-output data provides an insight into the use of producer services by micro, SME and LSE-dominated sectors, and by different industrial sectors (extraction, manufacturing, wholesale trade, etc.).

At European level (Table 15.1), the use of producer services as percentage of gross production is higher amongst the LSE dominated sectors than amongst the SME-dominated sectors, with the micro dominated sectors at a still lower level. One explanation for this might be the internal competencies of the enterprises: large enterprises have a greater ability to evaluate and access the services they require. Another explanation may be the differences in the nature of the activities (sectors) which each size class dominates.

Within producer services, SME dominated sectors use the most business services (NACE 83) whilst LSE dominated sectors use more banking and financial services (NACE 81 and 82).

Within the different countries it is notable that in some countries, such as Belgium, the United Kingdom, Finland, Norway, and Spain, the SME dominated sectors make the greatest use of producer services, while in Denmark, Italy, and Sweden, micro dominant sectors purchased the most producer services and with LSE dominated sectors used them least.

In Belgium, Italy, the United Kingdom, Norway, and Sweden, business services are the most used services by all size categories, whilst in France, Greece and Ireland, SME and micro dominant sectors purchase mainly business services and the LSE dominated sectors purchase primarily banking and financial services. In Germany, Luxembourg, the Netherlands, and Austria, banking and financial services are the most used by all the sectors. In Spain insurance services are the most bought, in Denmark and Finland the letting of real estate by the owner dominates; and in Portugal LSE dominated sectors buy mainly banking and financial services whilst micro and SME sectors primarily buy services of the 85 NACE sector (letting of real estate by the owner).

By industry (Table 15.2), it is clear that within Europe the purchase of producer services is highest within the producer services sector itself (12.3% of gross production), followed by the construction sector (8.7%) and manufacturing (5.4%). The high use by the con-

¹ Le conseil en PMI, la demand, in 'Evaluation du FRAC', MICE, Bernard Julhiet conseils, 1991.

² FEDEA, 1993.

struction sector can be explained by the need for technical services such as architects and civil engineers.

Table 15.1 Use of producer services as percentage of gross production, EU-16

	Purchase of goods and services (NACE 81)	From banking and finance (NACE 81)	From compulsory social security (NACE 82)	From insurance, pension funding, except compulsory social security (NACE 84)	From renting, leasing, hiring movables (NACE 84)	From letting of real estate by the owner (NACE 85)	From NACE 81, 82, 84, 85	From business services (NACE 83)	Total purchase of producer services (NACE 81-85)
Micro-dominant*	33.5	0.6	0.9	0.4	0.9	2.7	1.4	4.1	
SME-dominant	45.2	1.4	0.9	0.4	0.9	3.6	2.3	5.9	
LSE-dominant	50.0	3.4	1.1	0.3	0.5	5.4	1.8	7.2	
Total	44.8	1.9	1.0	0.4	0.8	4.0	2.0	6.0	

* Dominance is defined as micro, SME (10-499), LSE largest share in employment.

Source: Eurostat/EIM Small Business Research and Consultancy.

Table 15.2 Use of producer services by sector, as percentage of gross production, EU-16, 1988

	Total use (NACE 81)	From banking and finance (NACE 81)	From compulsory social security (NACE 82)	From insurance, pension funding, except compulsory social security (NACE 84)	From renting, leasing, hiring movables (NACE 84)	From letting of real estate by the owner (NACE 85)	From NACE 81, 82, 84, 85	From business services (NACE 83)	Total purchase of producer services (NACE 81-85)
Extraction	57.1	0.8	1.0	0.2	0.4	2.4	1.5	3.9	
Manufacturing	54.4	1.3	1.0	0.3	0.6	3.2	2.3	5.4	
Construction	43.8	2.9	0.8	0.5	1.2	5.3	3.4	8.7	
Wholesale trade	19.7	0.9	0.4	0.6	1.3	3.2	0.8	4.0	
Retail trade	11.4	0.2	0.2	0.1	0.2	0.7	0.2	0.9	
Transport & com.	36.9	0.7	1.5	0.3	0.7	3.2	1.7	4.9	
Producer services	35.3	6.5	1.4	0.5	1.2	9.6	2.8	12.3	
Personal services	51.3	0.9	1.1	0.5	1.0	3.5	1.4	4.9	
Total	44.8	1.9	1.0	0.4	0.8	4.0	2.0	6.0	

Source: Eurostat/EIM Small Business Research and Consultancy.

Manufacturing, construction, transport and communication mainly buy business services, while the wholesale trade and producer services primarily purchase banking and financial services. The high use of banking and financial services by producer services may be partly explained by the presence of the real estate sector amongst these services, as many banks are heavily committed to property investments. There are also a large amount of transactions within the banking sector itself.

In most of the countries the heaviest users of producer services are other producer service providers, but in Belgium, the United Kingdom, Finland, Norway, and Sweden the heaviest user of producer services as a proportion of gross production is the construction sector; and in Italy it is the personal services sector. In almost all the countries business services are the most bought services across all the sectors, but in Luxembourg, the Netherlands, and Austria banking and financial services are the most used by all the sectors; in Spain the insurance services are the most used by all the sectors; and 'letting of real estate by the owner' is the most used service by all the sectors in Finland and Sweden.

15.2.4 Internalisation and externalisation of services

The extent of internalisation (in-house provision) or externalisation (external purchase) of producer services¹ theoretically depends on the different price (or costs) quality (P/Q) ratios in external and internally provided services. SMEs appear to be often more interested in the price of the service, probably because they lack financial resources. Other complementary factors which determine the use of external or internal services are²: the adequacy of the external supply; the extent of uncertainty regarding the quality of externally provided services; the internal ability to control and stimulate the external service provider.

The degree of externalisation varies with the type of producer services, the size of the firm, and by country.

The highest degree of externalisation is evident in operational services³ and engineering (58% and 56%), financial services and advertising are also above the average level (41%) and the lowest degree of externalisation is found in public relations (11%), R&D (12%), and computing services (22%). The services usually supplied by a combination of internal and external provision are computing services, legal services, and public relations⁴.

The size of the firm is another factor which influences the internal or external sourcing of services. Small firms are characterised by a higher rate of internal service provision

¹ With internalisation of services we mean that services are provided in-house by the internal structure of the firms; externalisation means that services are contracted out to specialist firms and combined provision indicates that the same service is both internally provided and externally purchased by the firm.

² Holstrom B., The provision of services in the market economy, in Inman R. (Ed.) 'Managing the service economy: prospects and problems'; Cambridge University Press, Cambridge, 1985.

³ Operational services include cleaning services, catering, guard and security services, leasing of computer and office machines and other services.

⁴ Commission of the European Communities, Social Europe, reports and studies, n.3, 1993.

(44% of services are internalised within firms with 0-50 employees) with the services being informally provided by the entrepreneur himself, through his personal contacts, and through other non market relations with other providers mainly within the local environment. This trend has been found for a sample of French, German, Italian, Dutch, and British firms¹. Portuguese and Spanish firms were found to externalise those services which they could not develop in-house.

The demand for external producer services is higher amongst medium size firms (56% of the total services used were externally provided)². Medium sized firms are more capable of interacting with specialised service providers and can more easily afford the services.

Large firms are capable of internalising a large extent of their service requirements and to tailor these internal services to their specific needs. Their large size means it is often cheaper to bring services in-house. The degree of externalisation amongst large firms is therefore lower than amongst medium sized firms. The use of combined provisions is, however, higher, perhaps reflecting an awareness of other benefits of external services (Table 15.3)

In summary, large firms seem capable of applying the best make/buy solution for each specific service considered. They may develop useful synergies between the providing routine capabilities internally and seeking specialist external services.

Table 15.3 Degree of externalisation by company size (France, Germany, Italy, the Netherlands, the United Kingdom)

Employment	Externalisation	Internalisation	Combination
0-50	37	44	19
51-500	56	22	22
501-1000	38	29	33
1001-5000	39	35	26
>5000	37	33	30
Total	42	31	27

Source: P.M. McIntock, The cost of Non-Europe for business services, 1988.

Within the different countries France and Italy are characterised by high level of externalisation and low levels of combined provision, the Netherlands and the United Kingdom show relatively high rates of combined provision, whilst Germany has a high level of internal provision (Table 15.4).

¹ Peat Marwick McIntock, The cost of Non-Europe for business-services, 1988.

² Peat Marwick McIntock, 1988.

Table 15.4 Degree of externalisation by country, (%)

Country	Externalisation	Internalisation	Combination
France	56	30	14
Germany	32	47	21
Italy	47	33	18
Netherlands	39	18	43
United Kingdom	34	23	43
Total	39	31	28

Source: P.M. McIntock, *The cost of Non-Europe for business services*, 1988.

Contracting out to specialist firms seems to be a general trend, although it varies between countries, with specialist companies able to supply higher quality services than those which could be provided internally. That is related not only to the economies of scale but also to a learning process, with the quality of a service depending on the gradual accumulation of knowledge within the service provider.

Changes in company policy may also lead to greater use of external services, reasons include the externalisation of non-core activities¹; cost-cutting; the desire to reduce the workforce to the minimal sustainable level, and the need for flexibility which is achieved through using services on a contractual basis. Growth is also mentioned as a factor which leads to increased externalisation: companies may find expansion easier if they contract in services rather than seek to build internal resources, particularly in the absence of the internal expertise.²

15.2.5 The tertiarisation of employment in industrial firms

An interesting phenomenon is the tertiarisation (service orientation) of employment in industrial firms. This trend is evident in most European countries. In France the share of white collar employment (to the total employment in manufacturing) has increased from 34.5% to 39.7% in between 1982 and 1992, in Ireland the increase was from 21.6% to 24.4% between 1983 and 1990, in Italy from 15.8% to 20.4% between 1981 and 1991, in Spain from 25.2% to 27.9% between 1982 and 1989, in the Netherlands from 35.3% to 40.5% between 1983 and 1993. In Denmark, Germany, Luxembourg and the United Kingdom the share of white collar employment in manufacturing has also grown in recent years.

This increasing tertiarisation of employment within industrial firms, and the increasing externalisation of service provision, are two sides of the same coin. In fact, due to changes in the scientific, technological and industrial basis, it no longer makes sense any more to look at the industrial firm in a classical way: that is, focusing on the principal production activities and the blue-collar workers. As production becomes ever more

¹ Elfring, 1992.

² Peat Marwick McIntock, 1988.

knowledge-intensive it necessitates the reorganisation of production and changes in the division of labour between different types of employees, companies and sectors.

Greater focus on the effectiveness of the total production process, and not solely labour productivity, is the reason for the increasing importance of service functions embodied within manufacturing activities.

All in all, this changing business environment has led to an increasing demand for both in-house service production and the use of more specialised external producer services.

Case A

A study from the Netherlands¹ confirms that in most cases a high share of white collar employment within an enterprise is accompanied by a comparatively high use of external service providers, thus internal service providers often complement external service providers. Such relationships are especially common in knowledge intensive sectors. Those industries with low internal shares of white collar employment can be divided between those, such as the food industry, which also have relatively little contact with external service providers, and those sectors, such as clothing, textiles, and the manufacture of furniture, which appear to prefer to purchase externally provided services. The latter group comprises sectors with a low degree of concentration and a high number of small firms, the operating scale of many of these firms is too small to justify internal services providers.

15.3 EVOLUTION AND STRUCTURE OF PRODUCER SERVICES

15.3.1 Presentation of the quantitative information on producer services

It is possible to use two indicators to assess the relative importance of producer services in the European economy: their shares of employment, and of total value added.

Producer services account for 11,2% of Europe's total employment², 20% of the total value added; and 11.5% of the total number of enterprises (1,881,000 SMEs and 1,800 LSEs, Table 15.6). Among producer services, business services account for the largest share of employment (7.4%) and value added (11.9%); followed by banking (2.1% of total employment, 3.6% of the total value added).

¹ Dijken J.A. van, J.J.J. Donkers, Relatie industrie-diensten (Relation between manufacturing and services, EIM Small Business Research and Consultancy, Zoetermeer, 1993).

² Total employment does not include the primary and quarternary sectors and the Government.

Table 15.5 Employment in producer services as percentage of the total employment in micro, small, medium and large firms, EU-16, 1990

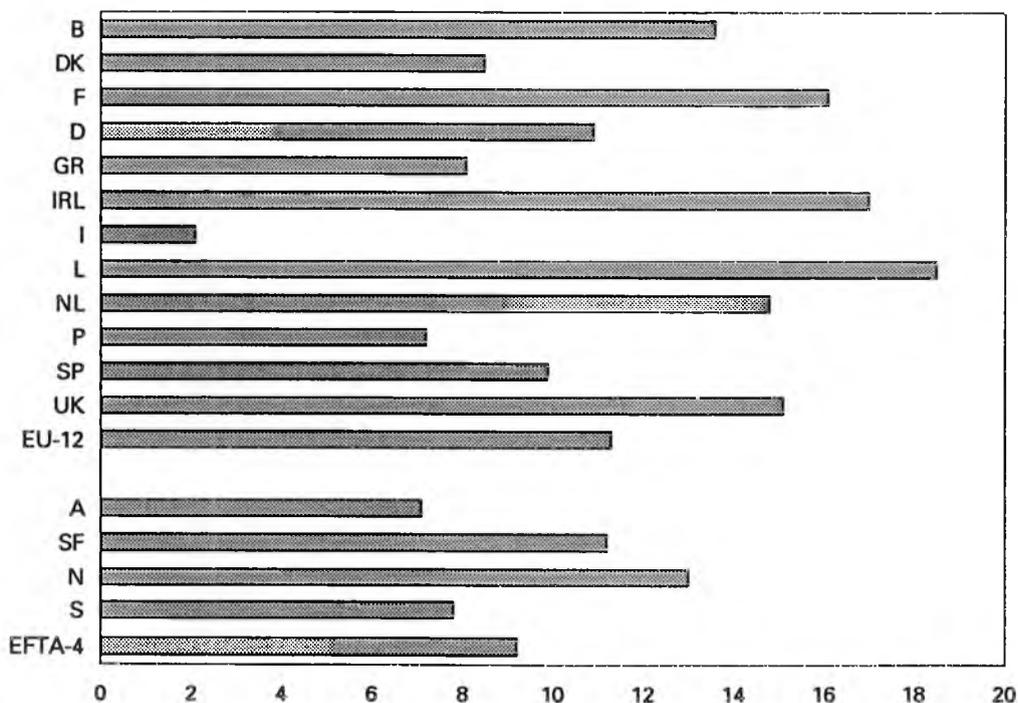
Sector	0-9	10-99	100-499	SME	500+	Total
Banking & Finance	0.1	1.1	2.7	1.0	4.9	2.1
Insurance	0.0	0.2	0.7	0.2	2.0	0.7
Renting of movable	0.4	0.3	0.3	0.3	0.3	0.3
Letting of real estate	0.9	0.3	0.6	0.6	0.3	0.5
Business services	8.9	7.7	6.4	7.9	6.1	7.4
Total	10.4	9.6	10.6	10.2	13.6	11.2

Source: Eurostat/EIM Small Business Research and Consultancy.

By enterprise size, producer services have the largest share of total employment in LSEs, followed by medium size enterprises.

At national level (Figures 15.1-15.2), Luxembourg has the highest share of producer services employment, followed by Ireland, France, the United Kingdom, and the Netherlands. Denmark has the highest share of value added in producer services, followed by Belgium, the United Kingdom, and Norway.

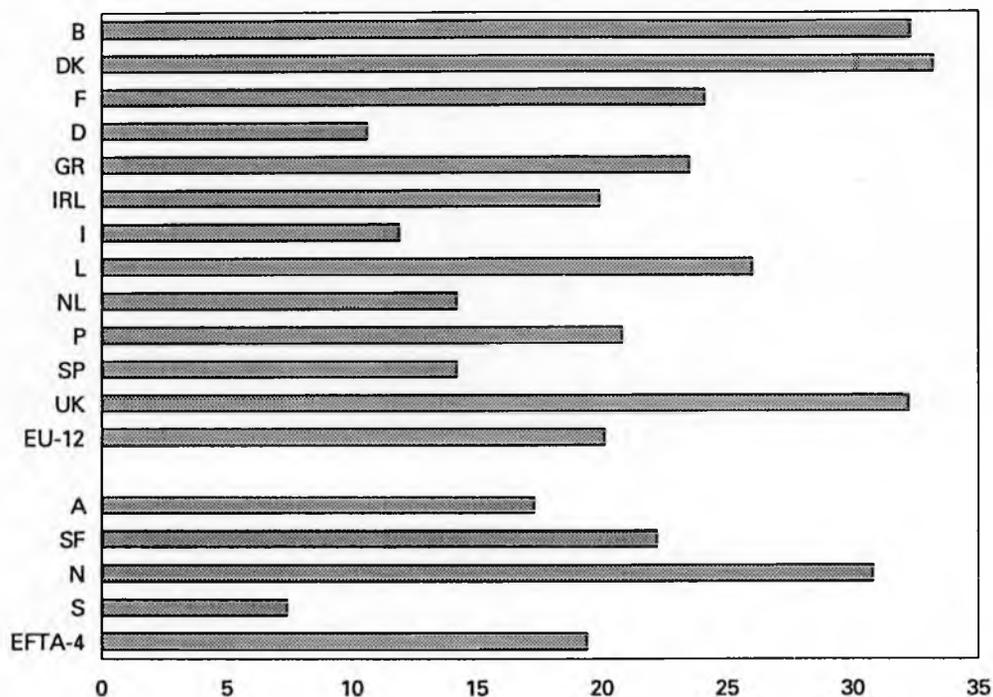
Figure 15.1 Share of employment in producer services, percentage, 1990



For Italy other sources give different percentages. For example the OECD Labour Force Statistics present a share of employment in producer services of 6.6%, while the Italian National Institute of Statistics (ISTAT) gives a percentage of about 10% for 1991.

Source: Eurostat/EIM Small business Research and Consultancy.

Figure 15.2 Share of value added in producer services, percentage, 1990



Source: Eurostat/EIM Small Business Research and Consultancy.

Table 15.6 Number of enterprises in producer services (x 1,000), EU-16, 1990

	0-9	10-99	100-499	SME	500+	Total
Banking & finance	13.7	7.9	1.8	23.5	0.6	24.1
Insurance	6.1	1.1	0.5	7.6	0.3	7.9
Renting of movables	82.9	3.4	0.2	86.5	0	86.5
Letting of real estate	254.1	3.5	0.5	258	0	258.1
Producer services	356.7	16	3	375.6	1	376.6
Business services	1,415.9	84.7	4.8	1,505.4	0.8	1,506.2
Total producer services	1,772.6	100.6	7.8	1,881.0	1.8	1,882.8

Source: Eurostat/EIM Small Business Research and Consultancy.

Except for Luxembourg and Austria, where banking and finance are the largest producer services by employment and value added, business services are the most important producer services in European countries.

In Greece, Ireland, Spain, the United Kingdom, and Austria LSEs have a larger share than SMEs of the value added in producer services. In Finland 57%, and in Norway 58.5% of the total value added in micro-firms comes from producer services.

France has the largest producer services sector, at 18.5% of all enterprises, followed by Luxembourg 18%, Germany 17.5% and the United Kingdom 14.4%.

An analysis of the producer services sector at the European level (Table 15.7) shows that SMEs dominate, with 65.3% of the sector's total employment. The only exception to this rule is banking and insurance which are dominated by LSEs.

With the exception of banking and insurance the largest shares of employment in the various producer services are found in micro-enterprises.

Table 15.7 Employment in producer services, percentage, EU-16, 1990

	0-9	10-99	100-499	SME	500+	Total
Banking & finance	1.7	13.5	19.1	34.3	65.7	100
Insurance	2.0	5.7	15.2	23.0	77.0	100
Renting of movables	38.7	23.9	11.5	74.2	25.8	100
Letting of real estate	53.9	15.3	16.2	85.4	14.6	100
Business services	37.3	26.0	13.1	76.5	23.5	100
Total	29.0	21.7	14.5	65.3	34.7	100

Source: Eurostat/EIM Small Business Research and Consultancy.

The average size of a producer services enterprise in Europe is 6 employees. The averages for Austria, Finland, Ireland, Luxembourg, the Netherlands, Norway, Sweden and the United Kingdom are greater, whilst the averages for Germany, Greece, Portugal and Spain are lower.

The data show that in every country the producer services are dominated by SMEs, but to different extents (Table 15.8); the employment in the sub-sectors show similar patterns to those discussed above at the European level, but it is notable that in three of the countries with higher employment shares in producer services (the United Kingdom, Ireland, and the Netherlands) the employment in business services has a polarised structure, with most of the employment being in micro or large enterprises. In Ireland 31.2% of employment is in micro-enterprises and 36.7% in LSEs, in the Netherlands 28.2% is in micro-enterprises and 29.2% in LSEs, in the United Kingdom 31.2% is in micro-enterprises and 37.1% in LSEs.

Italy has a different structure, with most of its business services employment in small (44.5%) or in medium sized enterprises (32.4%).

Table 15.8 Share of producer services employment, percentage, EU-16, 1990

	SMEs	LSEs
Belgium	59.2	40.8
Denmark	86.4	13.6
France	67.4	32.6
Germany	80.6	29.4
Greece	93.8	6.2
Ireland	58.6	41.4
Italy	72.8	27.2
Luxembourg	74.6	25.4
Netherlands	57.7	42.3
Portugal	60.0	40.0
Spain	73.1	26.9
United Kingdom	56.7	43.3
EU-12	65.1	34.9
Austria	58.6	41.4
Finland	66.2	33.0
Norway	66.2	33.8
Sweden	82.9	17.1
EFTA-4	68.4	31.6
EU-16	65.3	34.7

Source: Eurostat/EIM Small Business Research and Consultancy.

15.3.2 The growth of producer services

Producer services grew at a rate (1.4%) below the average annual change in value added across all the different sectors within Europe between 1988 and 1994¹ (Table 15.9). Within producer services, micro-enterprises had the best performance, followed by SMEs and LSEs.

¹ Data from 1991 to 1994 are estimates.

Table 15.9 Average change 1989-1994 of the real gross value added, by sector and size class, EU-16

Sectors	SMEs	500+	Total
Extraction	2.3	2.0	2.1
Manufacturing	2.5	2.8	2.6
Construction	0.7	-0.7	0.6
Wholesale trade	2.1	0.7	1.9
Retail trade	1.5	0.2	1.4
Transport & com.	2.4	1.6	2.1
Producer services	1.3	1.5	1.4
Personal services	1.6	-0.2	1.5
Total	1.9	1.9	1.9

Source: Eurostat/EIM Small Business Research and Consultancy.

However, in terms of employment producer services grew at the fastest rate: at an average annual growth rate of 1.5%, compared with -1.2% in manufacturing, -0.3% in retail trades and personal services and, 0.8% in wholesale trades (Table 15.10). Within the sector the micro-firms again showed the highest average growth rate, followed by small enterprises, and LSEs. Medium enterprises had the worst performance (-1.4%). Among the sub-sectors, banking showed the poorest performance (-3.2%), and business services the best (3.8%).

Table 15.10 Average change 1989-1994 of employment, EU-16

Sectors	SMEs	500+	Total
Extraction	0.4	0.7	0.6
Manufacturing	-1.0	-1.5	-1.2
Construction	0.3	0.4	0.3
Wholesale trade	0.9	-0.7	0.8
Retail trade	0.0	-2.4	-0.3
Transport & com.	1.6	-1.1	0.1
Producer services	2.0	0.5	1.5
Personal services	-0.4	0.3	-0.3
Total	0.1	-0.8	-0.1

Source: Eurostat/EIM Small Business Research and Consultancy.

The long-term growth of the service sector is attributable to increased demand from enterprises for intermediate services. The increase in manufacturers consumption of producer services can be attributed to the development of new specialist services, to the externalisation of services traditionally carried out within enterprises (e.g. cleaning, catering, marketing, accounting), and to technological change. Technological change has had a great impact on the requirement of new skills; hence the necessity of meeting the challenges posed by the new technology has resulted either in a continuously increasing externalisation of the functions previously performed internally or in the internal development of the necessary capabilities, mainly by large firms, thus exploiting economies of scale and scope.

Of all the sectors, producer services has the worst average annual growth rate (-0.1%) in terms of labour productivity (Table 15.11). This can be explained by the low capital intensity of the sector. Within the sector, micro-firms have the lowest average annual productivity growth rate (-1.5%), followed by SMEs (-0.5%), and large firms (0.9%). Banking have the highest rate of productivity growth (5.3%), while business services show the worst performance (-2.3%) (Table 15.12). The performance of the banking sub-sector can be explained by the high level of professional skills which characterise its employment, the complexity of its organisation, and the intensive use of modern information technologies.

Table 15.11 Average change 1989-1994 of productivity, EU-16

Sectors	SME	500+	Total
Extraction	1.9	1.3	1.5
Manufacturing	3.5	4.3	3.8
Construction	0.4	-1.1	0.3
Wholesale trade	1.2	1.4	1.1
Retail trade	1.5	2.6	1.7
Transport & com.	0.8	2.7	2.0
Producer services	-0.5	0.9	-0.1
Personal services	2.0	-0.5	1.8
Total	1.8	2.7	2.0

Source: Eurostat/EIM Small Business Research and Consultancy.

Table 15.12 Average change 1989-1994 of productivity, employment, value added, EU-16, by producer services subsectors

Sectors	Productivity	Employment	Value added
Banking & finance	5.3	-3.2	2.1
Insurance	3.7	-1.8	1.9
Renting of movable	1.4	-0.1	1.3
Letting real estate	-2.4	2.5	0.1
Business services	-2.3	3.8	1.5
Total	-0.1	1.5	1.4

Source: Eurostat/EIM Small Business Research and Consultancy.

15.3.3 Trends in the regional concentration of producer services

In various countries there is an extraordinary degree of concentration of producer services within the most developed regions, and also in the central areas of the main cities. This is related to the higher availability of supporting infrastructures, greater opportunities for face to face contacts, a proximity to most public institutions, the availability of qualified personnel, and the prestige of being located in a central area. (Tables 15.13, 15.14, 15.15).

Table 15.13 Geographical distribution of Spanish firms providing business services, 1990

	Percentage
Madrid	21.2
Barcelona	15.7
Valencia	5.5
Vizcaya	3.3
Sevilla	3.2
Zaragoza	2.1
Others	49.0
Total	100

Source: Garcia de la Cruz, J.M., Los servicios a empresas en España: un ferfil nacional y regional, 1993.

Table 15.14 Employment by industry and region in Denmark, January 1993

	Copenhagen region	Jutland*	Others**	Total
Mining and quarrying, electricity, gas and water	6,451	9,979	4,624	21,054
Manufacturing	115,833	268,699	96,647	481,179
Construction industry	44,721	67,527	35,718	147,966
Wholesale trade	69,634	70,774	25,765	166,173
Retail trade	65,116	93,296	40,206	198,618
Rest. & hotels	23,179	30,751	13,975	67,905
Transport	72,870	77,949	36,057	186,876
Financial services, business services	117,588	83,961	31,748	233,297
Education & research	67,617	83,566	37,096	188,279
Social & health service	141,408	177,281	82,108	400,797
Public services, general administration	87,597	89,516	40,915	218,028
Other services	56,401	56,720	24,504	137,625
Industry non stated	7,332	9,778	4,865	21,975
Total***	884,724	1,213,648	511,487	2,609,859

* Jutland: County of Nordjylland, Viborg, Aarhus, Ringkøbing, Vejle, Ribe and Sønderjylland.

** Others: County of Vestsjælland, Storstrøm, Bornholm and Fyn.

*** Including agriculture.

Source: Danish Technological Institute (DTI).

Table 15.15 Representation of service firms as proportion of total firms by region, the United Kingdom

Region	1991	1992	1993	1991/1993
South East	71.1	71.8	72.5	1.4
North West	71.1	71.8	72.5	1.4
Yorkshire & Humberside	64.9	67.6	67.6	2.7
West Midlands	61.8	63.3	63.3	1.5
East Midlands	61.8	58.8	63.3	1.5
Scotland	64.9	58.8	63.3	-1.6
Wales	61.8	58.8	58.8	-3
South West	61.8	58.8	58.8	-3
East Anglia	61.8	58.8	58.8	-3
North	64.9	63.3	63.3	-1.6
Northern Ireland	58.7	51.0	50.2	-8.5

Source: PA 1003 Business Monitor.

Enterprises in the producer services sector are characterised by strong links to their local region. This is due to the fact that the nature of producer services necessitates close relations between the user and the producer.

Producer services have an urban bias, especially the financial, insurance and real estate sub-sectors. There is a strong evidence of this sense in the metropolitan areas of the Randstad region in the Netherlands (Amsterdam, Rotterdam, The Hague, Utrecht); in the Copenhagen area; in Madrid and Barcelona; in central Norway; in Paris and in the towns of Grenoble, Montpellier, Toulouse and Strasbourg; in the south east of England (including London) and Manchester; in the town of Luxembourg; in Athens and Central Macedonia (Thessalonica); and in Milan, Rome and Turin.

The areas that are gaining the greatest increase in these services are those just outside the major agglomerations, where congestion and rents are lower, but within easy reach of the client base.

There is evidence of this in the Netherlands: the province of Brabant is close to the big metropolitan area of Randstad and is experiencing an increase in its population of business services. In Spain there has been a decreasing in the concentration of engineering and consultancy services in Madrid and Barcelona, while other towns have increased their shares. In some countries, such as the Netherlands, the growth of service employment is clearly inversely correlated with size of the urban centres, due to the increasing importance of congestion diseconomies. Norway, Finland and Italy also show signs of a de-concentration of service activities.

15.3.4 The internationalisation of services

While the European Union is by far the world's largest exporter and importer of services, the total trade in services equals only a third of trade in goods. The possibility for growth seems to depend on the degree and rate of change of regulatory and non-regulatory barriers. An issue in the international trade of services are the different regulations that exist for services in the various countries. For example, differences across countries in insur-

ance and banking regulations have resulted in dissimilar market structures and product prices, with much of the trade being at the factor rather than the product level as the individual requirement of the domestic regulations mean that non-domestic banks or insurance companies must create service units in the host country if they want to operate in that market¹.

Another issue related to the trade of services is their low tradability. The interpretation is that the transaction costs for services are high, because they do not involve exchange of property rights as does a transfer of goods. The seller must therefore monitor the transaction more carefully than in a transaction of goods, and this becomes more difficult in an international transaction because of the distance between the supplier and the user of the service. Furthermore, service transactions often involve the direct use of someone's labour, which can not be inspected before the transaction. The transaction costs are high in both cases, and this indicates lower tradability².

While the share of producer services in international trade has traditionally been very low, especially compared with the share of manufacturing, services are becoming increasingly tradable as improvements to communications allows greater ease of movement for both the service producer or the user.

There is some evidence that services are beginning to internationalise. In the Netherlands 'business services' have increased their international trade in recent years through gaining international clients, searching for new markets, and following their competitors into international market. Co-operation is a common route to internationalisation.

In Denmark accountants, data processing, consulting engineers and leasing of machinery have increased their share of exports between 1985 and 1990.

In Sweden the balance of payments data shows that transport and financial sectors account for about 30% of all Swedish exports. The share increased during the second half of the 1980s, which was mainly due to financial services trade.

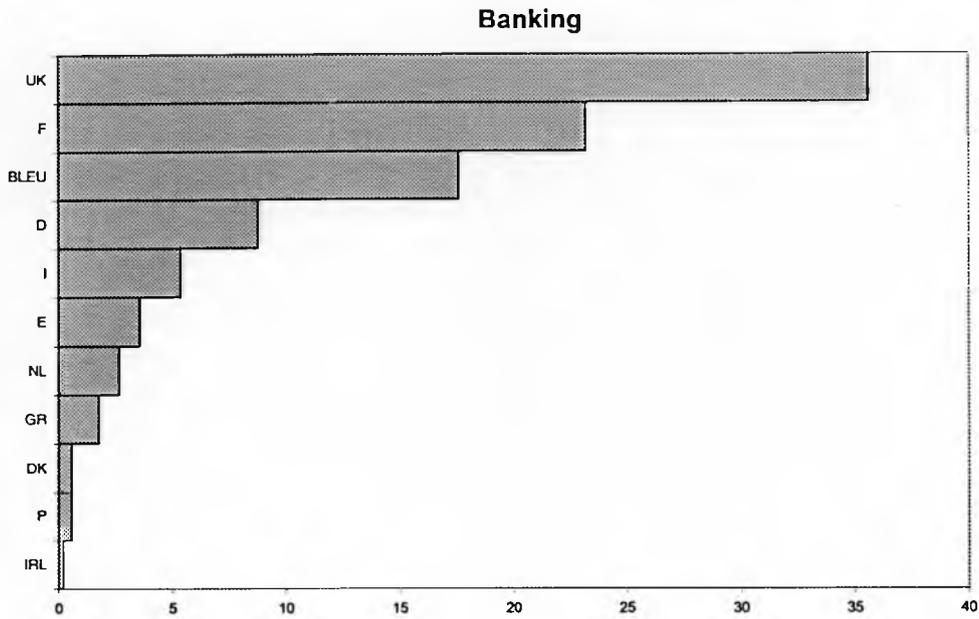
France is the largest exporter of services in the EU, and the second in the world. Its biggest positive balances are in tourism, construction, and business services. According to the balance of payment statistics, exported services *stricto sensu* account for 20% of all French exports. In terms of foreign direct investment (FDI), France is the largest investor of Europe and the second largest in the world. French FDI have developed strongly since 1986, especially in the EU, and this investment is led by banking and insurance services.

Within the EU (figures 15.3 and 15.4) Belgium and Luxembourg are the largest intra-EU exporters of business services, followed by the Netherlands, Germany and France. The United Kingdom is the largest exporter of banking services, followed by France, Belgium, and Luxembourg.

¹ Commission of the European Communities, 1993.

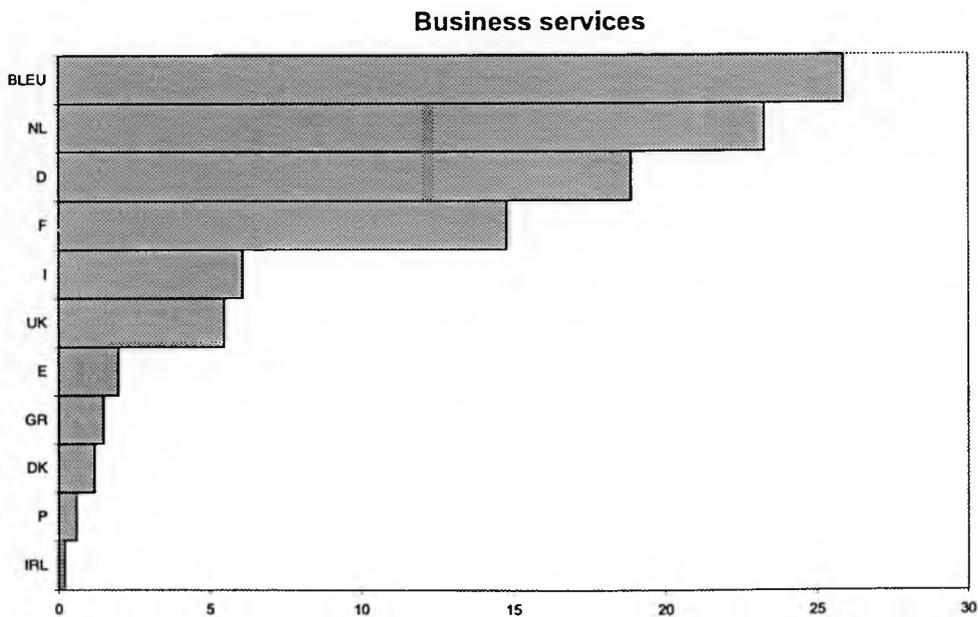
² Nutek, the EEA-Agreement and the Swedish service sector, draft, 1994.

Figure 15.3 Share of intra-EU export of business services by Member State, average 1987-89



Source: Commission of the European Communities, European Economy Social Europe, n.3, 1993.

Figure 15.4 Share of intra-EU export of banking by Member States, average 1987-89



Source: Commission of the European Communities, European Economy; Social Europe, n. 3, 1993.

15.3.5 The impact of the internal market on the business services sector

Due to a lack of information on producer services this section refers to only the business services sub-sector¹.

The completion of the internal market will have some positive effects on the sector. There will be a general expansion of economic activities which will benefit the sector through increased demand, and growth will also arise through the stronger competition and the need for improved productivity and competitiveness in all industrial and services sectors. Demand will also be stimulated by the growing externalisation of service functions and by the need for better quality suppliers, but there will be pressure to lower prices due to competition between increasing numbers of suppliers.

On the supply side, at least in more developed regions and advanced sectors, a wider range of more sophisticated services will be available; the supply will cover new segments of market such as small and medium-sized enterprises, and some developing regions; the concentration of business services will increase because there will be new service providers in developed areas where there are already producer services, and there will be new transnational networks through partnerships, franchising, joint ventures, or other types of co-operation.

These changes will especially affect larger service providers, while the smaller ones will continue to serve their niche markets benefiting from the proximity to their customers and from their intimate knowledge of their markets.

Additional employment, especially of qualified personnel, will arise from the completion of the internal market, and the spatial concentration of the supply of these services will lead to the clustering of advanced services in the developed areas, with the less developed regions covered either by standardised services which are easily exportable, or by locally supplied services.

15.4 NEW ISSUES AND PUBLIC POLICIES

There does not seem to be an explicit public policy toward the development of service activities in any country, but there are many policies which have an effect on services. It should also be pointed out that service activities are generally regulated to a greater extent than industrial activities.

An example of a policy for services affecting both the supply and demand sides, is the PEDIP Programme in Portugal. Enterprises can apply for assistance (for material investments, quality, external promotion, vocational training) for which they must prepare a dossier including technical, financial and economic data. Most of the Entrepreneurial Associations created special departments to assist the SMEs, but many individual consultants, consultancy firms and public agencies were also used by the applicants. Moreover, for certain specific sub-programmes, the PEDIP regulations required co-operation with specialist consultants, to be selected from a list approved by the Ministry of Industry.

This scheme has made SMEs aware of their own needs, and of the value of external services, but as the scheme subsidises all the 'actors' (both the demand and the supply)

¹ Commission of the European Communities, 1993.

SMEs may have gained the impression that these services can be gained for little or no cost.

Financial subsidies to stimulate the demand for services by SMEs are also available in other countries such as in Italy, where tax credits and capital contributions are offered (through the 317/91 Act) to SMEs that purchase business services. In France, the FRATT (Fonds Régionaux d'Aide au Transfert de Technologie) gives contributions to encourage the technology transfer from private and public laboratories to SMEs (incentives are provided to SMEs which use external laboratories), and the FRAC (Fonds Régionaux d'Aide au Conseil) provides contributions to encourage SMEs to use external advisors. In Ireland the industrial development agencies, principally Forbairt and the Irish Trade Board, subsidise firms which need technical and marketing services. In Sweden small enterprises with up to 50 employees have the opportunity to purchase services from external consultants at a subsidised rate. The subsidy may cover up to half the cost, or a total amount of SEK 100,000. The consultancy services should aim to accelerate the enterprises's growth and thereby create long-term employment opportunities. Enterprises in most industries are eligible: however enterprises within the automotive and steel industries are among those excluded. At the end of 1994, 637 enterprises had received the subsidy, totalling SEK 47 million. An estimated 915 new jobs have been created by the program to date.

A co-operation network programme has been established in the Valencia region; this encourages the establishment of co-operation networks among regional firms and between the regional firms and foreign firms. In the creation of these networks a key role is played by the network brokers, who are professional consultants. They are the intermediary which introduces firms to each other and they advice firms in a variety of fields or find the appropriate specialist when additional assistance is needed.

The first European model for such a scheme was developed in Denmark in 1989. This model for interfirm co-operation, called 'The Networking Programme', has been used in several industrial programmes in Denmark, and the concept has since been transferred to other European countries such as Portugal, Norway, and the United Kingdom.

Another field where public policy has targeted service provision has been the promotion of export. This may be through financial incentives for the creation of export consortia among SMEs (as in Spain and in Italy through the 317/91 and the 83/89 Acts), or the creation of special institutions which at the regional or local level help firms by doing marketing studies or organising trade missions by which entrepreneurs can travel abroad to promote commercial, technological, or production joint ventures. The Irish Trade Board provides grants to small and medium sized firms to help develop their international marketing capacity. Grants of up to half the costs (to a maximum of 12,500 ECU) for a range of marketing activities may be available in any one year.

Among the most well known initiatives at the European level that aim to promote the emergence of new firms in the service sectors are the formation of Business and Innovation Centres (BICs). BICs (often managed by public and private actors together) aim at introducing new and innovative activities in the region in order to reach a higher degree of industrial diversification. In the BICs enterprises have at their disposal important facilities such as space and common services, and easier access to qualified producer services such as advice and support in technological and financial fields.

These examples show that the development of SMEs policies at local level is inducing public authorities to promote policies that develop producer services.

Public schemes aiming at supporting SMEs with financial subsidies are facing increasing constraints due to European competition policies. Thus public authorities have designed new policy schemes that assist SMEs through the development of technology and the provision of services, and aim to improve the quality of the local environment in which SMEs operate. The provision of modern services also removes external diseconomies which represent a competitive handicap for SMEs in the global market and may have a positive impact on the overall level of competition by allowing the market entrance of new enterprises and decreasing the degree of concentration. Clearly these horizontal policies are compatible with the aim of the European competition policy.

16 THE CRAFT TRADES

Co-ordinated by EIM Small Business Research and Consultancy

MAIN POINTS

- At a European level increasing attention is being paid to crafts through policies and measures.
- The extent of policy measures for the craft sector varies between the Member States.
- In most of the Member States the importance of the craft sector is recognised.
- Young people are often not aware of, or not interested in, a vocational training or apprenticeships.
- Training methods must be adapted to reflect new developments and, more attention should be paid to post-apprenticeship training.
- Crafts and small enterprises generally face difficulties in obtaining practical information on technical requirements.
- Craft organisations recognise the need to collaborate with European Authorities so as to create policies adapted to the specific needs of the craft sector.

This chapter deals with problems of definition (16.1), assesses the craft trades in the Member States according to national definitions (16.2), and reports on the Second European Conference on Craft Industries and Small Businesses held in Berlin in September 1994 (16.3).

The second section which assesses crafts according to national definitions deals with the legal status of crafts (16.2.1), craft organisations (16.2.2), craft policies (16.2.3), and the importance of crafts in the Member States (16.2.4). As these topics were also reported in chapter 10 of the Second Annual Report of the European Observatory for SMEs *only new information, and recent developments*, are included, with more comprehensive coverage provided for the new Member States and Norway.

16.1 INTRODUCTION

Crafts account for a substantial share of all enterprises and employment in the Member States. However, it is difficult to assess their absolute importance as the term 'craft trades' has different meanings across Europe: 'Craft' in English is not synonymous with 'Handwerk' in German, nor with 'artisanat' in French, nor with 'Ambacht' in Dutch.

Essentially crafts provide individual goods and services and are characterised by:

- predominantly customised production and service, and therefore an absence of 'industrial' mass production;
- a relatively high proportion of skilled workers, trained for and qualified in their craft;
- an absence of a 'division of labour' in production, except those based on differences in skill levels or experience (for example: apprentice, journeyman, master-craftsman);
- a very low minimum efficient scale of production.

In addition to these, craft production is normally, but not necessarily, small-scale. Consequently, craft enterprises share the following characteristics with most micro-enterprises:

- independent status;
- combined ownership and management;
- the personal involvement of the enterprises' owner in production/service provision;
- close links between the enterprise and the family are common;
- the enterprise is usually self-financed, or financed by the owner.

The medieval guilds are at the root of Europe's craft industries. Formal regulation of the apprenticeships required to enter today's craft-trades link the ancient guilds to modern crafts and professional practice. The emergence of industrial society diminished the importance of these guilds, but also produced new economic organisations and institutions, including a number of 'modern crafts', such as printing, metal processing, and the repair of consumer and capital equipment. These changes left crafts defined and legally regulated in different ways across Europe. The result is the present situation with some countries having no legal definition, whilst others have a very detailed definition, and most are in-between. In the United Kingdom for example, crafts are not legally defined and minimal legal requirements exist when establishing a (craft) business. In Germany by contrast there is strong craft regulation, explicit definitions, and strict entry requirements.

Consequently, efforts to define crafts at the European level have so far been problematic, by different definitions the concept of crafts may cover a wide range of economic activities, in manufacturing, construction and services, or at the other extreme just artistic handicrafts. To make Europe-wide statistical monitoring possible, steps have been taken to create a European definition of craft trades. In the Second Annual Report a method was discussed by which it was possible to produce comparable statistics on the craft trades, and the non-comparability of national craft statistics was a prominent issue during the run-up to the Berlin-conference. The European Commission organised a pre-conference on craft statistics in June 1994 in Göttingen¹, and a preparatory conference on craft definitions and statistics in September 1994 in Rome. At the Berlin-conference in September 1994 it was concluded that comparable statistics on the craft trades should be made available in the near future.

16.2 THE CRAFT TRADES IN EUROPE-16

In this section only information on the new Member States, Norway, and changes within the other EU countries since the Second Annual Report² will be reported as far as the legal status (16.2.1), the organisation and infrastructure (16.2.2) and the specific national policies (16.2.3) are concerned. The paragraph "The importance of craft trades in Europe-16" (16.2.4) provides the most recent information about *all* countries.

16.2.1 Legal status

In this paragraph only information *additional* to the Second Annual Report is presented.

¹ König, W. and K. Müller (Eds.), *Craft Industries in Europe. Proceedings. Conference of European Institutes on Small Business with Special Emphasis on Craft Industries*, Göttingen 1994.

² The European Observatory for SMEs, *Second Annual Report*, Chapter 10, *Craft Trades*, Zoetermeer, 1994.

France

Although neither the legal status nor the definition has changed since the Second Annual Report, additional information provides greater clarification. The craft sector consists of enterprises on the Craft register (*Répertoire des Métiers*), and craft enterprises are defined by three criteria:

- **activity:** an activity is defined as craft when it belongs to a legally defined list of 80 occupations; in principle access to craft activities is free, but regulations exist for some occupations, such as hairdressers, taxi drivers, ambulance drivers, removal enterprises, and enterprises which inspect the condition of cars;
- **size:** the number of wage earners should not exceed 10, but up to two relatives and up to two apprentices are not considered as wage earners, and for a period of up to three years 15 wage earners are permitted. After this only those craftsmen with the title of 'Maître artisan' or 'Artisan' can remain registered. A 'Maître artisan' is a person with the diploma 'brevet de maîtrise' or an equivalent qualification. An 'Artisan' is someone who has been registered in the *Répertoire des Métiers* for six years, or has the diploma 'Certificat d'Aptitude Professionnelle', or an equivalent qualification;
- **independence:** the activity must be operated in a wholly independent way (no subsidiary).

Germany

At the beginning of 1994 a revision to the Craft Law came into force. This aimed to promote cross-sector activities, and reduced the entry barriers to a craft occupation.

Ireland

Although only a working definition of the craft sector exists there are statutory requirements for designated craft apprenticeships. These apply in the construction sector, the engineering sector (excluding electronics), the paper, and printing industries. Under the 1994 Apprenticeship Levy Act, these sectors are subject to a levy for the purpose of covering apprentices' wages. This is an additional 0.25% on top of the normal employer's pay related social insurance payments (PRS).

Luxembourg

A bill is being drafted which will make a number of structural changes in the system that certifies craft expertise (see chapter 7).

New Members and Norway

Austria

Recent liberalisation has loosened the legal definition of crafts. Crafts were previously defined legally by a specific qualifying exam ('Gewerbeordnung'), and the sector by a list of occupations. In Austria craft trades comprise mainly construction, manufacturing, and personal services.

Finland

There is no legal or official definition of craft trades in Finland. The popular concept of crafts is essentially applied to arts or handicrafts, with products produced in small quantities. This concept does not include the service crafts like hairdressers or dental technicians.

Sweden

The craft sector is not legally defined in Sweden, nor does a generally agreed institutional definition exist. Craft enterprises cannot be distinguished from other enterprises in official statistics.

Norway

Craft is not legally defined, but education and apprenticeships within the craft sector are regulated by law. Generally 3 to 4 years of apprenticeship and/or theoretical education is required before undertaking the Craft certificate examination. 'Mastership' is regulated by law. Craftsmen who have practised their trade for 6 years, or 2 years after gaining the Craft certificate, can apply for the Master's exam. People with skills in craft-type occupations (except plumbers) can start a business even if they do not have a Master certificate, but they cannot use the Master trademark. A list of about 50 occupations are legally regulated.

Craft includes handicraft and to some extent art. The handicraft sector includes both the formally educated and those with traditional skills for which no formal training is available.

16.2.2 Organisation and infrastructure

In this paragraph only information *additional* to the Second Annual Report is presented.

Belgium

The most important semi-public institutions for SMEs, relevant to the craft trades are: the Superior SME Council, the National Social Insurance Institute for the self-employed and the National Professional Credit Bank and the research institutes: Small Business Research Institute (KMO), Research and Documentation Centre for SME and Centres for Scientific and Technical Research.

The most important organisations providing training and consultancy services are:

- Vlaams Instituut voor Zelfstandig Ondernemen (VIZO) (Flemish Institute for Independent Entrepreneurship; Flanders);
- Institut pour la Formation Permanent des Classes Moyennes et des PME (Institute for Permanent Education of SME; Wallonia), with 5 regional organisations;
- Ministère de la Région Wallone, Service des Conseils d'entreprises (Ministry of Wallonia, consultancy for enterprises; Wallonia);
- Kamers voor Ambachten en Neringen (Craft and Trade Chambers), with 5 regional and 9 sub-sector establishments.

Germany

There are no changes compared to the Second Annual Report, but there are now official translations of terms relating to skilled crafts in Germany¹.

Greece

Although the organisational structure and infrastructure of craft trades did not change they are raising their profile due to developments in EU policy for crafts. The organisations have expressed their strong desire to participate in the decision making process and the implementation of the new Community Programmes. They developed information activities with leaflets and meetings of their members, particularly after the Berlin Conference.

EOMMEX (Hellenic Organisation of Small and Medium-sized Industries and Crafts), the handicraft organisations, the General Confederation of Small and Medium-sized Businesses, Traders and Craftsmen of Greece (GCSMBC) and the Central Union of Commerce have agreed to work together to look after the crafts interests after the final approval of the programmes included in the Community Framework Programme (1994-1999) and other Community Initiatives. In the future important developments in the infrastructure and environment of the craft sector are expected with the active participation of the craft organisations.

Ireland

The largest organisation, the Irish Business and Employers' Confederation (IBEC), is a combination of the Confederation of Irish Industry and the Federation of Irish Employers and has 4,000 members.

Italy

The Confederazione Generale Italiana dell' Artigianato (CONFARTIGIANATO) (Italian General Craft Federation) has a total of 480,000 members (360,000 mainstream enterprise members were mentioned in the Second Annual Report).

The Netherlands

The two main employers associations relevant to crafts and SMEs in general, the 'Koninklijk Ondernemersverbond' (KNOV) (Royal Dutch Employers Association) and the 'Nederlands Christelijk Ondernemersverbond' (NCOV) (Dutch Christian Employers Association) have been merged into one association: 'Koninklijke Vereniging MKB Nederland' (Royal SME Netherlands).

¹ Handwerkskammer = Chamber of Skilled Crafts
Zentralverband des Deutschen Handwerks (ZDH) = German Confederation of Skilled Crafts
Deutscher Handwerkskammertag (DHKT) = German Confederation of Chambers of Skilled Crafts
Bundesvereinigung der Fachverbände des Handwerks (BFH) = German Association of Skilled Crafts Confederations
Deutsches Handwerksinstitut (DHI) = Institute for Crafts and Skilled Trades

Spain

In addition to the information in the Second Annual Report, the Dirección de Coordinación de Comercio y Artesanía, a 1980s creation, aims to co-ordinate craft trades and policies that affect them across the 17 Spanish Regions. The most relevant institution linked to the craft sector is the Fundación Cultural Española para el Fomento de la Artesanía.

New Members and Norway

Austria

All enterprises have to register with the Economic Chambers. The section 'services and crafts' within the Chamber represents the interests of both craft enterprises and other trades but mostly services (including modern services such as promotional activities, consultancy, electronic data processing, and software production).

The 'Institut für Gewerbe und Handwerksforschung (IfG)' (Institute for Small Business Research) is a research institute, financed by the craft sections of the Economic Chambers and the federal and state governments.

Besides the Chambers there are a number of other organisations that promote the interests of their members.

Finland

There are a number of handicraft organisations in Finland. Registration of membership is obligatory for craft entrepreneurs. The main craft organisation is 'Pienteollisuuden Keskusliitto' (Central Federation of Small Industries), its focus is on small-scale industry, handicrafts, industrial art, building trades and services. Several more specific and industry or regionally oriented federations also exist, these co-operate closely with the Central Federation of Small Industries. A number of general trade associations include craft type activities, but the orientation is sectoral rather than craft based.

In the handicraft sector 'Käsi- ja Taideteollisuusliitto' (The Finish Crafts and Arts Organisation) is a nation-wide consultative organisation. Its guiding principle is to maintain and keep up to date expertise in Finnish crafts. On a national level the organisation consists of 22 Crafts and Arts Associations and they have 10 Crafts and Arts Centres, while at a local level there are about 200 Craft Centres.

Different organisations provide a number of services such as information, advise, training, marketing, professional journals; arrange exhibitions, and help with access to finance. The Central Federation of Small Industries has also established a specific Education and Training Foundation for handicrafts and small scale industry.

A typical craft entrepreneur does not have a professional education but has rather learnt his profession through practice. Annually about 3,000 students graduate from the professional schools but there is no analysis of their subsequent employment. Apart from the different professional schools there is a University of Art and Design which provides academic and continuing training in crafts.

The number of apprenticeships is not great but increasing; doubling between 1994 and 1995.

Sweden

Journeyman's and master-craftsmen's certificates are administered by the Federation of Private Enterprises/Swedish Crafts Council (Föetagarnas Riksorganisation/Hantverksrådet). This is the largest and most representative professional organisation for crafts and small enterprises. The organisation has about 30,000 enterprises and around 60,000 individual members, of which an estimated 40% can be characterised as craft enterprises.

Norway

Registration is not obligatory for craft businesses, and the main associations are: 'Bygghåndverksfagenes Landsforening' (Norwegian Federation of Building Craft Enterprises), 'Håndverkfagenes Landsforening' (Norwegian Federation of Craft Enterprises), 'Norske Kunsthåndverkere' (Norwegian Association for Arts and Crafts) and 'Husflidlag' (National Federation of Norwegian Arts and Crafts).

Each trade has its own national and regional trade associations, which are normally members of the above mentioned associations.

Norway Crafts is a national centre for crafts, small industry enterprises, and handicraft. It aims to develop and promote products based on Norwegian traditions. Three regional centres co-operate with Norway Crafts.

16.2.3 Specific national policies

Also in this paragraph only information *additional* to the Second Annual Report is presented.

Denmark

Following the election in 1994 the two ministries relevant to crafts were combined into the Ministry of Business and Trade. Although not aimed specifically at the craft sector, two legal changes are important. First the new 'closing act' has allowed longer opening hours for shops and secondly a subsidy scheme which provided state subsidies for improvements to houses has been discontinued. In the past this arrangement has had a positive effect on employment in the craft sector.

France

The 'Loi MADELIN' (February 1994) (see Chapter 7) is of particular importance to craftsmen and was partly based on the recommendations of the craft professions umbrella organisation (UPA).

Through this law the Ministry of Enterprises and Economic Development in charge of SMEs, trade and crafts, adopted a Programme for Crafts.

The major aims of this programme are:

- Definition of craft. Several issues are being dealt with or will be dealt with in the near future such as new professions, regulation of the access to crafts (only in those sectors in which security of consumers can be endangered by under-qualification), and the size-limit of craft enterprises;
- Development of apprenticeships and training of craftsmen by means of:
 - improving the attraction of craft professions;
 - training tutors for apprenticeships;
 - approval by the Ministry of the rules for craft sector examinations;
 - development of a training path for crafts;
 - development of new technologies for education;
 - development of short technical and vocational training courses;
 - mutual recognition of the craft diplomas in France and Germany;
 - simplification of tax relief for the training of the self-employed.
- Improvements in the social protection of craftsmen. The 'Loi Madelin' improved this but it will also be pursued further;
- Economic development of the craft sector. Public supports and actions will be concentrated on:
 - access to market and quality;
 - innovation and the diffusion of technology;
 - regional development;
 - promotion of artistic crafts.
- Developing the promotion of the craft sectors.

This programme will be developed in close co-operation with the craft chambers and their umbrella organisation (APCM), the 'Institut Supérieur des Métiers', and professional organisations.

Greece

Within the Community Framework Programme (1994-1999), and particularly within the Operational Programme for Industry, special provisions have been adopted for the development of handicrafts. These include:

- technical and artistic assistance to handicraft enterprises;
- promotion of handicraft products;
- development of specialised Handicraft Centres;
- the creation of experimental workshops for handicraft sectors;
- subsidies for handicraft enterprises that purchase equipment;
- the publication of technical guides;
- studies and codification of traditional handicraft products.

Subsidies are given to enterprises with less than 20 employees to allow them access to consultancy services.

Also, although not specific to craft enterprises, the creation of Mutual Guarantee Funds, interest rate subsidies on SMEs loans, and the creation and development of credit co-operatives, are expected to have a major influence on the craft sector.

Chambers of Commerce and professional organisations are subsidised to assist them in the development of a wide range of services to their members.

Ireland

The above mentioned 1994 Apprenticeship Levy Act (see section 16.2.1 Legal status) is applied to designated craft sectors.

Italy

There is no new specific craft policy. At the regional level specific interventions which have a crafts dimension have been made. The most important examples are:

- Regional policies for the craft sector, Law of Veneto Region, 22 June 1993 n° 18;
- Regional incentives to craft enterprises' development, Law of Liguria Region, 14 June 1993, n° 28; Campina Region 5 April 1993 n° 17; Piemonte Region 10 December 1993 n° 28; Basilica Region 14 April 1993, n° 18;
- Regional realisation of national law n° 317 of 5 October 1991, Lombardia Region, 22 February 1993, n° 17.

Policy is aimed at developing partnerships and technological innovation, providing financial support to facilitate growth and transformation of craft activities, to assist with the new needs of the craft sector, and to provide vocational training for craft entrepreneurs.

Luxembourg

A bill is being drafted which will introduce a number of structural changes to the system that certifies expertise. The reforms are based on three principles:

- Linking management courses to vocational training. Under the new system entry barriers will be drastically reduced. At the moment, people who do not meet the entry criteria, persons already in possession of the certificate of expertise but wishing to extend their knowledge, and persons who did not take all the required exams are excluded from preparatory courses, including management courses.
- Introduction of a modular system of management courses. The school-like system will be replaced by a more flexible system of modules, allowing participants to choose their own combination.
- Promotion of the 'professional career' concept in the SME sector by offering alternative certificates. For management courses not only will the access conditions be abolished, but a new certificate will be introduced. This diploma can either be considered as a final qualification or a step towards further training.

The Netherlands

Shop opening hours have been liberalised, which will influence consumer oriented craft trades.

Portugal

General SME policy applies to the craft sector, however, in the Community Framework Programme special attention has for the first time been paid to craft trades. This affected the 'Sistema de Incentivos Regionais' (SIR) (Regional Incentive Scheme), through which financial grants and interest rate allowances are now granted to craft industries start-ups, and for business development, or for changes in business location when these activities contribute to regional development.

Also under the new INTERREG operational programme for Portugal, financial grants have become available for the start-up and development of craft businesses by persons who became unemployed as a result of the elimination of borders due to the economic integration.

Within the operational programme for SMEs, under the EU's 'SME Initiative', a number of new measures have been designed to support micro-enterprises and crafts, including support for start-ups that generate new jobs and for business developments, especially concerning competitiveness and know-how. The main instruments are grants and interest rate allowances.

The United Kingdom

The Government raised its grant to the Crafts Council by 1.1% last year, whilst reducing the funding to the Arts Council, its parental body. The introduction of the National Lottery in the United Kingdom will increase future funding for the arts, including handicrafts.

The New Members and Norway

Austria

Apart from specific legal regulations, as for instance licenses and training, policies are designed by the Ministry of Economic Affairs and the corresponding departments of the various state departments usually in accordance with the Economic Chambers. Specific craft policies mainly refer to the promotion of trade specific investment promotion schemes, and financial support for vocational education and training, consulting and research.

Finland

There is no ministry for crafts, and craft matters come under the remit of the Ministry of Trade and Industry (entrepreneurship), the Ministry of Education (education and training), the Ministry of Labour (education, training and start-up grants), the Ministry of Finance (taxes), and the Ministry of Agriculture and Forestry. There is no specific national policy for crafts, however, in 1994 a new committee was founded in the Ministry of Trade and Industry with the objective to concentrate on the problems and importance of the craft sector. The committee will look at statistical deficiencies in order to provide data that is comparable with that available at the European level.

Sweden

General SME policy is important to crafts, but there are no special crafts policies.

Norway

General SME policies apply to crafts (see chapter 7), these are focused on three fields: framework conditions, financing opportunities, and the transfer of competencies. The organisations responsible are the Ministry of Industry and Energy, the Norwegian Industrial and Regional Development Fund, and the Ministry of Local Government and Labour.

Norway Crafts was established by the Ministry of Agriculture and the Ministry of Local Government and Labour to promote crafts, art and handicrafts. In 1994 a new educational system for vocational training was introduced. The new system includes two years of academic studies and two years of work-experience in an enterprise, after which it is possible to take the Craft Certificate exam. Compared with the earlier system, students now receive a more academic education.

16.2.4 The importance of craft in Europe-16

This paragraph presents the most recent information about *all* countries.

Belgium

According to its legal definition, the social and economic importance of crafts in Belgium is limited. In 1992 5,011 enterprises were officially registered as craft enterprises, which is less than 1% of all enterprises. However, a rough estimate suggests that 30% of all the self-employed could be considered as craft-workers. The reason for the small number of craft enterprises is the fact that an enterprise which sells goods is no longer registered as a craft enterprise. A lot of enterprises registered in the trade register are generally, but not legally, craft businesses. Although the conditions of registration are the same for trade and craft businesses, there are fewer restrictions on trade enterprises, so entrepreneurs prefer this status to that of craft enterprises.

Denmark

The number of establishments increased in all sectors between 1991 and 1992, while the number of employees and skilled workers decreased.

Table 16.1 Establishments, employment and turnover of craft enterprises in Denmark, 1992

	Establishments	Employment	Turnover (1,000 ECU)
Bakery	1,533	17,714	509
Printing office	n.a.	32,468	1,794
Smith's and machine craft	n.a.	79,799	n.a.
Bricklayer's craft	3,235	14,740	727
Carpentry	5,890	26,582	1,514
Painter	2,897	12,746	571
Tinsmith	2,856	17,773	1,186
Electrician	2,458	22,259	1,269
Chimney sweeper	n.a.	n.a.	n.a.
Motor mechanic	5,138	16,283	1,357
Hairdressers	7,479	14,416	n.a.

Source: Generel Erhvervsstatistik of handel, 1994.

France

The total number of craft enterprises in France in 1994 was 782,712.

Table 16.2 Craft enterprises according to size-class (%) in France, 1994

Size class	%
0	46.0
1	17.9
2-3	16.3
4-5	7.7
6-10	8.1
>10	3.9
Total	100

Source: La France de l'Artisanat, les Chiffres clefs 1994.

Of the 2,010,000 people working in the craft sector, 1,140,000 were wage earners, 748,000 non-wage earners, and 122,000 apprentices.

Table 16.3 Enterprises and employment per craft sector in France, 1994

	Enterprises	Employment
Food crafts	106,002	329,000
Manufacturing crafts	148,045	453,000
Building crafts	286,274	664,000
Repair, transport & other services	237,219	560,000
Other	5,172	5,000
Total	782,712	2,010,000

Source: La France de l'Artisanat, les Chiffres clefs 1994.

In 1993 52,937 new craft enterprises were created, there were 16,374 take-overs and 63,164 closures in the sector.

In January 1994 71% of the craft enterprises registered in the 'Répertoire des Métiers' were Sole Traders, 25% Limited Liability Companies and 2.8% Public Limited Companies.

Greece

The Greek craft sector is not legally defined but includes handicraft, artistic businesses and all micro-businesses in trade and services.

Table 16.4 Enterprises and employment in the craft sector in Greece, 1988

	Enterprises	Employment	Average enterprises size
Manufacturing crafts	133,000	287,000	2.2
Trade	167,000	275,000	1.6
Service craft	20,000	28,000	1.4
Total	320,000	590,000	1.8

Source: NSSG census 1988.

More recent data about the craft sector in Greece is not available.

Germany

The official statistics focus on craft employment rather than on craft enterprises, so complete statistical data on craft enterprises is difficult to obtain. The unification of Germany has led to further statistical problems.

Data from the German Confederation of Skilled Crafts for 1993 shows that there were 658,568 enterprises in Germany (including the new 'Bundesländer') which could be considered craft enterprises by the legal definition. An additional 106,800 had the status of 'craft-like'.

Table 16.5 Craft employment and turnover in Germany (new 'Bundesländer' excluded), per sector (1993)*

	Employment	Turnover (MECU)
Construction	1,038,700	73,534
Metal and electronics	1,178,600	114,690
Wood processing	226,300	16,699
Textiles, leather, clothing	75,600	4,047
Food crafts	482,200	31,017
Health service**, hairdressing, cleaning	772,300	14,002
Printing, ceramics, glass-bowling, photography	91,000	6,956
Total	3,864,600	260,944

* Without craft-like enterprises.

** Opticians, dental mechanics.

Source: Statistisches Bundesamt 1994.

The new 'Bundesländer' have shown a net increase of 45,000 craft enterprises and 600,000 employees in the craft sector since reunification.

Ireland

In Ireland crafts means handicrafts and their economic importance is small. The Craft Register contains 780 individual handicraft workshops and companies, and approximately 100 more are not registered. A rough estimate of total handicraft workforce in Ireland is 6,000 - 7,000 full-time and 10,000 - 15,000 part-time, including housewives who produce knitwear and sell it from their homes.

A recent article¹ on skilled production and maintenance workers defines a number of craft-like occupations. Production crafts include engineering and metal workers, woodworkers, skilled clothing and textile workers, printers and skilled building workers. Usually employees in these sectors are trained and educated through apprenticeships or other vocational training. The number of skilled production workers was 87,500 in 1991. Employment of skilled production workers is forecast to grow by 8,200 (over 9%) between 1991 and 1998 (to 95,700). In addition, employees working with electrical and electronic equipment, and employees mainly involved in mechanical processes (motor mechanics, maintenance fitters) accounted for a further 54,300 workers in 1991. This employment category is forecast to grow by 17% from 54,300 in 1991 to 63,400 in 1998.

¹ Canny, A., G. Hughes, J.J. Sexton, Occupational Employment Forecasts 1998, FAS/ESRI Manpower Forecasting Studies, Report no.4, ESRI Dublin 1995.

Italy

According to the legal definition of crafts, there are over 1.3 million craft enterprises in Italy which employ (including the self-employed) more than three million people.

Table 16.6 Craft enterprises and employment in Italy, 1991

	Enterprises	Employment	Average enterprise size
Manufacturing craft	548,000	1,573,000	2.7
Construction	383,000	703,000	1.8
Repair	475,000	291,000	1.7
Services	205,000	545,000	2.7
Total	1,357,000	3,112,000	2.3

Source: CERVED, Tagliacarne 1992.

Luxembourg

Table 16.7 Craft enterprises, employment, average enterprise size, Luxembourg, 1993

	Enterprises	Employment	Average enterprise size
Food crafts	477	4,253	8.9
Fashion and hygiene	791	3,369	4.3
Mechanics	730	5,923	8.1
Building	1,624	27,541	17.0
Arts and handicrafts	187	1,644	8.8
Other	58	300	5.2
Total	3,867	43,030	11.1

Source: Chambre des Métiers du Grand Duché de Luxembourg.

Compared to 1992 the number of enterprises slightly increased (by 1.4%). The increase in employment stayed behind of that of enterprises with 0.4%. Average enterprise size decreased in four of the six craft sectors, while in the food crafts the average enterprise size increased from 8.5 to 8.9.

The Netherlands

Based on the definition of crafts as enterprises with less than 10 employees in production, building, engineering, and consumer services, there are 115,000 craft enterprises employing 331,000 persons. These figures are not comparable with those of the Second Report, as data for enterprises with less than 10 employees was previously not available.

Table 16.8 Enterprises, employment and average enterprise size per craft sector, the Netherlands 1993

	Enterprises	Employment	Average size
Production crafts	34,500	82,750	2.4
Building and civil engineering	20,700	72,850	3.5
Consumer service crafts	59,800	175,430	2.9
Total	115,000	331,009	2.9

Source: EIM Small Business Research and Consultancy.

Portugal

There are no available statistics as an official definition of the craft sector (or a selection of craft-like sectors) does not exist.

Spain

According to the Fundación Española para el Fomento de la Artesanía there are three main types of craft activities:

- Artistic crafts, in which hand-work is fundamental for the production as well as for the design of the product;
- Craft services, for example repair, instalment, or assembly activities;
- Food crafts such as bakers, grocers.

Table 16.9 Main figures of the Spanish craft sector, 1993

	Enterprises*	Employment
Artistic crafts	14,765	58,508
Craft services	270,320-297,260	n.a.
Food crafts	14,530-16,700	n.a.
Total	299,615-328,725	n.a.

* Except for artistic crafts, figures are estimated.

n.a. = not available.

Source: Fundación Española para el Fomento de la Artesanía.

Table 16.10 Number of artistic craft enterprises by activity in Spain, 1993

Activity	Number of enterprises
Wood furniture	2,427
Other wood products	1,240
Vegetal fibre	692
Ceramics	2,901
Marble, stone and plaster	498
Glass	297
Metal	1,531
Leather	1,403
Textile	1,005
Jewellery	1,413
Musical instruments	219
Other artistic crafts	1,139
Total	14,765

Source: Fundación Española para el Fomento de la Artesanía.

Table 16.11 Number of craft service enterprises by type of activity in Spain, 1993

Activity	Number of enterprises
Repair	95,500-101,920
Instalment and assembly	93,020-103,300
Maintenance	10,120-11,900
Provision of personal services	36,560-39,840
Manufacturing of personal goods	15,840-18,300
Agricultural services	19,280-22,000
Total	270,320-297,260

Source: Fundación Española para el Fomento de la Artesanía.

The United Kingdom

The precise size and importance of the UK's craft sector depends on the definition used. Recent research by the Crafts Council estimated the number of craftspeople (operating in handicrafts) on 25,000 in 1993, but by a wider definition there were about a quarter of a million 'craft-workers', and the number of people with 'craft skills' (that is vocational skills) is still greater (there are for instance 290,000 engineers and technicians who are members of the Engineering Council).

Under the narrow definition of crafts which reflects most peoples' understanding of crafts (applied arts) recent research by the Crafts Council has shown:

- the sector is dominated by textiles, ceramics, wood, and metal work/jewellery;
- the sector increased in employment by almost 20% between 1981 and 1993;
- since 1981 a major shift from part-time to full-time work has taken place, with over half of the craftsmen now working full-time;

- the survival rate of craft enterprises is improving, despite the recession of the early 1990s;
- the average turnover (sales) of a full-time craftsman was 51,890 ECU in 1992, and of a full-time craftswoman 24,580 ECU. The gap between women's and men's earnings has reduced over the last decade.

Using the wider definition of people with 'craft skills' (vocational skills) the sector is much larger and 18% of UK's engineering workforce have these skills. The Engineering Council's survey of 4,000 SMEs found that there was a mismatch between the skills desired and the skills available in the labour market. Sixty percent of SMEs had problems recruiting appropriately skilled staff, and 72% anticipated future problems. This reflects the recent concern in the United Kingdom about the lack of vocational (or craft) skills in the workforce and the government has been trying to provide vocational courses as an alternative to academic studies in schools.

New Members and Norway

Austria

Crafts ('Handwerk') are not defined statistically, nor institutionally represented, but membership of the Economic Chamber is compulsory. This organisation reflects the various sectors and until recently it was organised in six sectors: 'Gewerbe', industry, trade, banking and insurance, transport and tourism. About two years ago the sector 'Gewerbe' became 'Gewerbe und Handwerk' (Gewerbe and crafts). The sector contains crafts and various service industries, but even after renaming the term 'Handwerk' was not defined.

According to the Economic Chamber, the 'Gewerbe und Handwerk' sector is the largest in the Austrian economy by the number of enterprises and employment. Furthermore, from 1988 to 1993 the average growth rate in the number of enterprises in this sector was well above average. The increase was mainly due to services rather than traditional crafts.

Finland

Only a rough estimate of the importance of crafts can be given as craft entrepreneurs can not be distinguished from other SMEs. The number of handicraft enterprises (therefore excluding, for example, repair and maintenance services, and the building trades) is estimated at 6,000, the number of employees 10,000. Seventy percent of enterprises had a turnover below 42,000 ECU¹.

Sweden

Since 1941 about 20,000 individuals have received the Master Certificate for crafts. The certificate is awarded in roughly 100 professions. As the system is voluntary, and as it is not necessary to have a certificate to run an enterprise, this is not a reliable indicator of size of the craft sector. Some indication of the number of enterprises and employment in craft-type activities is given below.

¹ Committee report of the Ministry of Trade and Industry, 1989

Table 16.12 Enterprises and employment in craft oriented branches in Sweden, 1994

	Enterprises < 10		Employment in enter- prises < 10 employees	
	employees	Total enterprises	(incl. owner)	Total employment (incl. owner)
Bakeries	1,107	1,313	2,492	12,598
Printing offices	6,117	6,894	8,879	57,863
Smiths and machine craft	7,234	8,401	12,377	109,627
Bricklayers	378	411	474	1,658
Carpentry	1,708	1,724	885	2,607
Painter	4,209	4,494	3,957	15,924
Tinsmith	n.a.	n.a.	n.a.	n.a.
Electrician	5,846	6,230	7,390	27,785
Chimney sweeper	305	362	933	1,883
Motor mechanic	8,334	8,510	8,285	20,242
Hairdresser	10,442	10,488	4,417	13,481

n.a. = not available.

Source: Basfakta 94, Tabeller ur företagsregistret, Statistiska centralbyrån (SCB) (Basic Facts 94, Tables from the register of enterprises, Statistics Sweden).

Norway

As the craft sector is not legally defined there is no statistical register of enterprises or employment. Craft enterprises will be found in the statistics according to industry, for example as bakers or hairdressers.

Some indication of the sectors size is however given by the number of craftsmen with the Master Certificate which totals about 20,000, and the number of craftsmen who passed the Craft Certificate exam in 1993 was approximately 13,000.

The number of handicraft enterprises is estimated to be somewhere between 2,500 and 5,000 but considering the great number of enterprises which are too small to be VAT-registered, the total number may be much higher.

16.3 CRAFT TRADES AND THE BERLIN CONFERENCE¹

In 1989 the European Commission submitted to the Council a discussion paper on craft industries and small businesses. The subsequent debate led to the First Conference on Craft Industries and Small Businesses held in Avignon in 1990. The Second Conference in Berlin was organised:

- to recall and underline the importance of craft industries and small businesses in Europe;
- to set out the characteristics of these enterprises, and the challenges facing them in the context of the Single Market;

¹ The conference was attended by 1,200 participants from 31 countries and was held at 26 and 27 September 1994. Participants represented businesses, local, national and European Craft Organisations and Governments. In the preparatory symposia 2,000 persons took part.

- to detail the progress made since the First Conference.

The Commission supported the organisation of 12 preparatory symposia, one in each Member State on subjects of major interest to the craft industries and small businesses. This was to stimulate a Europe-wide debate and to permit the exchange of best practice. Conclusions of the preparatory symposia resulted in the 'Outline of the Twelve Pre-Conferences', from which the European Commission developed the working paper: 'Craft Industries and Small Businesses: The key to growth, employment and innovation'. This served as the basis for the Berlin Conference.

16.3.1 Problems addressed

The pre-conferences all had a special theme relating to crafts. A number of problems came up for discussion, such as:

Policy differences between countries

At a national and European level politicians and organisations are debating how to create favourable conditions which allow the creation and development of vigorous small businesses and craft enterprises. The aim is to help these enterprises overcome the weaknesses which stem from their small size and to transform these weaknesses into strengths. Meeting the needs of craft enterprises and representing their interests is difficult due to their variety and the different concerns of the Member States.

Competition from outside the European Market

The European Union is confronted by world-wide structural changes especially the emergence of new low-cost manufacturers who are not constrained by environmental regulations. First large companies and then smaller subcontractors have been forced to make great efforts to regain their international competitiveness in the context of free and open markets. Even the craft industries have had to review their production, management and export strategies to make themselves more competitive¹.

Training

Skills-enhancement is an important factor in growth, competitiveness and job creation. Quality is first and foremost a question of mastering a trade and is inextricably linked with vocational and continuous training. The importance of craft learning in the development of conceptual and practical skills is not sufficiently recognised in most education systems. In many countries young people are not aware of, or not interested in, vocational training and apprenticeships, and post-apprenticeship training is often not available. Training methods must be adapted to new developments, and qualifications should be comparable across Europe.

¹ As stated by Commissioner Raniero Vanni d'Archirafi in his opening address at the Berlin Conference.

Integration in the European Single Market

Although the right to establish craft enterprises, and the freedom to provide services, is enshrined in law, the conditions under which these rights can be exercised have not been established in every Member State, and national regulations on the provision of services vary, and occasionally prevent cross-border activities by enterprises.

Environmental protection

The pre-conference on environmental protection in Europe stated that the ever increasing environmental legislation makes it increasingly difficult to satisfy the environmental requirements and these measures often cause small enterprises considerable problems. Environmental requirements also vary among the Member States.

Crafts and quality standards

Technical problems relate to the compulsory introduction of quality and certification standards. Craft and small enterprises generally face many difficulties in obtaining practical information on these procedures and the procedures are often ill suited to SMEs.

Financing investments

The growing competition in world markets makes new investments essential. In general the conditions for financing place small enterprises at a disadvantage compared with larger enterprises. They can also only make limited use of financial instruments established for medium-sized and large businesses, or mutual guarantee funds¹.

The need for external counselling

Unlike medium-sized and large enterprises, whose human and material resources make it possible to integrate services such as information and communication, small businesses cannot develop these essential services.

Innovation is often triggered by, amongst other things, knowledge and technology transfer from partners in networks, and by awareness-campaigns by public sector organisations. The quality and character of these intermediaries must be sufficient to meet the required demand, and intermediaries understand their client companies. Therefore, access to advisory and information centres, and co-operation with research centres, should be easier.

Central and Eastern Europe

The need to recognise the important role of craft and SME organisations in the development of Central and Eastern Europe was underlined. To stimulate economical development, mutual relations and co-operation between SME organisations in the East and West should be intensified. Effective co-operation depends on reliable information concerning the different partners, and therefore it is important to identify independent, repre-

¹ In some countries mutual guarantee funds concern primarily the craft sector.

sentative and viable craft and SME organisations in Central and Eastern Europe. Businesses to business projects should be stimulated, and contacts should be focused on business communities.

16.3.2 Towards an adequate policy

Introduction

Craft and small enterprises are confronted by structural changes and increasing competition in the global market, trends which are forcing them to review their production, management, and export strategies. Craft and small enterprises have the potential through their variety and qualities to contribute to the development of the European economy and to create employment; most new jobs are created in enterprises with less than 10 employees. This job creation role can only be maintained and strengthened through efficient SME policies which appreciate the characteristics of these enterprises.

Since the first Conference on Crafts in Avignon in October 1990, the European Commission has proposed the 'Integrated Programme in favour of SMEs and the Craft Sector'¹, which has encouraged mutual consultations and the exchange of experiences between Member States. Furthermore it encourages Member States to co-ordinate business environment improvements. The Commission has already improved the accessibility to tools which now exist as part of the EU business policy, for example Euro-Info Centres, BC-Net, Business Co-operation Centres, INTERPRISE, EuroManagement. However, the competencies at the disposal of crafts and small enterprises in terms of information, financing, and training, remain insufficient for them to fully exploit the benefits of the existing programmes.

The *Second Annual Report of the European Observatory for SMEs* sets out the problems and obstacles facing crafts and small enterprises, and it provided recommendations. The *Berlin Conference* has done the same. This section makes a connection between the *Second Annual Report* and the *Berlin Conference* and states similarities and differences between them. Some themes discussed in Berlin however were not covered by the *Second Annual Report*, such as Partnerships with Central and Eastern Countries, the Role of Spouses, Environmental Issues and the Significance of Design-led Crafts.

Political or economic problems

The *Second Annual Report* (and the *Berlin Conference*) emphasised the need for a common European identity for crafts and small enterprise. Knowledge of the role and economic importance of craft trades and small enterprises should be enhanced through detailed studies and sectoral analysis. Underlining the importance for a common approach, the *Second Annual Report* presented the first methodology to allow cross-country comparison of the craft sector on a harmonised basis.

The report also noted that some general EU regulations, for example VAT-administration, subsidy application forms and requirements, and environmental policies,

¹ The Programme has been proposed by the Commission and has been supported by the Council (Council Resolution of 10 October 1994).

do not make allowances for the characteristics of crafts and small enterprises. Special attention was also requested for potential high growth companies.

Cross-border business, personal, and institutional flows are occurring, but on a limited scale. Flows seem to be increasing gradually, but are still hampered by barriers, particularly language and cultural differences. It was noted that a majority of experts interviewed for the *Second Annual Report* were not fully acquainted with the trans-national developments taking place, and to take place in future, as a consequence of the completion of the internal market.

The *Berlin Conference* stated that craft and SME organisations should collaborate with the European Authorities and that they should be consulted in the development of European policies in order to make specific allowances for the characteristics of these enterprises. Furthermore, attention should be paid to the different types of enterprises within this group (for example, micro enterprises, high growth potential enterprises, and women entrepreneurs).

International measures on VAT should be replaced by taxation in the country of origin, and medium-sized partnerships should be taken into account regarding tax harmonisation. The overall environmental requirements on firms should not be increased.

At the conference it was thought that greater advantage could be taken from the increase in international trade, but the *Second Annual Report* as the Berlin Conference stated that the greater part of craft trades are locally or regionally orientated.

Conclusions: The need for a common European definition of the craft enterprises is obvious, as regulations and policies must be based on comparable and reliable statistics. Despite the internal market there are still many differences in the regulations, taxes, and administrative and social formalities required in the different Member States. The best way to harmonise these is by co-operation and consultation between authorities, trade organisations, and business representatives. EU regulations should make allowances for the peculiarities of crafts and small enterprises.

Structural or individual problems

Training

A training policy that benefits crafts and other small enterprises requires the support of the European Union and the support of national, regional, and local authorities. Through national and EU-programmes various training schemes should be created and made accessible. Lasting effective inter-relations between schools and enterprises should also be encouraged to improve the image of crafts and small enterprise amongst young people.

In the *Second Annual Report* observed weaknesses in the craft sector were:

- the low level of education of employees;
- the low participation in continuing vocational training;
- a low recruitment of school-leavers;
- a low availability of skilled employees;
- a poor acquaintance amongst pupils and students with craft occupations and training possibilities.

Craft experts regarded education and training as the best means to stimulate technological diffusion.

At the *Berlin Conference*, skills-enhancement was seen as a condition for growth, competitiveness, and job creation. Suggestions were made to:

- promote the dual system;
- define new approaches and encourage innovations in the training of (new) entrepreneurs, managers, and employees;
- set up a centre for the exchange and dissemination of ideas;
- pay attention to environmental aspects in vocational training.

Much will be gained by the international exchange of experiences and trainees, but a pre-condition is to establish the legal status of the trainees and to create comparable standards for general and vocational training.

The *Second Annual Report* mentioned the Experimental Training Scheme for the international training of entrepreneurs, and suggested an international training institute to consider the networking of different national training schemes.

Conclusion: To stimulate the growth in the craft sector and SMEs, and to create employment, special attention should be paid to attune vocational training to business practice. Young people must be made aware of the existing vocational training. To keep pace with new developments attention should be paid to the availability of post-apprenticeship training for entrepreneurs, managers, and employees. Much can be learned by an international exchange of best practice, common methods of evaluating training systems should also be established.

The *Second Annual Report* and the *Berlin Conference* agreed on these needs, but the *Second Annual Report* also pleaded for an evaluation of the accessibility of European Community information on training and education schemes.

Information

The *Second Annual Report* noted the importance of market information, especially as internationalisation is affecting craft and small enterprises, despite the fact that most of these enterprises are strongly oriented towards local and regional markets. The report recommended the stimulation of international co-operation through trade associations.

At the *Berlin Conference* an information gap was identified between entrepreneurs, the authorities and trade organisations. The conclusion was that accessibility should be improved. Contacts between policy-makers, representatives of trade organisations, and businesses, should also be intensified. The creation of stable networks between enterprises and the development of co-operation projects between enterprises, were recommended.

Conclusions: Trade associations in the craft trades should be stimulated to co-operate at a national and international level. Transfer of know-how often takes place through awareness campaigns in which trade organisations and national programmes can play an important role.

Administrative burdens and finance

In the *Second Annual Report* the need for constant vigilance by authorities, from the local to European level, to prevent unnecessary burdens on crafts and small enterprise was underlined. Administrative burdens should be internationally monitored, with attention paid to 'late payments'. Furthermore, capital markets operate differently across Europe, with implications for competitiveness.

The *Berlin Conference* recommended the improvement of finance for craft enterprises, by enhancing co-operation with banks, and reinforcing the mutual guarantee system. The considerable burden on enterprises should be reduced by simplifying and reducing taxation.

Conclusions: Differences between the Member States in supplying long term loans, seed and venture capital, should be reduced with greater harmonisation of systems. Efforts to unify fiscal, social, and administrative formalities should be furthered, and the impact of policy measures should be assessed before and after their implementation. In general the *Second Annual Report* and the *Berlin Conference* agreed on the necessity to improve access to finance for these types of enterprises. However, the *Second Annual Report* was more concerned with a levelling of conditions at European level so as to avoid unfair competition, while the *Berlin Conference* was more concerned with actual co-operation between enterprises and banks.

Technical problems

The *Second Annual Report* concluded that intermediate manufacturing enterprises serving industrial customers will face the need to upgrade the quality of both their equipment and organisations. If they fail to adjust to new technologies they will lose market share. Standardisation and certification are becoming ever more important.

Present EU technology programmes are considered to be barely relevant to the craft sector. The Report was pleading for:

- co-operation between small and larger enterprises in several technological areas;
- the use of consultants in assessing the financial, commercial, and organisational viability of technology projects;
- better access to finance for innovations;
- special attention to be paid to the dissemination of new technologies in the crafts sector through education and training systems. Crafts people consider these systems to be the most effective means through which to upgrade their technological skills.

Special attention should be paid to the links between the many technology programmes, and the technological information centres for SMEs, in the Member States.

The *Berlin Conference* suggested that there is a need for further attention to product/service quality in enterprises, and urged wider use of quality certification.

The Conference stated that:

- craft and small enterprise participation in European research and technology programmes should be improved;
- a more consistent approach should be developed from the existing diversity of programmes across the EU.

Conclusions: There is an undoubtedly need for harmonised norms and standards, but information must be easy accessible to entrepreneurs and must not raise the burdens on business. The objectives regarding quality must be realistic and consistent with market demand. Professional organisations should be involved in establishing regulations, standards, and quality guidelines, especially at European level, and these should be appropriate for small enterprise.

General conclusion: The main points discussed at the *Berlin Conference* were in line with those in the *Second Annual Report* of the European Observatory for SMEs, which recognised the general problems faced by crafts and small enterprises. However, the approach in the *Second Annual Report* differs from that of the *Berlin Conference* as the Report was concerned with employment creation, the implications of the White Paper on Growth Competitiveness Employment, and was intended for policy makers at the EU level. The *Berlin Conference* was by contrast thematic and more detailed, emphasising the role of trade and other organisations as intermediaries between the European Union and businesses.

PART IV CONCLUSIONS

17 SME INTERNAL MARKET MONITOR

Co-ordinated by EIM Small Business Research and Consultancy

MAIN POINTS

- The business environment - from the viewpoint of SME-performance - has improved over the 1988-94 period. This improvement occurred in a period characterised by mainly convergent trends in the business environments of the twelve Member States of the EU.
- There is evidence that the convergence of the business environment in the EU-12 has been positive with regard to SME-performance
- Value added growth amongst SMEs has been substantial over the 1988-94 period: averaging 2,7% per annum in the EU over the period, and ranging from more than 3% in Germany and Luxembourg, to less than 1% in the United Kingdom.
- Value added growth amongst SMEs during this period has been export-led, either through direct exporting, or indirectly through the export growth of large scale enterprises for which SMEs are sub-contractors.
- Compared with LSEs, employment growth of SMEs has been relatively strong. However, compared to the value added growth amongst SMEs themselves, SME employment growth has been disappointing, particularly in Ireland, Italy, Spain and the United Kingdom, where SME employment declined between 1988 and 1994.
- The larger part of value added growth in SMEs was matched by growth of labour productivity, with only a minor part of value added growth in SMEs being reflected in employment growth.
- Although economic growth of SMEs certainly has not been jobless, SME-growth in 1988-94 was job-extensive (that is, employment grew at a much slower rate than value added), a phenomenon which might be related to insufficient functioning of labour markets, the fact that mainstream labour market policies are not very well suited to serve SMEs and to increased productivity related to the growing dependency of SME-growth on international and exposed markets.
- Comparing the Member States of the EU-12 with the EFTA-4 countries, SMEs in the EU-12 have clearly outperformed those in the EFTA-4 countries over the 1988-94 period with regard to value added, turnover, and employment growth.

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continued

- In the 1988-93 period there was a slight decrease in the new enterprise birth rate in both the EU-12 and in the EFTA-4 countries.
- Average enterprise size has declined over the 1988-94 period in both the EU-12 and in the EFTA-4 countries.
- In general, the business environment in which SMEs operate has been converging in the EU-12, that is, the business environments of the Member States became increasingly similar across the European Union.
- Fiscal and monetary policies in the EU-12 have converged over the 1988-94 period. Labour market policies, in particular active labour market policies, have diverged over the same period.
- The economic strength and the prosperity of the Member States are converging, as are conditions on the capital and labour markets, and efforts on technology and innovation.
- SME dynamics (entry and exit rates, and the characteristic functioning of SMEs) have converged in the EU-12 over the 1988-94 period.
- Contrary to the business environment and SME dynamics, SME-performance (in terms of value added, employment, and exports) has diverged in the EU-12 over the 1988-94 period. This finding is largely dependent on the 'deviant' patterns of growth shown by SMEs in the United Kingdom and Italy.
- On most areas of the business environment, SME dynamics, and SME performance, the EFTA-4 countries have been becoming increasingly similar to the EU-12 over the 1988-94 period.
- In only two areas: labour market policies, and capital market conditions, the EFTA-4 countries are moved away from the conditions found in the EU-12.
- Despite these trends, the distance between the EU-12 and the EFTA-4 countries remains substantial. Only in the areas of economic strength and prosperity, and of SME-performance relative to business goals, are the EFTA-4 countries more similar to the average in the EU-12 than are the twelve Member States themselves. The lack of cohesion on these two variables was caused by the 'outlier-position' of some of the southern countries in the EU-12.

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- SME-performance, is among other things, influenced by governments fiscal and monetary policies, GDP per capita developments, and SME-dynamics (including the birth and death rate of enterprises, the share of micro enterprises, and average enterprise size).
- Fiscal policies - in particular the decline of government consumption and investment expenditure - depressed SME-performance over the 1988-94 period.
- The average stance of monetary policies - in particular the pragmatic (i.e. non-restrictive) money supply policies - had a stimulating influence on SME-performance in the same period.

17.1 INTRODUCTION

The SME Internal Market Monitor (SIMM) focuses on monitoring SMEs in the internal market. The general objective of the monitor is to provide policy makers at the European and national levels with information about the performance of SMEs and the factors which influence them. Through this effective policies can be developed which are geared to improving the performance of SMEs in the Union.

The general objective can be sub-divided into three working objectives of the monitor:

- The first objective of the monitor is to give a dynamic overview of the performance of SMEs and the business environment in which SMEs operate.
- The second objective of SIMM is to analyse the impact of the completion of the internal market on SME-performance and SMEs business environment. Essentially, is the performance of SMEs, and the nature of their business environment, converging or diverging, and is the 'quality' of the business environment improving?
- The third objective of SIMM is to analyse the relationship between the business environment and SME-performance, in other words to explain SME-performance through their environment, and so provide information for future policy-making.

The monitor in the Second Annual Report of the European Observatory for SMEs focused on an assessment of convergence tendencies in the Union at indicator level and a first attempt was made to relate SME-performance to business environment indicators.

Following suggestions by the Commission, this year's monitor develops these themes through:

- the convergence analysis which is extended from indicator level to country level, and which makes it possible to provide information on the convergence/divergence between countries rather than between variables;

- paying more attention to the assessment of the relationship between the business environment and SME-performance, and a more straightforward assessment of the impact of the completion of the internal market on SME-performance;
- an extension of the analysis from 12 to 16 countries to include the New Member States (Austria, Finland and Sweden) and Norway. It is therefore possible to assess the state of SMEs in the new Member States at the time of their entry into the Union.

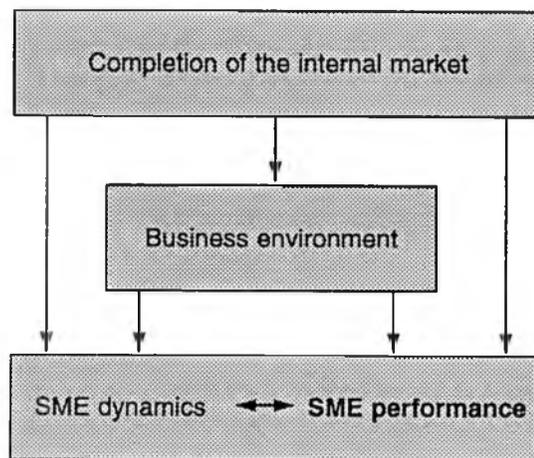
The range of the analysis is also been extended with substantially more indicators of the business environment brought into the analyses.

Given the general objective, that the monitor should shed light on SME-performance, the conceptual model of the monitor is as follows. SME-performance (in terms of value added, turnover, exports, employment, and profitability) is thought of as being primarily determined by the dynamics of small and medium sized enterprises (the characteristics of SMEs and the specific functioning and behaviour of SMEs in markets).

But, SME dynamics and SME-performance are influenced by the business environment, which includes government policies, the structure and developments of markets in which SMEs operate, and the industrial relations in the country of operation. The business environment also defines the opportunities for SMEs, and the room in which they can manoeuvre.

Furthermore, it is assumed that the economic integration in the European Union, through the completion of the internal market, influences the parameters of the business environment of SMEs, and therefore SME-performance.

Scheme 17.1 Conceptual model



This chapter aims to develop for policy-makers, insights into the determinants of SME-performance, so that policies can be designed more effectively to support SME-performance.

The structure of this chapter is as follows.

In section 2 some key indicators of SME-performance, business dynamics, and the business environment, at the EU-12 and EFTA-4 level are presented. This section presents an overview of SME-performance, SME-dynamics, and the business environment of SMEs, in the EU-12 and the EFTA-4 countries.

In section 3 the business environment and SME-performance are monitored and the question of whether the completion of the internal market is leading a convergence in the business environment and SME-performance in the European Union is addressed. The position of the EFTA-4 countries in relation to the European Union of the twelve Member States is also analysed.

In section 4 SME-performance is explained in terms of the business environment and SME-dynamics indicators, and indications are presented on how the business environment for SMEs can be improved. The issue whether the completion of the internal market has had positive effects on SME-performance is also discussed.

Appendix 1 to this chapter contains profiles of the 16 countries included in the report.

In Appendix 2 the convergence analysis is presented in greater detail and illustrated through country-plots; these give insight into the position of individual countries in the EU-12.

Appendix 3 provides a list of the variables included, together with the results of the convergence analysis on these variables

17.2 KEY INDICATORS AT THE UNION- AND EFTA-4-LEVEL

17.2.1 Business performance and business dynamics

Since the second half of the 1970s high unemployment has been the most severe social and economic problem in the European Union. Therefore employment growth in SMEs has, especially in comparison with employment growth in large scale enterprises, attracted much attention. Despite methodological problems¹, it has been found that in the 1988-94 period, when there was a slight reduction in aggregate employment in the EU-12, employment declined in large scale enterprises, whilst employment in SMEs increased. Growth in employment in small and medium-sized enterprises almost compensated for the reduced employment in LSEs.

Two observations should be made with regard to this. First, the dramatic gap between the employment performance of Europe and that of the United States, a phenomenon which deserves thorough analytical attention, on which no detailed analytical attention will be paid at the moment, however. Secondly, even if employment performance amongst SMEs is superior to employment performance in LSEs, the former is still somewhat disappointing. Table 17.1 shows that the employment performance of SMEs in the EU-12 lags behind other SME performance indicators. For example, a comparison of value added growth in EU-12 reveals that the larger part of economic growth in SMEs is matched with productivity growth and only a small part with employment growth. Furthermore, exports and especially profits in SMEs have risen rapidly, but employment growth in the 1988-94 period has not been very great. Although no jobless growth in

¹ See chapter 1 and chapter 3 for a discussion on methodological difficulties in this respect, in particular the problematic of the size distribution fallacy and how is dealt with these difficulties in this report.

European SMEs can be discerned, economic growth in SMEs certainly is job-extensive at the moment. The key-question at the moment is why SME-growth is job-extensive. Section 4 will address this issue.

A comparison of the performance of SMEs in the EU-12 and the EFTA-4 countries reveals that SMEs in the Union by far outperform SMEs in the EFTA-4 countries; only in profit-growth are SMEs in the EU-12 comparable to SME in the EFTA-4 countries.

Table 17.1 SME performance 1988-94 (annual %-change)

	EU-12	EFTA-4
Employment	0.7	-1.1
Value added	2.7	1.0
Turnover	1.5	-4.0
Exports	1.7	-0.7
Profits	5.1	5.0

Source: Eurostat/EIM Small Business Research and Consultancy.

Table 17.2 shows some marked differences between SME dynamics in the EU-12 and in the EFTA-4 countries. First of all, the EU-12 shows a slow decline of the birth rate of new enterprises per 1,000 inhabitants, while the EFTA-4 countries show a more marked decline; but the survival rate of start-ups is somewhat higher in EFTA-4 countries than it is in the EU-12.

Secondly, the size of production units differs widely between the EU-12 and the EFTA-4 countries; the average enterprise in the EU-12 is about two-thirds of size of the average enterprise in the EFTA-4 countries. The share of micro-enterprises in particular is much lower in the EFTA-4 countries.

Thirdly, the producer services (see chapter 15) have a much greater presence in the EU-12 than in the EFTA-4 countries, and the gap has been growing over the 1988-94 period.

Table 17.2 SME dynamics 1988-94

	EU-12		EFTA-4	
	1988	1994	1988	1994
Start ups /1,000 inhabitants	4,4	4,4	4,9	4,0
Survival rate (5 years)		53		56
Share micro enterprises	92	91	84	85
Average enterprise size	7,5	6,7	12,5	10,6
Presence producer services	11,4	13,6	9,6	9,4

Source: Eurostat/EIM Small Business Research and Consultancy.

17.2.2 Business Environment

SMEs, which form the larger part of the private economy in terms of enterprises, employment, and value added, operate in a business environment which determines their opportunities and room for manoeuvre. In section 17.3, the question of whether national business environments within the EU-12 are converging, will be assessed. In section

17.4 the delicate question of the relationship between the business environment and performance of SMEs will be examined. In this section a short overview will be presented on the business environment indicators at the EU-12 and EFTA-4 level.

In the Union as a whole, the total tax-burden (direct taxes, indirect taxes and social contributions) remained stable in the 1988-94 period; at the same time the tax-burden decreased in the EFTA-4 countries, although the total tax-burden in these countries remains above that in the EU-12 (see Table 17.3).

Table 17.3 Business environment 1988-94

	EU-12		EFTA-4	
	1988	1994	1988	1994
Direct taxes (%GDP)	14.1	13.9	16.6	16.0
Indirect taxes (%GDP)	13.8	13.9	17.9	17.4
Social contributions (%GDP)	12.1	12.2	12.6	13.5
Real short term interest rate	3.8	4.5	4.6	4.1
Liquidity ratio (money supply/GDP)	0.71	0.78	0.65	0.65
Expenditure active labour market policies (% GDP)	0.87	0.97	1.01	1.49
Expenditure passive labour market pol. (%GDP)	1.74	2.15	1.05	2.83
Gross expenditure R&D as % GDP	1.48	1.77	1.99	2.17
Business expenditure R&D as % GDP	0.91	1.07	1.25	1.27
Inflation	4.6	4.1	4.5	2.3
Share prices (1990 = 100)		95		85
Capital income share (profit rate)	36.0	40.9	30.1	32.9
Gross fixed capital formation (% GDP)	20.6	18.7	24.6	18.2
Unemployment rate (% labour force)	9.7	11.3	3.3	9.0
Long term unemployment share	51.8	41.6	9.5	14.4
Youth unemployment (% labour force)	21.8	16.7	11.7	16.4
Imports (%GDP)	40.6	39.6	32.6	31.5
Exports (%GDP)	40.7	40.1	32.9	34.4
Trade union density (% employment)	46.0	37.1	65.7	64.2

Source: Eurostat, OECD.

Monetary conditions in the Union have changed somewhat in the past six years. The picture is not unequivocal: real short term interest rates increased, making credit a little more costly, but the money supply relative to nominal GDP grew substantial and this may be more important for SMEs than LSEs (see section 17.4); providing SMEs with greater room for manoeuvre. In the EFTA-4 countries the reverse was apparent, credit became cheaper whilst the liquidity ratio was stable at a level much lower than that in the Union.

In both the EU-12 and the EFTA-4 countries governments took a more active stance on labour market policies; but rising unemployment caused a substantial growth in passive (compensatory) labour market policies as well, especially in the EFTA-4 countries. The

(growing) difference in the expenditure on active labour market policies between the Nordic EFTA-4 countries and the EU-12 remains striking.

Concerning technology and innovation, in both the EU-12 and the EFTA-4 countries, total gross expenditure as well as business expenditure on R&D increased substantially in the 1988-94 period, and the gap between the EU-12 and the EFTA-4 countries will reduce in the long run (see also chapter 11).

Regarding conditions in financial and capital markets, inflation decreased, and at a faster rate in the EFTA-4 countries than in the EU-12. Share prices, despite the recent economic upswing in most countries and a sharp rise of the capital income share are still below the levels at the beginning of the decade. Gross fixed capital formation in the EU-12 in 1994 was slightly below the level it had been in 1988, while a greater decrease was apparent in the EFTA-4 countries over the 1988-94 period.

Labour market conditions remain serious: the already high level of unemployment in the EU-12 increased further in the 1988-94 period, while in the EFTA-4 countries, which had full employment throughout the 1970s and 1980s, unemployment has increased rapidly and is approaching the level found in the Union (EU-12). In the EFTA-4 countries long term unemployment in particular has increased sharply, although it remains low relative to the EU-12. Youth unemployment in the EFTA-4 countries is also approaching the high EU-12 level.

Finally, the degree of involvement of national economies in the global market remained stable in the EU-12 over the past 6 years, while the EFTA-4 countries increased their share of exports; but a gap between the two groups of countries remains.

17.3 MONITORING CONVERGENCE IN THE INTERNAL MARKET

The completion of the internal market in the European Union is arguably the point of gravitation of the social, economic and political union of the Member States of the EU. The key-issue in the framework of the completion of the internal market is the convergence of the national economies.

First, convergence of national economies has been a key-objective of the EU (or the EC) since the early 1970s. Secondly, convergence of the national economies is expected to arise through the ongoing process of social and economic integration, which includes the completion of the internal market. Thirdly, the convergence of national economies in the framework of a free internal market is expected to have a positive influence on the economic prosperity and competitiveness of the European Union as a whole.

So, one of the essential questions to be answered by SIMM is whether the economies of the Member States of the European Union are converging or diverging, and what impact these processes are having on the economic prosperity of the European Union in general and on SME-performance in particular.

In this section the development of SME-performance and the business environment will be monitored, including a convergence-divergence analysis concerning the EU-12. It will also be analysed whether the EFTA-4 countries are becoming increasingly similar or dissimilar to the EU-12. Detailed results of the convergence analysis, and a graphical representation of the analysis are to be found in Appendix 2 to this chapter. A list of indicators used in the analysis,

and an indication of convergence or divergence at the variable-level can be found in Appendix 3 to this chapter. This analysis is comparable with that in the Second Observatory Report.

17.3.1 Business Environment

The business environment of SMEs can be divided into three domains: the state, the market, and the system of industrial relations. Each of these fields can be subdivided into various subdomains, which can themselves be sub-divided further into different aspects, which are built up by various indicators (see scheme 17.2). For example, within the state's domain, the sub-domain of fiscal and monetary policies can be distinguished. Within this subdomain the aspect of taxation policies can be identified, which aspect is built up, at least in this analysis, of direct taxes, indirect taxes and social contributions (see Appendix 3 for a complete list of indicators included in the SIMM).

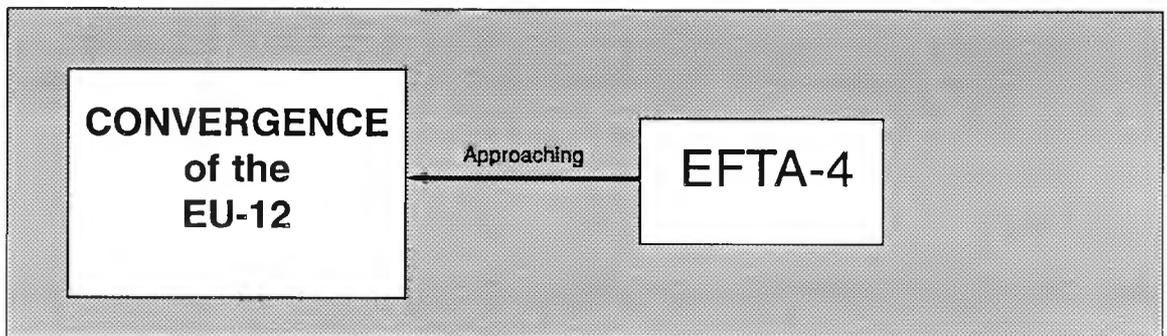
Scheme 17.2 Business Environment

State	<i>Fiscal and monetary policy</i>	Taxation policy
		Structure of government outlays
	<i>Labour market policy</i>	Monetary policy
		Specific SME-policies
<i>Burdens on business</i>	Passive labour market policies	
	Active labour market policies	
	Specific SME-policies	
Market	<i>Technology</i>	Regulatory burdens
		Financial efforts on R&D
		Public / private financing
	<i>Capital and finance</i>	Labour efforts on R&D
		Capital market
		Financial system
	<i>Labour market</i>	Cost structure
		Participation
		Flexibility
	<i>Economic strength</i>	Prosperity
Strength domestic economy		
Power relations labour market parties		
Industrial relations		Labour market institutions

Fiscal and monetary policies

Fiscal and monetary policies show considerable convergence within the EU-12, with fiscal and monetary policies in the Member States of the European Union increasingly resembling each other. At the same time, these policies in the EFTA-4 countries are also approaching those of the EU-12. For example the traditional pragmatic expansionary stance on monetary policies adopted (at least Nordic) in the EFTA-4 countries has tended to change towards the more restrictive stance favoured in the Union. At the same time, the structure of government expenditure has moved in the direction of relatively greater emphasis on social transfers and relatively less emphasis on government consumption and investment expenditure (for details and the country plot, see Appendix 2).

Scheme 17.3 Fiscal and monetary policies



Direct and indirect taxes and social contributions are an important element of fiscal and monetary policies. In EU-12, as well as the EFTA-4 countries, the tax and social premium-burden remained stable in the 1988-94 period. Ignoring some exceptions aside, figure 17.1 shows that the countries with a high level of taxation have lowered their burden, while countries with a relatively low level of taxation have increased that burden. At least for direct and indirect taxes there has been some convergence (see Appendix 3 for further details on convergence and divergence at variable level).

A significant gap remains in the tax burden imposed in the EU-12 and the EFTA-4 countries.

Apart from taxation policies, the structure of government expenditure is an important aspect of fiscal policies, and, as will be shown in section 17.4, this is important to SME-performance. As figure 17.2 illustrates, the structure of government expenditure varies widely between the Member States. For example, government investment expenditure is particularly high in the southern Member States, while it is relatively low especially in the Nordic and Low countries, where government social expenditure is relatively high.

Figure 17.1 Direct and indirect taxes and social contributions as % GDP

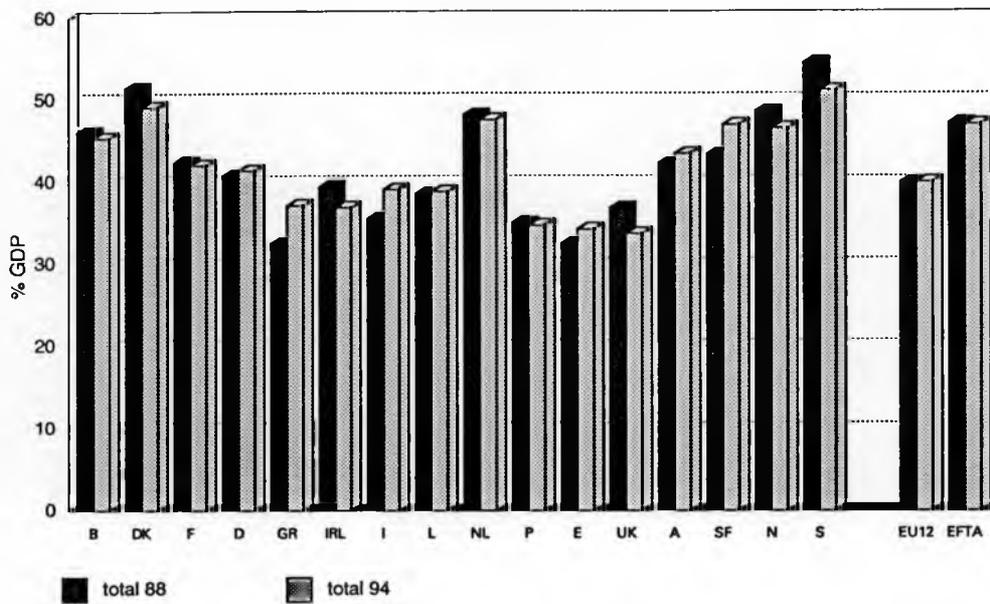
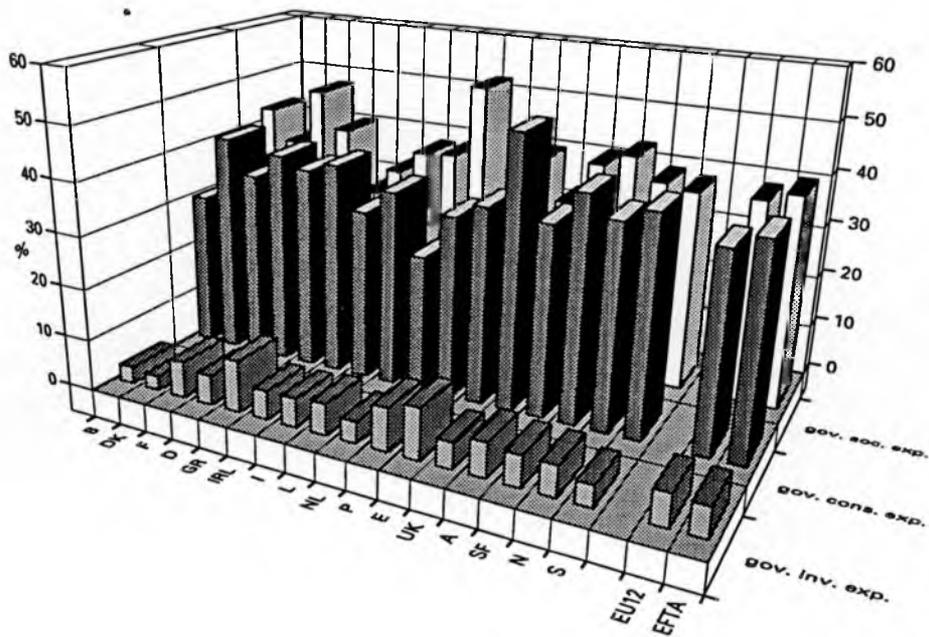
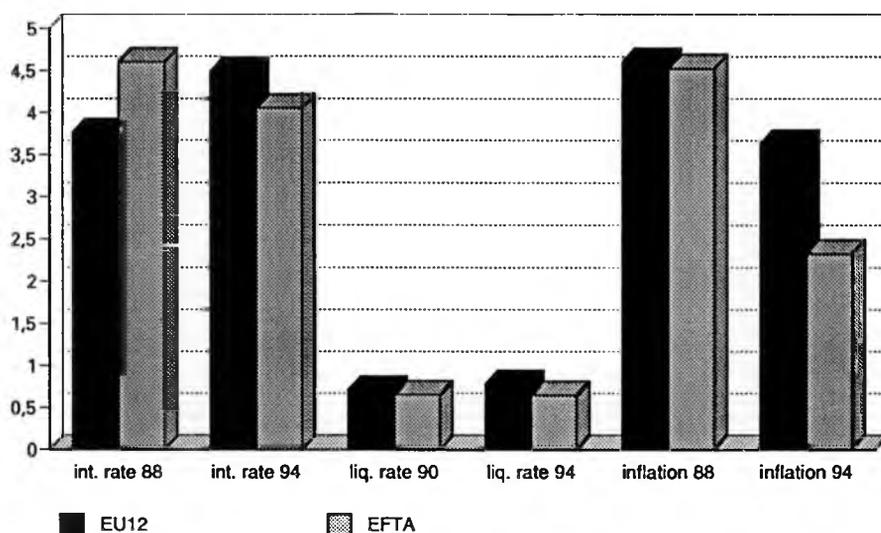


Figure 17.2 Structure of government expenditure



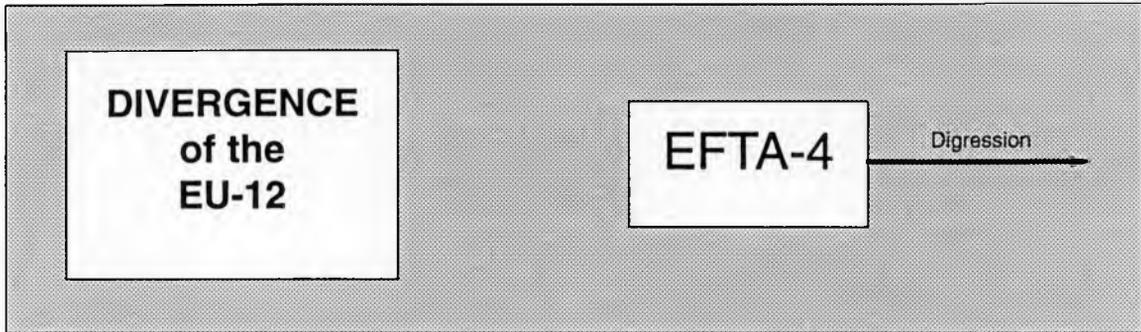
Besides fiscal policies, monetary policies are also an important, and often underestimated, factor in the business environment. In the 1988-94 period monetary policies was, on the one hand, somewhat restricted (the cost of credit increased a bit in the EU-12) but on the other hand the availability of credit increased considerably (measured by the liquidity ratio - the money supply as a percentage of nominal GDP). At the same time, monetary conditions, indicated by decreasing inflation, became more favourable in both the EU-12 and in the EFTA-4 countries (see Figure 17.3). All in all these developments seem to have had a positive impact on SME-performance (see section 17.4).

Figure 17.3 Monetary indicators



Labour market policies

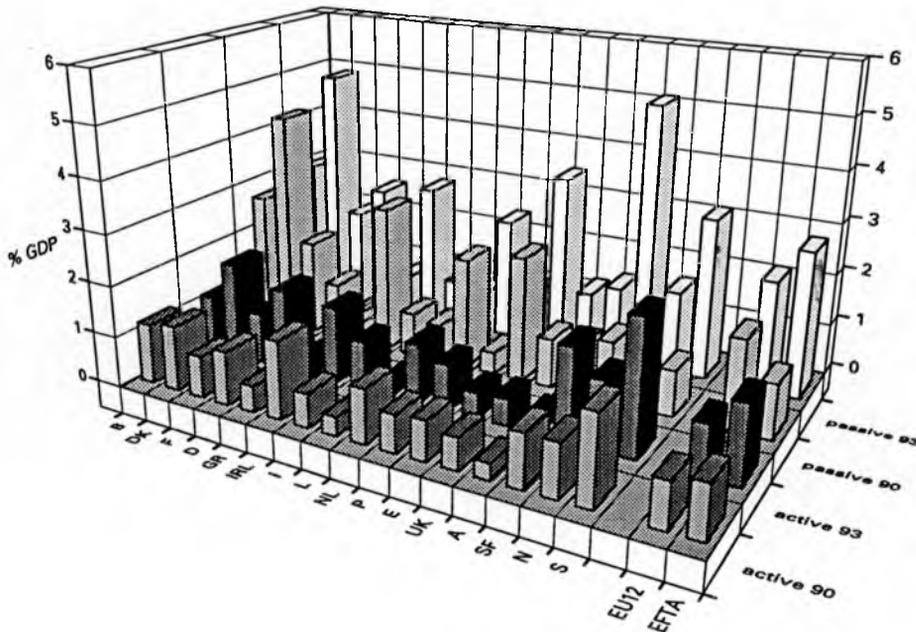
Labour market policies diverged to a considerable extent in the EU-12, and the EFTA-4 countries are moving away from the centre of gravity in the EU-12. Although the EFTA-4 countries have traditionally had a more active stance in this area, they have increased their active labour market policies to a greater extent than the EU-12 in the 1988-94 period.



Despite this divergence, expenditure on active as well as passive labour market policies increased considerably in the 1988-94 period in both groups of countries. The increasing expenditure on passive policies (compensating for unemployment or disability by the supply of social benefits) was an automatic response to rising unemployment, the increasing expenditure on active labour market policies (training, and employment creation policies) was a deliberate attempt to reduce unemployment.

As Figure 17.4 shows, traditions in labour market policies vary considerably between countries, and the differences even increased. The Nordic countries, Germany, and France, have substantially higher expenditures on active labour market policies than the other countries, while countries such as Belgium, Denmark, Ireland and the Netherlands traditionally pay greater attention to passive labour market policies.

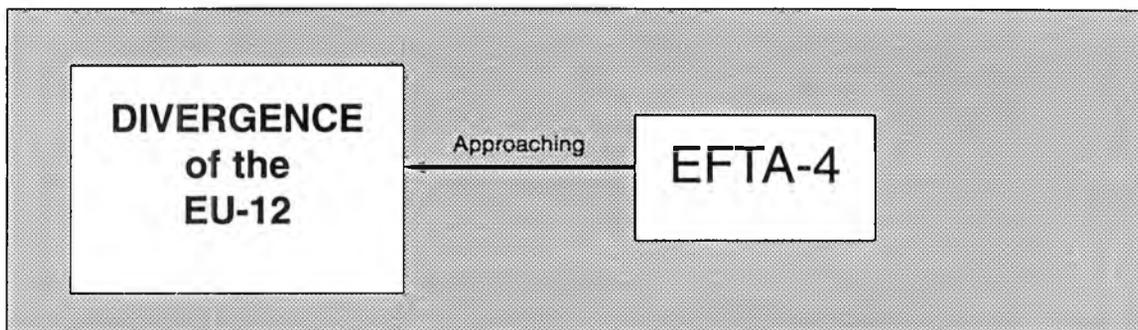
Figure 17.4 Expenditure on active and passive labour market policies



Burdens on business

Private enterprises may benefit from the various forms of state intervention in the economy, but private enterprise also has to carry several state imposed burdens. These burdens can be divided between the financial burdens and the regulatory burdens.

Scheme 17.5 Burdens on business



If both types of burdens are taken together, the countries of the EU-12 are diverging. The EFTA-4 countries are however, approaching the EU-12, especially in relation to their regulatory burdens, which are increasing in these countries at a faster rate than in the EU-12.

Concerning the nature of the burdens, it seems that in the EU-12 the regulatory burden has increased during the 1988-94 period, but at the same time the financial burden has diminished slightly (see Appendix 2 to this chapter for further details).

Technology and innovation

The business environment with respect to technology and innovation converged significantly in the European Union during the 1988-94 period. The EFTA-4 countries also became more similar to the EU-12, especially through bringing their public/private mix of R&D financing more into line with the pattern found within the EU-12.

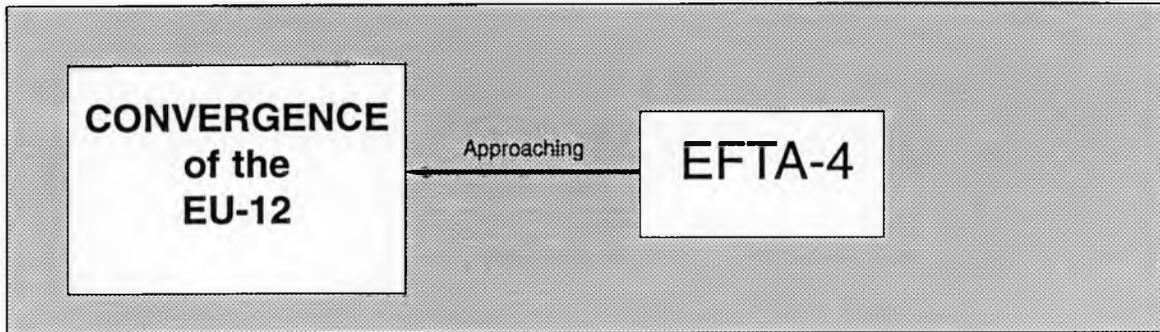
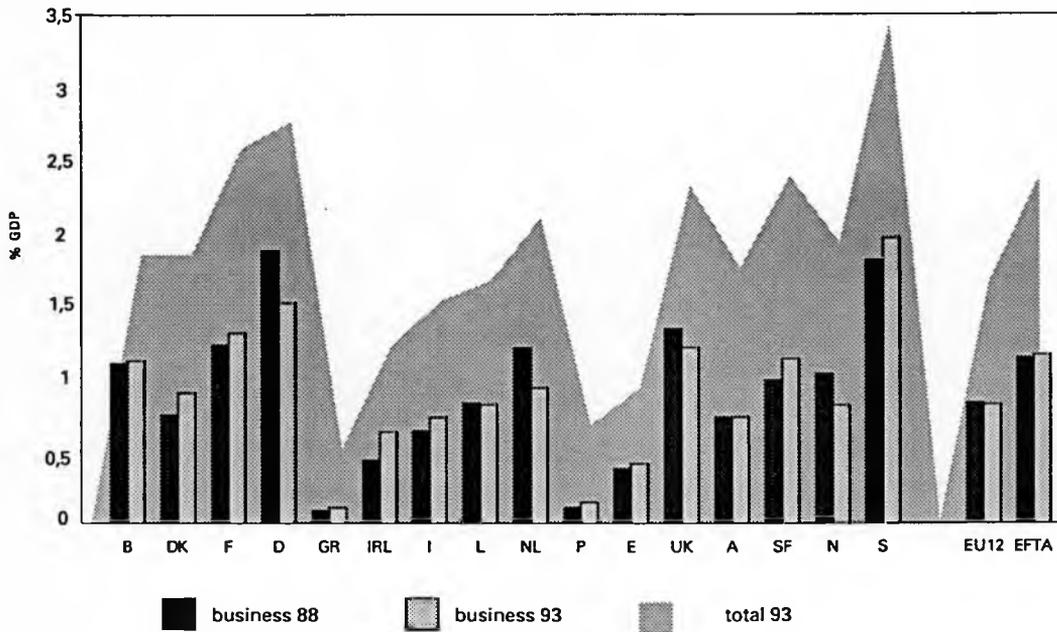


Figure 17.5 provides some information on R&D efforts in the EU-12 and in the EFTA-4 countries. The figure shows that average total R&D-expenditure as a percentage of GDP is much higher in the EFTA-4 countries than in the EU-12.

Within the EU there is considerable variation in the total R&D effort as well as in the R&D effort financed by industry. Belgium, Denmark, France, Germany, the Netherlands, and the United Kingdom clearly are the highest R&D-spenders, while the southern countries lag behind.

Figure 17.5 Expenditure R&D



Capital and finance

Conditions in capital markets have shown substantial convergence over the past six years within the EU-12, and at the same time the capital market characteristics in the EFTA-4 countries have moved away from those in the EU-12; investment intensity in the EFTA-4 economies decreased much more than they did in the EU-12 during the 1988-94 period, and the availability of venture capital became, at least in Finland and Norway, somewhat more favourable than (on average) within the EU-12.

Scheme 17.7 Capital and finance



Convergence in capital markets within the EU-12 is mainly explained by venture capital conditions, which are converging rapidly.

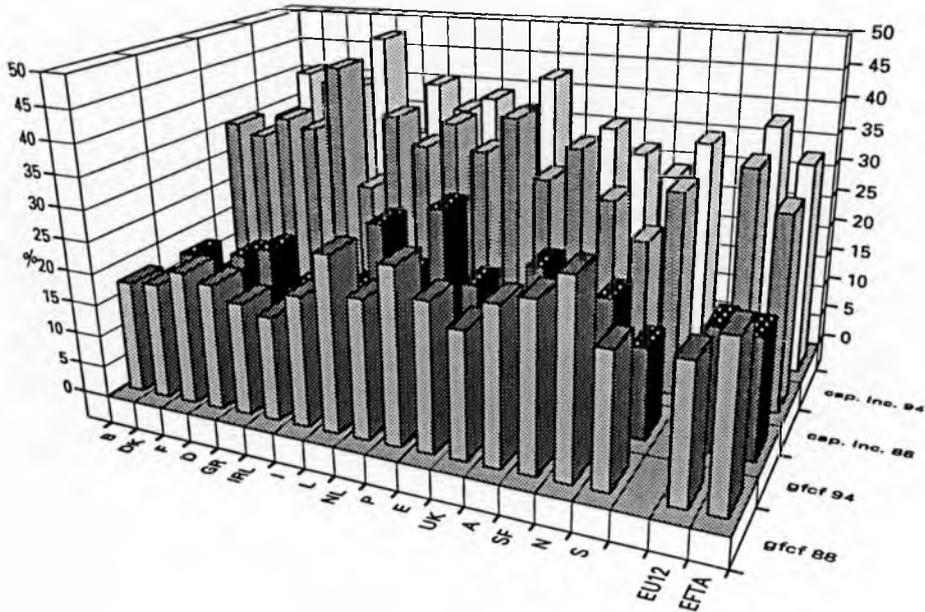
Apart from venture capital conditions, important business environment indicators include the investment rate and the capital income share (an indicator of enterprise profits).

The investment rate has decreased significantly in the 1988-94 period, within the EU-12 and in the EFTA-4 countries. The decline has been particularly large in the EFTA-4 countries, which had an investment rate in 1988 well above that of the EU-12, but by 1994 their rate lagged behind the EU-12 (see Figure 17.6).

The capital income share increased substantially in the 1988-94 period, in both groups of countries. The EFTA-4 countries managed to function with much lower capital income shares than the EU-12.

A comparison of the two indicators shows that the investment rate in a country is not a straightforward function of the profitability of private enterprise.

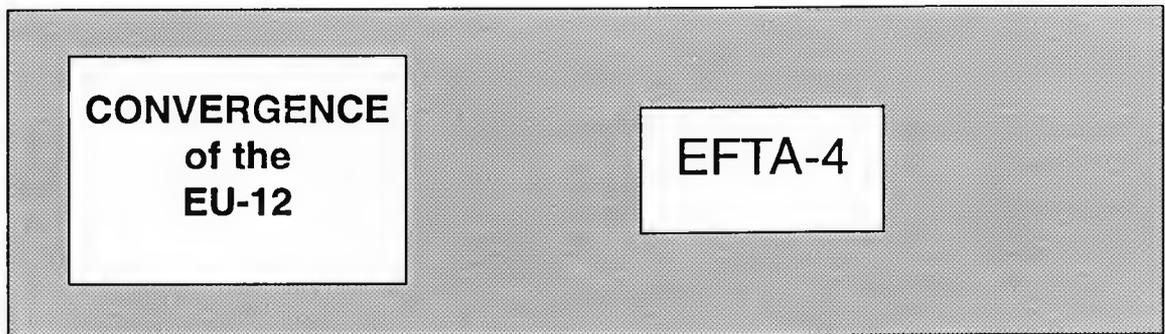
Figure 17.6 Gross fixed capital formation and capital income



Labour market

In general labour markets are converging in the EU-12. The EFTA-4 countries are neither approaching, nor are moving away from the EU-12.

Scheme 17.8 Labour market



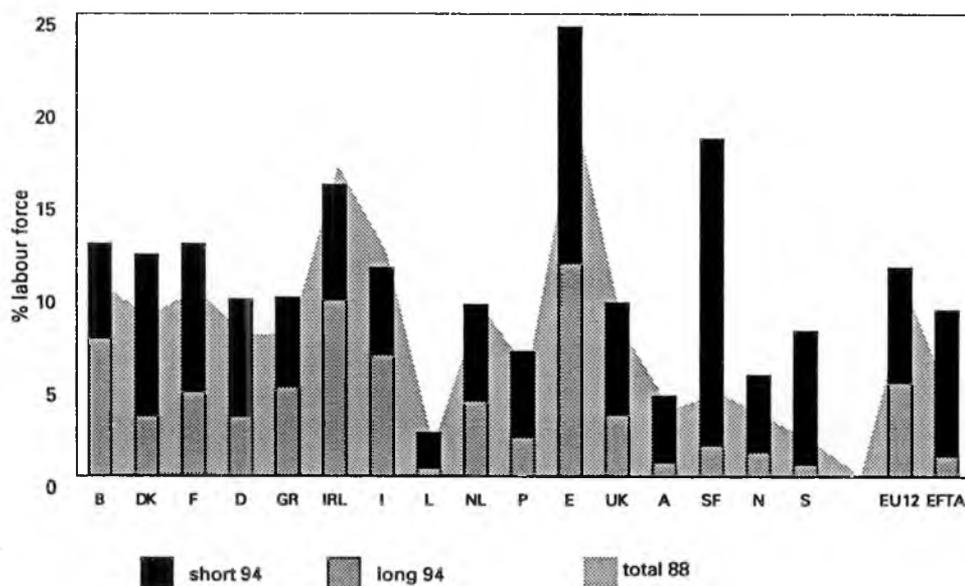
Despite this generally convergent trend, there are some more particular trends in the European labour markets that are of particular importance. First of all, almost all Member

States of the EU-12 are moving towards a white collar/service-sector dominated labour market, a process which started some time ago and which is still going on at a fast pace.

Another characteristic feature of the labour markets in the EU-12 is their growing dual character, especially caused by high and long-term unemployment. In the 1988-94 unemployment increased considerably in all countries except Ireland and Italy. In most countries long-term unemployment decreased, but short-term unemployment rose (see Figure 17.7).

The most dramatic increase in unemployment has occurred in Finland, Norway and Sweden, countries which managed to keep unemployment at bay during the 1970s and 1980s.

Figure 17.7 Long- and short-term unemployment

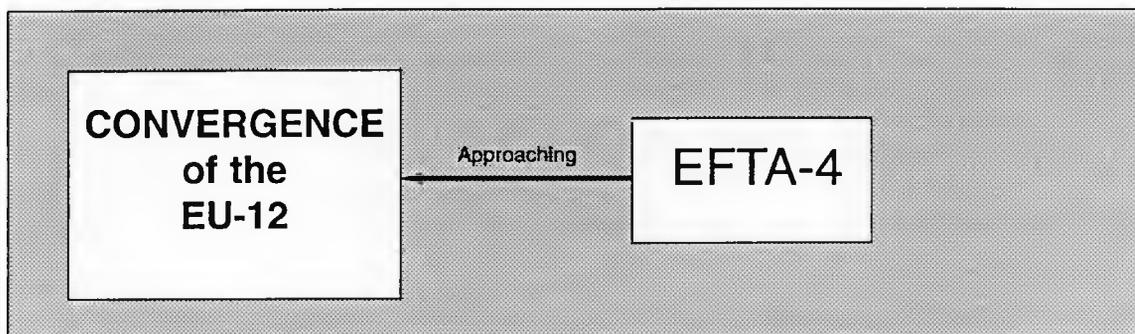


Economic strength

In terms of economic strength (composed of indicators on size of the economy and economic prosperity), the EU-12 showed a tendency to converge over the 1988-94 period, an outcome of the integration process which was foreseen, and was considered highly desirable.

At the same period the EFTA-4 countries approached the EU-12, as their lead in economic prosperity was reduced, and relatively gaining on the size of the domestic economy relative to the EU-12 countries.

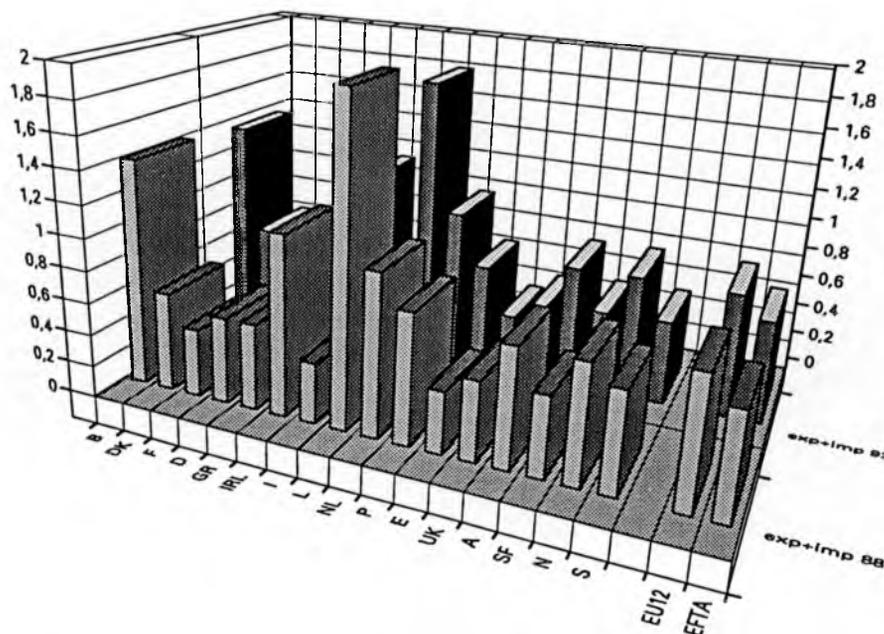
Scheme 17.9 Economic strength



Furthermore, the competitive positions of the EU-12 countries have converged, as has the degree of internationalisation, although the difference between the Member States of the EU-12 remains substantial (see Figure 17.8).

As can be seen in the figure, in their degree of globalisation (measured by the import and export shares) the EFTA-4 countries remain between the large EU-12 countries (with low import and export shares) and the small EU-12 countries (with high import and export shares).

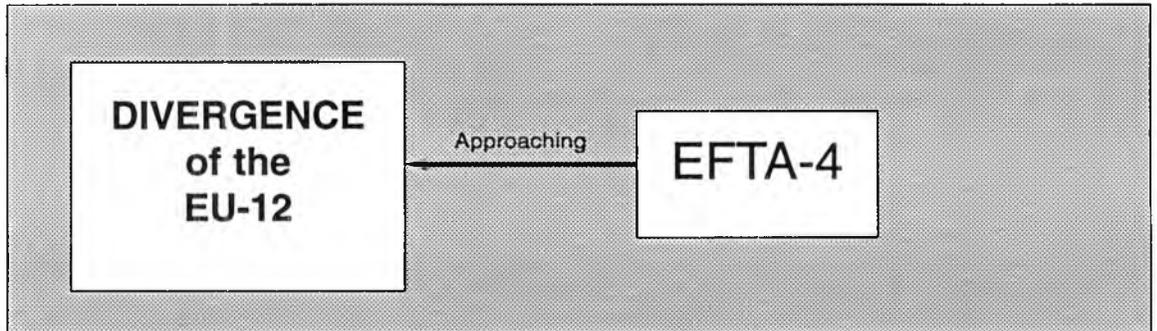
Figure 17.8 Export and import share GDP



Industrial relations

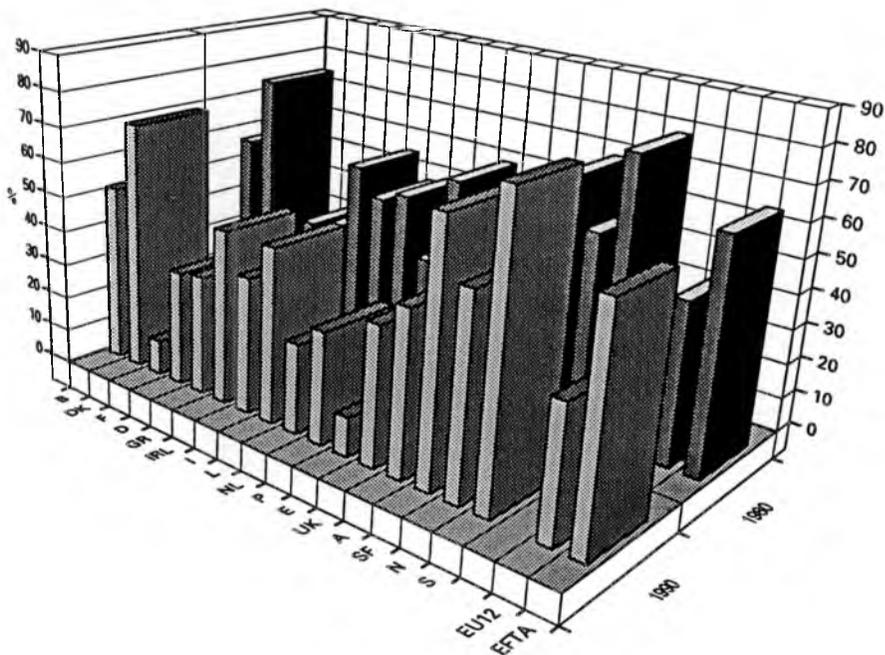
In the area of industrial relations the Member States of the EU-12 are diverging. At the same time the EFTA-4 countries are approaching the EU-12: trade union power in the EFTA-4 countries is diminishing, mainly as a consequence of steep increase in unemployment.

Scheme 17.10 Industrial relations



An essential, though not decisive, aspect of the power relations in the labour market and in industrial relations generally, is the trade union density (membership of trade unions as a percentage of the workforce). Figure 17.9 shows that in all countries, with the exception of Finland and Sweden, trade union density is declining, sometimes steeply. Trade union density has traditionally been much higher in Nordic countries (see Figure 17.9).

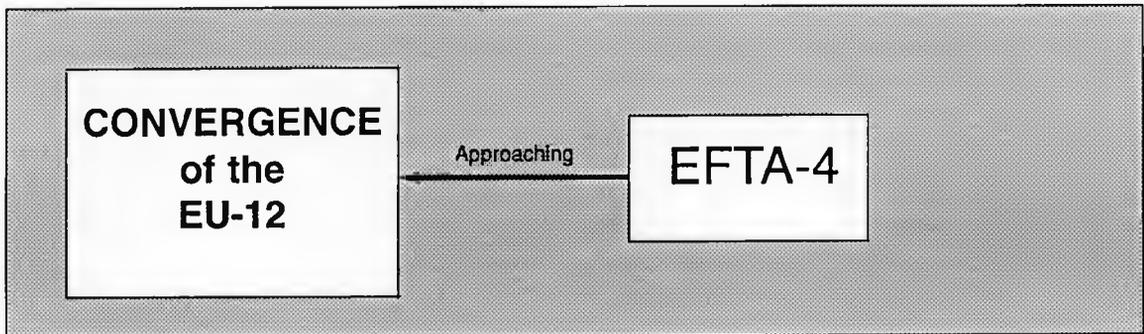
Figure 17.9 Trade union density (membership as % of wage- and salary earners)



17.3.2 SME Dynamics

Regarding the dynamics of small and medium sized enterprises - which includes the dimensions of production unit size, entry rates, and the concentration rate - the Member States of the EU-12 have converged over the last 6 years. The EFTA-4 countries have approached the EU-12, with their relatively low rate of concentration in particular rising relative to the EU-12.

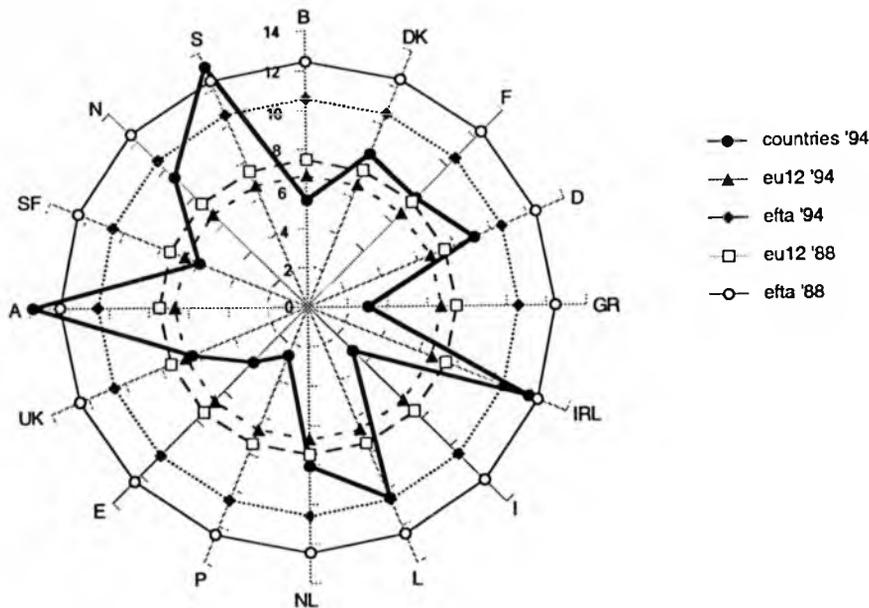
Scheme 17.11 SME dynamics



With the entrance of three of the EFTA-4 countries into the European Union, the average enterprise size has changed considerably, since the average enterprise size in the EFTA-4 countries was considerably larger than that in the EU-12.

The overall average enterprise size is declining in the EU-12, and doing so more rapidly in the EFTA-4 countries.

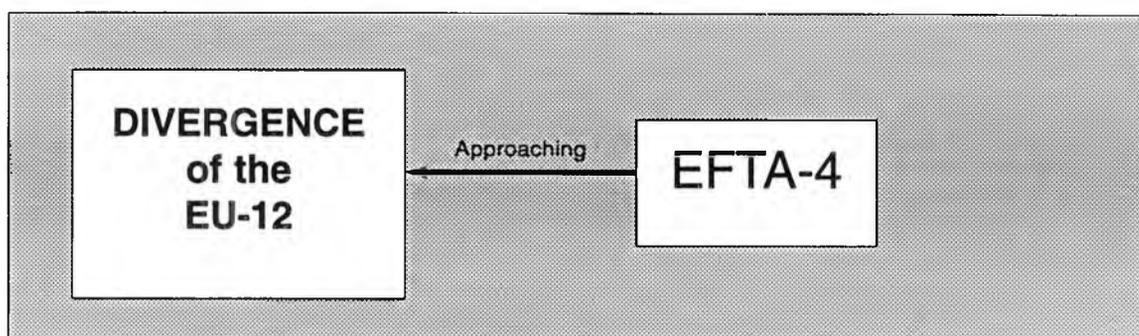
Figure 17.10 Estimated average enterprise size 1994



17.3.3 SME Performance

SME-performance is in general diverging in the EU-12, Italian SMEs in particular have demonstrated a very different performance, while the EFTA-4 countries have approached the EU-12. The increasing similarity in the two groups of countries is due to SMEs gaining a greater share of production (of goods and services) in the EFTA-4 countries, with an increase from a relatively low level to a higher, more EU-12 like, level, and the profitability of SMEs in the EFTA-4 countries has also grown closer to the EU-12 standard.

Scheme 17.12 SME performance



SME-performance can be divided into 4 main domains: profitability, share in value added, export share, and employment share. On the first of these, profitability, SMEs are converging, but on the other dimensions those in the EU-12 are diverging. However, only in value added performance is this divergence substantial.

The next figures give more information about SME-performance. In all countries except Italy the profit-share of SMEs is increasing substantial, but the differences in the profit-shares between the countries, and also between the EU-12 and the EFTA-4 countries remain considerable (see Figure 17.11).

Figure 17.11 Profit share in SMEs 1988-1994

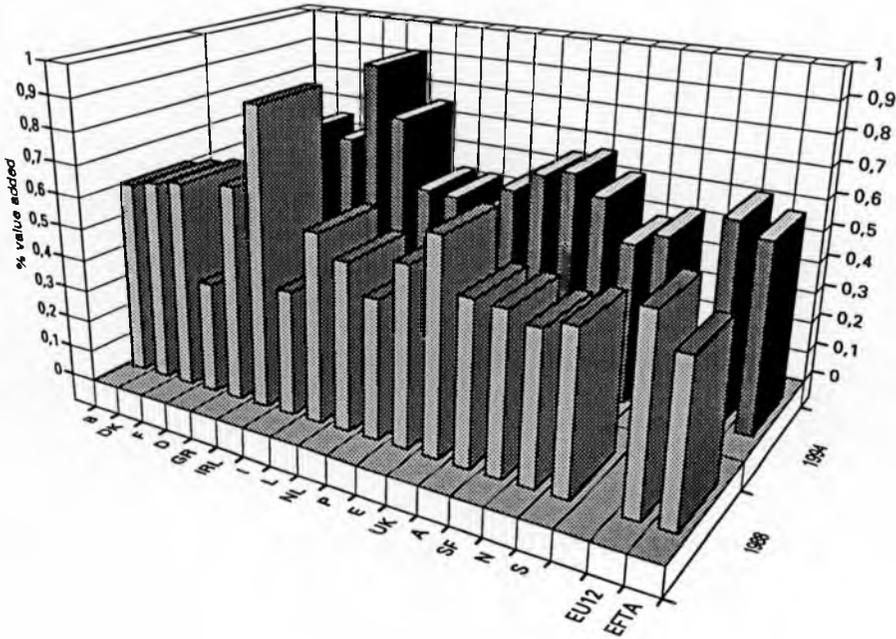
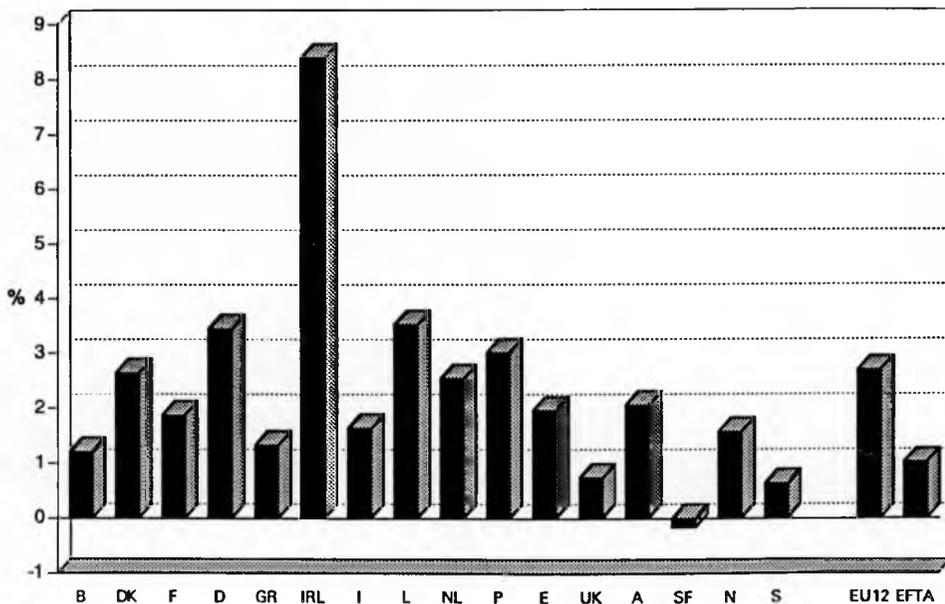


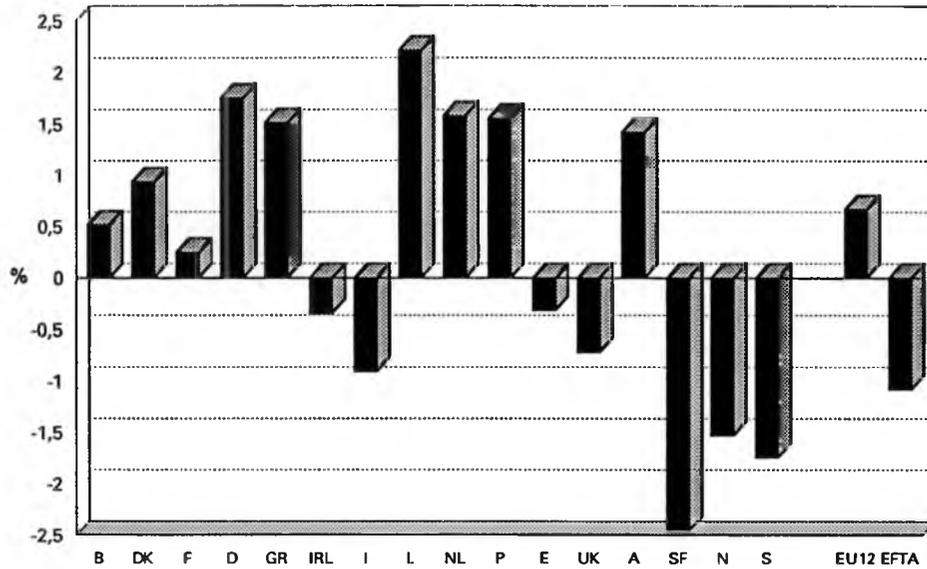
Figure 17.12 presents the real growth of value added in SMEs. Growth was much higher in the EU-12 than in the EFTA-4 countries in the 1988-94 period, but also varied substantially between countries. Apart from Ireland, which had an exceptional growth rate, growth was highest in Germany, Luxembourg and Portugal. Value added growth in Belgium, the United Kingdom and Sweden was very low and in Finland it was negative.

Figure 17.12 Growth value added SMEs 1988-94 (%/year)



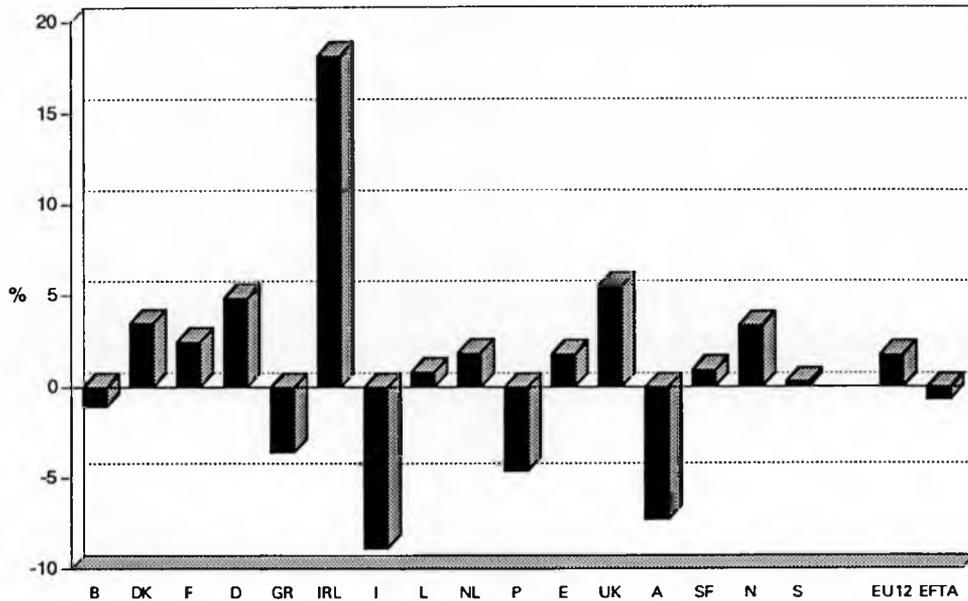
Of all performance indicators employment growth showed the greatest variation. In Ireland, Italy, Spain, the United Kingdom, Finland, Norway and Sweden, employment in SMEs declined substantially. In Belgium and Denmark employment growth was only very modest, and in the other countries employment growth was substantial (see Figure 17.13).

Figure 17.13 Employment growth SMEs 1988-94 (%/year)



Finally, export-growth amongst SMEs also varied substantially between the countries. SME-exports declined in Belgium, Greece, Italy, Portugal and Austria, whilst in Denmark, France, Germany, the United Kingdom, and Norway, export growth was substantial (see Figure 17.14).

Figure 17.14 Export growth SMEs 1988-94 (%/year)



17.3.4 Convergence in the EU-12 in the 1988-94 period: summary

In the preceding sections each issue (also see Appendix 2) has been analysed to assess whether the Member States of the EU-12 have been converging or diverging in the 1988-94 period. The evidence will be summarised in this section.

The concept of convergence (or divergence) has a dynamic nature; it can only occur over time. Convergence in economies means that economies are becoming more similar according to one or more indicators. For example, if two countries, one rich, the other poor, develop over a certain time period in such a way that the relative difference between them is reduced (the rich country may initially be three times richer than the poor country in terms of GDP/capita, but at the end of the period it may be twice as wealthy) convergence is said to have occurred. The procedure developed in this chapter makes it possible to discern convergence or divergence for several indicators at the same time (see Appendix 2).

The static counterpart of the dynamic concept of convergence (or divergence) is coherence. The concept of coherence can be illustrated with the same example: at the beginning of the period, when the rich country was three times as wealthy as the poor country, the degree of coherence within this group of countries is low (because the distance be-

tween the two countries in terms of GDP/capita is high), but at the end of the period the coherence is much higher (because the distance between the two countries is reduced).

Linking these concepts together, convergence is the same as increasing coherence, and divergence is the same as decreasing coherence. The degree of coherence is measured as a distance at a point in time, but the degree of convergence (or divergence) as an increase (or decrease in the case of divergence) of the distance between the countries in a certain period of time¹.

In Table 17.4 the degree of coherence and convergence are presented for several domains of the business environment, for SME-dynamics, and SME-performance.

As can be seen, 'Burdens on business' are the most coherent in 1988 and 'Economic strength' is the least coherent in that year.

Subtracting the value for 1988 from that of 1994, gives the difference in the coherence between the two years. If the difference positive, the coherence has decreased, which means divergence has occurred. If the difference negative, the coherence has increased, and convergence has occurred.

The question whether the completion of the internal market has led to a convergence in the business environments and/or in business performance cannot be simply answered, as the overall picture is mixed. In general it can be said that considerable parts of the business environment have converged, but in some important domains divergence remain.

Table 17.4 shows that fiscal and monetary policies are converging in the EU-12, but that, on the other hand, labour market policies are diverging.

Efforts in technology and innovation, conditions on the capital market, the situation on the labour market, and the economic strength of Member States are converging, while industrial relations, and the regulatory burdens on business are diverging in the EU-12.

Concerning business dynamics, the Member States of the EU-12 are converging.

Finally, SME-performance can be divided into two dimensions, the first refers to their performance in relation to the objectives of enterprise (value added, profits), whilst the other refers to objectives which are not necessarily business objectives of private entrepreneurs but are objectives with a societal value (employment, export). Both types of SME-performance have been diverging over the 1988-94 period, but mainly because of the deviant behaviour of SMEs in Italy and the United Kingdom.

¹ Since the concepts of convergence and coherence are closely related to distances (between countries) the convergence analysis is carried out with the multivariate technique of Multi-Dimensional Scaling. The output of MDS-analysis are graphical plots (presented in Annex 2), which situate (in this case) the countries in measured distances to each other, and statistics which are presented in table 17.4. The values in the table are indexes for the degree of coherence (total 1988 = 100), the lower the index is (which means the lower the distance between the 12 Member States), the higher the degree of coherence. If the degree of coherence in 1994 is higher than in 1988, then the subtraction of the two coherence indexes is negative, which means convergence. Finally, to be precise, the coherence measures are indexed sums of squares of Euclidean distances.

Table 17.4 Coherence and convergence in the EU-12

Domain	1988	1994	1988-94	EU-12	Distance EFTA relative to EU-12
Business environment					
Fiscal and monetary policy	112	98	-14	convergence	approaching
Labour market policy	83	103	20	divergence	digression
Burdens on business	87	94	7	divergence	approaching
Technology and innovation	99	85	-15	convergence	approaching
Capital and finance	106	99	-7	convergence	digression
Labour market	91	82	-9	convergence	neither/nor
Economic Strength	129	110	-19	convergence	approaching
Industrial relations	90	100	10	divergence	approaching
Business dynamics	102	98	-4	convergence	approaching
Business performance					
SME-performance (business)	98	125	27	divergence	approaching
SME-performance (society)	104	118	14	divergence	approaching
Total	100	101	1		

Source: EIM Small Business Research and Consultancy.

Another important conclusion that can be drawn is that the EFTA-4 countries have, to a considerable extent, been approaching the EU-12 over the past six years. Only in the areas of 'labour market policy' and 'capital and finance' have the EFTA-4 countries moved away from the EU-12 position. In all other domains apart from the labour market, in which no significant change either way occurred, the EFTA-4 countries are approaching the EU-12.

This does not mean however, that the EFTA-4 countries are typical EU-countries, if such a thing exists. The next table, which indexes the distance of the EFTA-4 countries to the EU-12¹, gives an indication of the degree of coherence between the EFTA-4 countries and the Member States of the EU-12. In two areas (Economic Strength and SME-performance (business goals)) the score of the EFTA-4 countries is less than 1, which means that the EFTA-4 countries are, on average, closer to the EU-12's centre of gravity than are, on average, the 12 Member States. In the other areas the EU-12 countries are still mainly closer to each other than they are to the EFTA-4 countries (see Table 17.5).

¹ To be precise, the average distance of the EU-12 countries to the centre of gravitation of the EU-12 is computed, and indexed at 1, and the average distance of the EFTA-4 countries to the centre of gravitation of the EU-12 is computed. If this average distance is above 1, than the distance of the average EFTA-country from the centre of gravitation EU-12 is higher than the distance of the average EU-12 country and vice versa.

Table 17.5 Distance* between EFTA-4 and EU

Domain	EFTA-4 (EU-12 = 1)
Fiscal and monetary policy	1.4
Labour market policy	4.3
Burdens on business	3.4
Technology	3.6
Capital and finance	2.8
Labour market	4.6
Economic Strength	0.6
Industrial relations	2.6
Business dynamics	2.5
SME-performance (business)	0.9
SME-performance (society)	1.2
Total	2.4

* Indexed distance:

<1 = EFTA-4 closer to EU-12 than average EU-12-country.

>1 = EFTA-4 farther away from EU-12 than average EU-12-country.

Source: EIM Small Business Research and Consultancy

17.4 EXPLAINING BUSINESS PERFORMANCE

17.4.1 The relationship between the Business Environment and Business Performance

In this section, the relationship between the performance of SMEs and the characteristics of the business environment, will be examined. The central aim of this section is to provide insights that explain SME-performance in terms of SME dynamics and SMEs business environment. These insights provide practical indications which policymakers can use in the development of SME-policies which are geared to improving SME-performance.

The three most essential indicators of SME-performance are employment, value added, and exports. In this section the relationship of each of these indicators with the business environment will be analysed, that is, how their development can be explained in terms of the business environment.

Several theoretically plausible causal relations between environment and performance indicators hypotheses were formulated, which have then been tested for their statistical significance through time-series and cross-section analysis.¹

¹ In the framework of the readability of this section, not all hypotheses and respective test results are presented here; the presentation is limited to those findings which are most policy-relevant.

Although the results of the statistical analyses presented in this section all are statistically significant and therefore give relevant information on the direction of the relationships between business environment and SME-performance, the data do not yet warrant for firm conclusions concerning the precise importance of the relationships, i.e. the precise quantitative impact of the business environment indicators on SME-performance. The results of the section therefor should be interpreted with some caution and be interpreted and understood as relevant practical indications.

After this, the various aspects of the business environment which stimulated SME-performance or depressed SME-performance in the 1988-94 period were identified.

Explaining SMEs employment performance

Employment growth in SMEs is generally assumed to be influenced by government policies, the market (the functioning of markets and market conditions), and industrial relations. Apart from the business environment, it is assumed that SME-performance is influenced by the business dynamics of SMEs, that is the specific functioning of the SME sector in the national economy. In this section it will be shown which of the aspects of the business environment and SME dynamics have an influence on SME-employment.

The State

Government policies have various dimensions, among them fiscal, monetary, and labour market policies.

Concerning fiscal policies, it can be hypothesised that the amount and structure of taxation and expenditures respectively, have an impact on employment performance of SMEs, where a high tax-burden is assumed to negatively influence SME-employment, whilst government investment and consumption expenditure, and government social transfers expenditure, affect SMEs positively and negatively respectively.

It was found however, that the amount and structure of taxation was not of major importance to employment developments in SMEs. On the other hand, it was found that the structure of government expenditure was of importance. The amount of government consumption and investment expenditure was positively correlated, and government expenditure on social transfers were negatively correlated with the employment performance of SMEs (see Table 17.6).

At the same time, however, the amount of government expenditure on R&D was negatively correlated with employment in SMEs, a phenomenon which points to LSEs as the major beneficiaries of government funded R&D efforts (also see chapter 13), and possibly the crowding out of lower productivity modes of production in SMEs.

The hypothesis that employment performance is at least partly determined by monetary policies could not be falsified. To be precise, the hypothesis that interest rates influence employment performance of SMEs had to be falsified. On the other hand, there is some evidence that more or less expansive money supply policies have a positive influence on employment developments in SMEs; a relatively high liquidity ratio (money supply as a percentage of nominal GDP, an indicator of the room for manoeuvre describing the investment and growth behaviour of SMEs) seems to be of importance for the employment performance of SMEs.

The hypothesis that active labour market policies have a positive impact on employment performance of SMEs had to be falsified to indicate that current active labour market policies don't have the potential to stimulate employment in SMEs (also see chapter 8).

Market

It is generally hypothesised that performance of SMEs is influenced to a greater extent than the performance of LSEs, by the level of purchasing power in an economy. This hypothesis was not rejected by this analysis; GDP/capita indeed has a positive influence on the employment performance of SMEs. At the same time, however, negative influences of the wage share and labour cost developments were found, indicating that cost components of wage developments in SMEs cannot not be ignored.

In the sub-domain of capital and finance average national profit levels had a positive influence for employment-growth in SMEs, and share prices, which indicate the general conditions of financial and capital markets, also have a positive influence on employment growth.

The overall purchasing power in the economy is therefore important to SMEs, and at the same time the income distribution between the production factors cannot be neglected (see Table 17.6).

Industrial relations

Industrial relations indicators were not found to be related to employment performance of SMEs.

SME-dynamics

Apart from external influences, the dynamic behaviour of SMEs themselves are related to employment performance. First, the export-share of SMEs was positively correlated to employment performance. Secondly, the rate of new enterprises formation influences the employment performance of SMEs substantially: the higher the rate of new enterprises formation, the more positive will be the employment record of SMEs. Related to this, the sole trader density has a positive influences on the employment record of SMEs (see Table 17.6).

In section 17.2 it was concluded that SME-growth in the 1988-94 period was job-extensive. Although the present analyses and knowledge certainly does not justify any final statements in this respect, two observations might shed some light on this phenomenon. First, it appears that active labour market policies have little or no influence on the employment performance of SMEs, and may have led to a situation in which SMEs, in their endeavour to grow, were forced to 'choose' labour-extensive growth paths, instead of 'choosing' labour-intensive growth paths. The evidence in chapter 8 supports this reasoning by showing that manifest labour shortages and/or recruitment problems (apparently not prevented by active labour market policies) did not really hamper production growth, but did depress employment growth in SMEs.

The second observation is that (as is also shown in chapter 1) SME-growth, despite the level and development of domestic demand, is highly export led, which indicates that SMEs have to function in highly competitive international markets (for example as sub-contractors (also see chapter 3)) and this forces SMEs to try to close the productivity gap between themselves and LSEs.

In any case, employment performance and its determinants should be monitored in greater detail, as SMEs are one of the few sources of employment growth.

Table 17.6 Business environment indicators influencing SME employment 1988-94

Environment indicator	R*
Government consumption expenditure	.50
Government investment expenditure	.52
Government transfers	-.48
Government R&D expenditure	-.76
Liquidity ratio	.45
GDP/capita	.51
Business expenditure R&D	-.87
Capital income	.62
Share prices	.61
Rate of Return	.62
Labour cost / employee	-.72
Wage share	-.74
Export share SMEs	.66
Sole Trader density	.60
New entrepreneurship rate	.49

* Pearsons R (Pearsons R is a statistical measure for the relationship between variables, .00 meaning no relationship and 1.00 meaning perfect relationship; + means a positive relationship, - means a negative relationship).
Source: EIM Small Business Research and Consultancy.

Impact business environment on employment performance SMEs

The analyses give rise to an assessment of factors which were stimulating and or depressing the employment performance of SMEs in the first half of the 1990s, which provide some indications for the policy-agenda for the remaining half of the 1990s. In Table 17.7 these factors are summarised, the stimulating factors are those which supported employment growth in SMEs, whilst depressing factors tended to suppress employment growth in SMEs, over the 1988-94 period.

Table 17.7 SME-employment -stimulating and -depressing factors 1988-94

Stimulating factors	Depressing factors
Increasing liquidity rate	Decreasing government investment
Increasing profits	Decreasing government consumption
Increasing GDP / capita	Increasing government transfers
Increasing share prices	Increasing wage share
Increasing export share SMEs	Increasing government expenditure R&D
	Increasing business expenditure R&D
	Decreasing entrepreneurship rate

Source: EIM Small Business Research and Consultancy.

Explaining the economic growth SMEs

As with the employment performance of SMEs, the business environment indicators were analysed to find those that influence value added in SMEs.

State

Economic growth in SMEs was, as employment growth, not significantly influenced by national taxation policies, but was influenced by the structure of government expenditure in the 1988-94 period. As with employment growth, government R&D expenditure seems to have had a negative influence on general SME-performance, for the same reasons as those described in the previous section. Nonetheless, this finding warrants further research.

As with employment performance, money supply policies tend to positively influence SME-growth, indicating that non-restrictive, pragmatic, monetary policies, are a positive influence on economic growth in SMEs (see Table 17.8).

Market

Of the general market indicators, GDP per capita (as a measure of domestic purchasing power), the degree to which SMEs are able to enter foreign markets, the general profit rate, and labour costs, were all of significant importance to the economic growth of SMEs.

Industrial relations

No significant influences on the economic growth of SMEs were found amongst the indicators of national systems of industrial relations.

SME-dynamics

Concerning the dynamic functioning of SMEs themselves, it appears that genuine business dynamics indicators such as average enterprise size, the share of micro enterprises, and the sole trader density, influence the general SME-performance (see Table 17.8).

Table 17.8 Business environment indicators influencing SME value added 1988-94

Environment indicator	R
Government consumption expenditure	.43
Government transfers	-.62
Government R&D expenditure	-.72
Liquidity ratio	.46
Inflation	.50
Business expenditure R&D	-.77
Capital income	.50
Rate of Return	.44
Labour cost / employee	-.48
Wage share	-.57
GDP / capita	.70
Export share SMEs	.70
Average enterprise size	-.49
Sole trader density	.52
Share micro enterprises	.48

Source: EIM Small Business Research and Consultancy.

These relationships also allow for an assessment of the factors which were stimulating or depressing economic growth in SMEs over the 1988-1994 period (see Table 17.9).

Table 17.9 SME-economic growth-stimulating and -depressing factors 1988-94

Stimulating factors	Depressing factors
Increasing liquidity rate	Decreasing government consumption
Increasing profits	Increasing government transfers
Increasing share micro enterprises	Increasing wage share
Decreasing average enterprise size	Increasing government expenditure R&D
Increasing export share SMEs	Increasing business expenditure R&D
Increasing GDP / capita	
Decreasing inflation	

Source: EIM Small Business Research and Consultancy.

Explaining SMEs export share

Lastly, the export performance of SMEs is much less influenced by general domestic indicators relating to purchasing power than is the general economic, or employment, performance of SMEs. Instead, cost-components rather than demand components influence the export performance of SMEs.

State

Rather than the structure of government expenditure, SMEs export performance seems to relate to the amount and structure of taxes and social contributions. Monetary policies

are also important, however, indicating that certain domestic room for manoeuvre is necessary for performance abroad (see Table 17.10).

Market

The export-share of SMEs in a country is, as with general economic and employment performance, somehow related to efforts private enterprises, stimulated by R&D policies of governments or not, pay to R&D activities, seemingly able at crowding out SMEs for some part by paying relatively much attention to technology and innovation.

Export performance of SMEs is also correlated with the total export- and import-share of a country, which indicates that factors which influence the total export orientation of a country, like the size of the home market, also influence the degree of internationalisation amongst SMEs (also see chapter 5).

Finally, it is interesting to see that a high rate of new enterprises formation had a negative impact on SMEs export performance, indicating that a relatively large share of very young micro enterprises (which tend to have relatively low export shares), negatively influences the export performance of the SME-population in general.

Table 17.10 Business environment indicators → SME exports

Environment indicator	R
Government R&D expenditure	-.70
Indirect taxes	-.45
Social contributions	-.43
Liquidity ratio	.43
Business expenditure R&D	-.60
Export quote	.56
Import quote	.60
New entrepreneurship rate	-.46

Source: EIM Small Business Research and Consultancy.

The results of the analysis of factors which stimulate and depress SMEs export performance are shown in Table 17.11.

Table 17.11 SME-export share -stimulating and -depressing factors 1988-94

Stimulating factors	Depressing factors
Decreasing indirect taxes	Increasing social contributions
Increasing internationalisation	Increasing R&D-efforts
Decreasing entrepreneurship rate	
Increasing liquidity rate	

Source: EIM Small Business Research and Consultancy.

17.4.2 The effects of the completion of the internal market on performance of SMEs

In this section three questions will arise: *Has the business environment in the EU-12 improved in the last 6 years?* (section 4.2.1); *Has the converging tendency in the 1988-94 had a positive effect on the performance of SMEs?* (section 4.2.2) and *Is convergence positive per se for the performance of SMEs?* (section 4.2.3). Although the state of knowledge on the integration process in the EU-12, as well as the understanding of the causes of SME-performance, are quite substantial, these questions can only be answered in a preliminary fashion

Has the business environment improved?

Present evidence makes it possible to assess the issue of the quality of the business environment from the viewpoint of the performance of SMEs. Answering the question of whether the business environment has improved in the period around the completion of the internal market, requires an analysis of both the relationships between environment and performance, and an understanding of the specific developments in the business environment over the 1988-94 period.

The conclusion that any aspect of the business environment has improved requires that that aspect be related to SME-performance, and that the development of that aspect of the business environment has changed in the appropriate direction. In other words, an aspect of the business environment can be said to have improved, if the specific development of that aspect has stimulated SME-performance.

Example

Suppose for example that SME-performance (in terms of employment or value added) is positively influenced by the level of GDP per capita. In this case the business environment can be said to have improved over the 1988-94 period if GDP per capita increased in the EU-12. If GDP per capita in the EU-12 decreased, the business environment would have said to be deteriorated.

If a business environment indicator has a negatively relationship with SME-performance, the opposite reasoning stands. Suppose, for example, that total labour costs has a negative relationship with employment in SMEs. The business environment could be said to have improved over the 1988-94 period if the level of labour costs decreased, but if labour costs increasing, the business environment would be said to have deteriorated.

The results of this assessment are summarised in Table 17.12. This shows that the monetary environment, in terms of the liquidity ratio, has improved, which is explained by the phenomenon that SME-performance is positively influenced by an expansionary stance concerning money supply policies and that money supply policies were more or less expansionary, at least not restrictive, in the 1988-94 period.

The same reasoning holds for the other business environment indicators in Table 17.12. The growth in GDP per capita, the globalisation of economies, the general growth of

profits in the economies of the EU-12, the relative buoyancy of capital and share market, and the increased dynamics of micro enterprises, are all assessed as improvements.

Three aspects of the business environment have deteriorated however. First, fiscal policy and especially the structure of government expenditure, have deteriorated through the ongoing increase in the share of social transfers and the decrease in the shares of government consumption and government investment. This has to be considered as a more or less severe deterioration of the business environment, since the spin off of transfer payments on general economic growth is much lower than the effects on economic growth of government investment en consumption.

Table 17.12 Improvement business environment by domain 1988-94

++	--
Monetary policy	Fiscal policy
GDP / capita	Social policy
Globalisation	R&D efforts
Profit income	
Situation labour market	
Capital market	
Dynamics micro enterprises	

Source: EIM Small Business Research and Consultancy.

Closely connected to this, the stance on social policy must be considered as a deterioration of the business environment, although a minor one. The growing social premium burden has had a negative impact upon SME-performance on global markets.

Finally rapidly increasing R&D efforts, must, from a viewpoint of the functioning and performance of SMEs, be regarded as a deterioration of the business environment. This may arise because mainstream R&D policies are not specifically directed at, or suited to, SMEs, and therefore not only create a comparative disadvantage amongst SMEs but also have the potential to crowding out modes of production which are dominant in SMEs.

Has convergence been positive?

Has convergence been positive over the 1988-94 period? The answering of this question requires an assessment of the aspects of the business environment which have been converging in the 1988-94 period, an estimation of the relationship between these environment variables and SME-performance, and an analysis of the behaviour of these aspects of the business environment in the 1988-94 period.

Example

An assessment of whether convergent tendencies in the business environment have been positive over the 1988-94 period requires a positive answer to three questions:

1. Has there been convergence concerning the aspect of the business environment in the 1988-94 period?
2. Is there a statistical relationship between that aspect of the business environment and SME-performance?
3. Has the business environment developed in the appropriate direction (improvement) over the 1988-94 period?

Consider, for example, GDP per capita. This indicator has been converging in the 1988-94 period, there is a (positive) statistical relationship between this indicator and SME-performance, and GDP per capita increased in the 1988-94 period, which indicates an improvement in the business environment for SMEs. So, as all three questions were positively answered, we can conclude that, by this indicator at least, convergence has been positive over the 1988-94 period.

The results of the analysis, shown in Table 17.13, are not unequivocal, although it could be argued that in general the convergent effects of the completion of the internal market are positive.

The most important negative aspect of the completion of the internal market was the convergence of fiscal policies: due to policies directed at diminishing the government debt, which generally means that in particular government consumption and investment expenditure have decreased, the performance of SMEs has been depressed.

Table 17.13 Convergence of the business environment: positive or negative?

Positive	Negative
Monetary policies	Fiscal policies
GDP / capita	R&D efforts
Dynamics micro enterprises	
Globalisation	
Profit income	

Source: EIM Small Business Research and Consultancy.

The most positive aspects of the completion of the internal market concern money supply policies, the development of GDP per capita in the Member States, the internationalisation of the EU-economies, the profit-situation of private enterprise, and the growing dynamics of micro-enterprises.

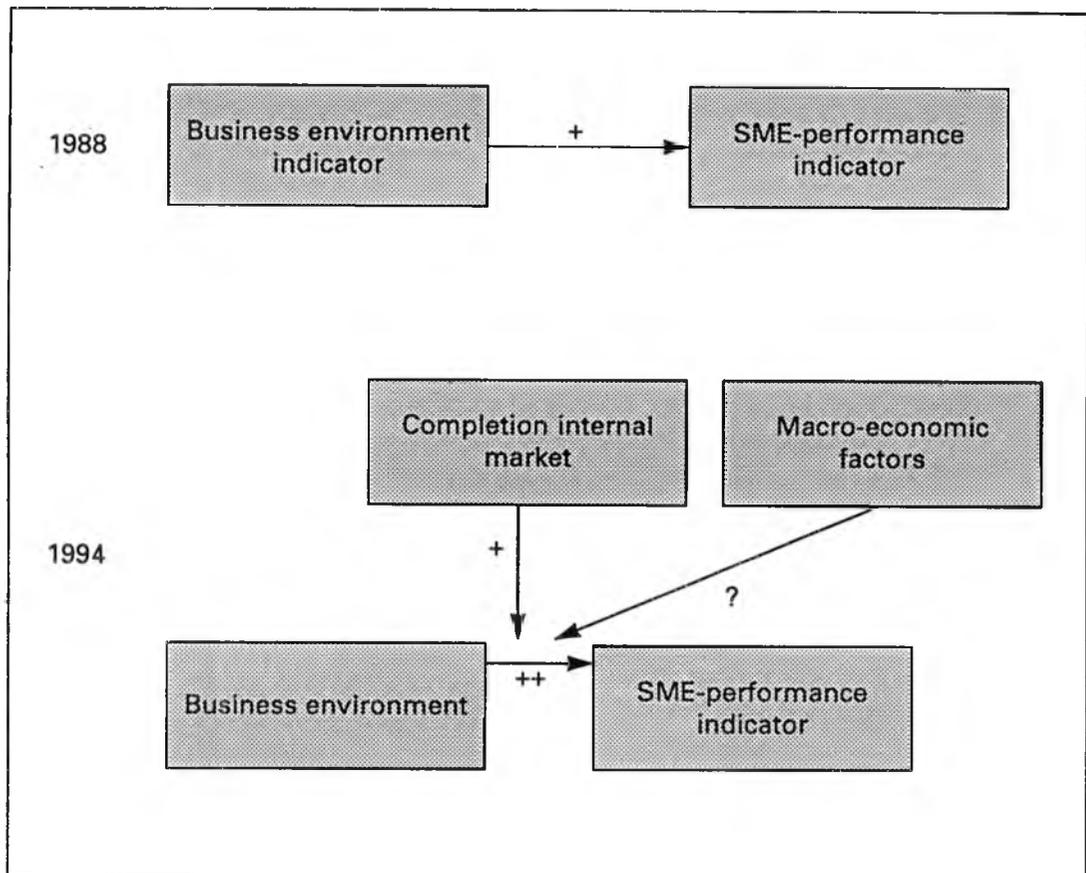
Is convergence positive in itself?

The most important question concerning the completion of the internal market concerns an assessment of convergence itself. It is assumed that convergence of national econo-

mies will be positive for SME-performance, and general economic performance. In this section a preliminary assessment will be undertaken of the validity of this hypothesis.

The assessment procedure is as follows. It is initially assumed that the relationship between a converging business environment variable (or domain) and a performance indicator is influenced by the completion of the internal market, or the ongoing process of social and economic integration, amongst the Member States of EU-12, in such a way that the intervening variable (the completion of the internal market) has a positive influence on the direction and/or strength of the relationship (see scheme 17.13). In other words the hypothesis (to be tested) is, all other things being equal¹, that the completion of the internal market has such an influence on the relationships between the business environment and SME-performance that in the end SME-performance benefits from the completion of the internal market.

Scheme 17.13



The assessment procedure was as follows. Firstly, areas and variables of the business environment were selected which were significantly related to SME-performance and which also had been converging over the 1988-94 period.

¹ Other things remaining equal, which of course is a rather heroic assumption, since general macro economic factors, as the scheme already indicates, may very well influence relationships under consideration.

Secondly, the hypothesis was tested that the completion of the internal market has had a positive influence on the outcome of the relationship between the business environment variables and the SME-performance indicators, that is, that the strength of the relationship between the business environment indicator and the SME-performance indicator has improved (from the point of view of SME-performance) between 1988 and 1994.

The outcomes of these tests are summarised in Table 17.14.

Table 17.14 Convergence in itself, positive or negative effect

Domain	+/-
Monetary policy	++
Profits	++
Globalisation	+
Situation labour market	+
Fiscal policy	+
Social policy	-
Business dynamics	-
Total	+

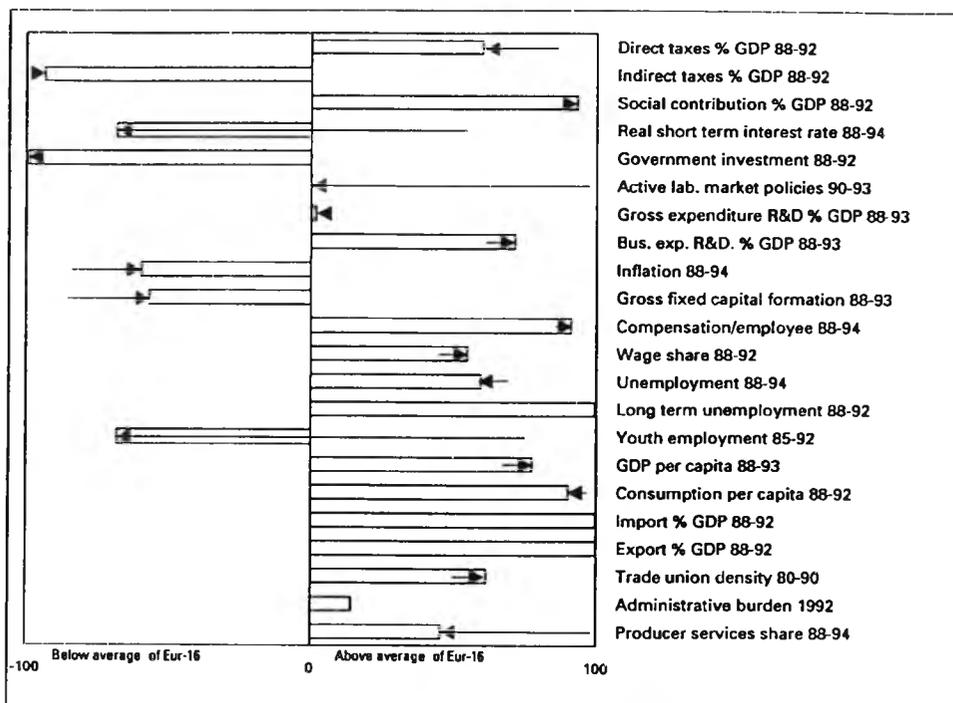
Source: EIM Small Business Research and Consultancy.

The overall conclusion is that convergence of the business environment in the EU-12 is, at least from the viewpoint of SME-performance, positive in itself.

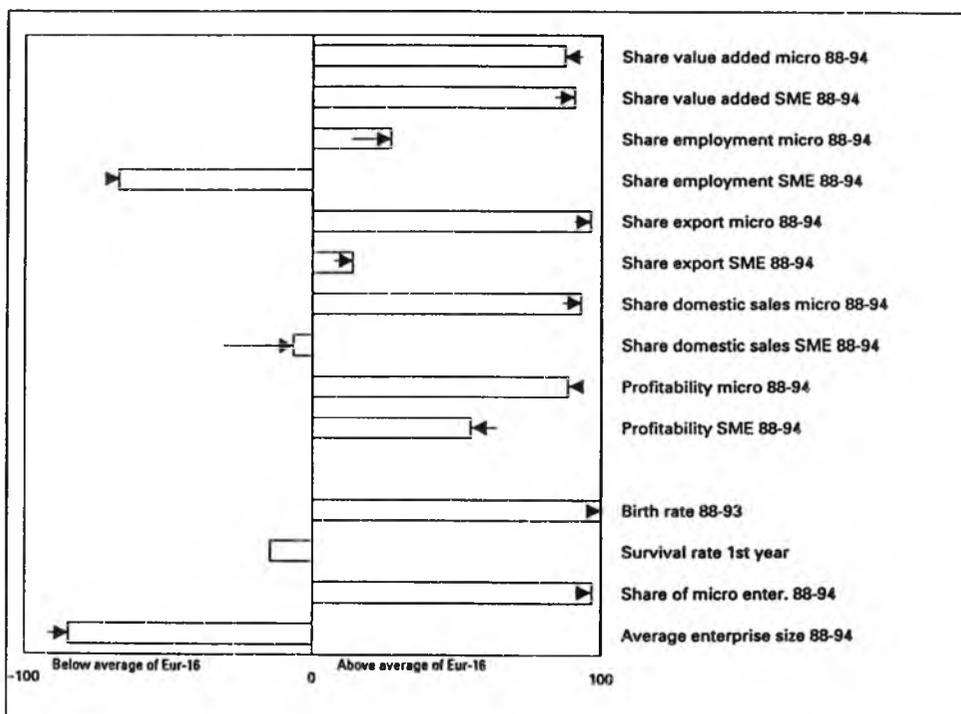
Appendices to Chapter 17

Appendix 1 Country profiles

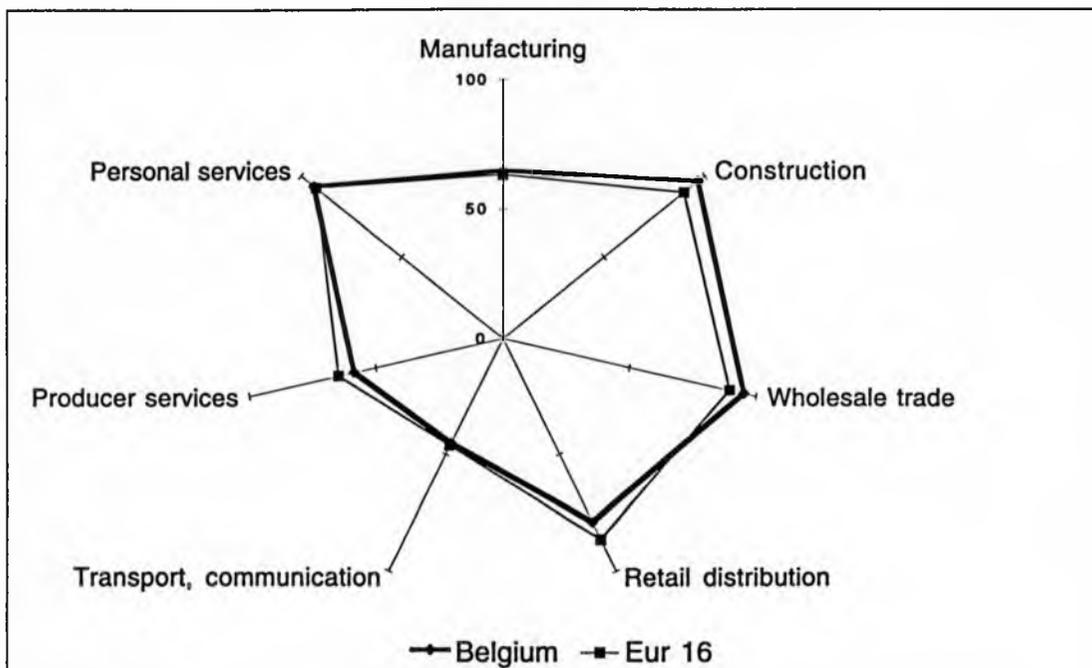
BELGIUM BUSINESS ENVIRONMENT



BELGIUM BUSINESS PERFORMANCE AND DYNAMICS



The bars represent the indicators in the most recent year, relative to the unweighted mean (average = 0) of the countries. The arrows represent the change since the first year.



Belgium's GDP per capita is well above the EUR-16-average and grew faster than the EUR-16-average in the 1985-93 period. Concerning government intervention in the economy, the tax-burden is well above the EUR-16-average, although it is decreasing; and government investment expenditure is well below the EUR-16-average.

Belgium's total expenditure on R&D is almost the same as the EUR-16-average.

Unemployment, although decreasing, is well above the EUR-16-average, and long term unemployment is amongst the highest in the EUR-16.

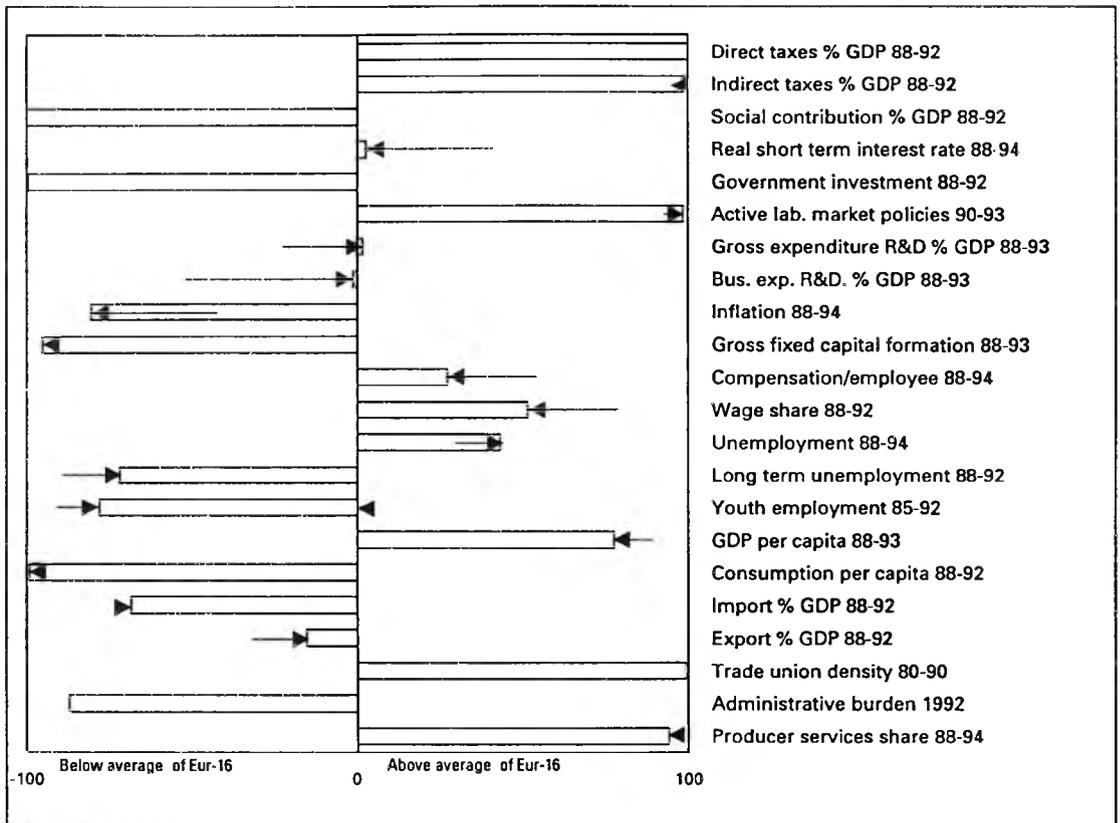
Measured by its level of imports/exports, Belgium is one of the most open economies in the EUR-16.

The rate of new entrepreneurship in Belgium is well above the EU-average and on this aspect of business dynamics Belgium performed much better than other countries in the 1988-93 period.

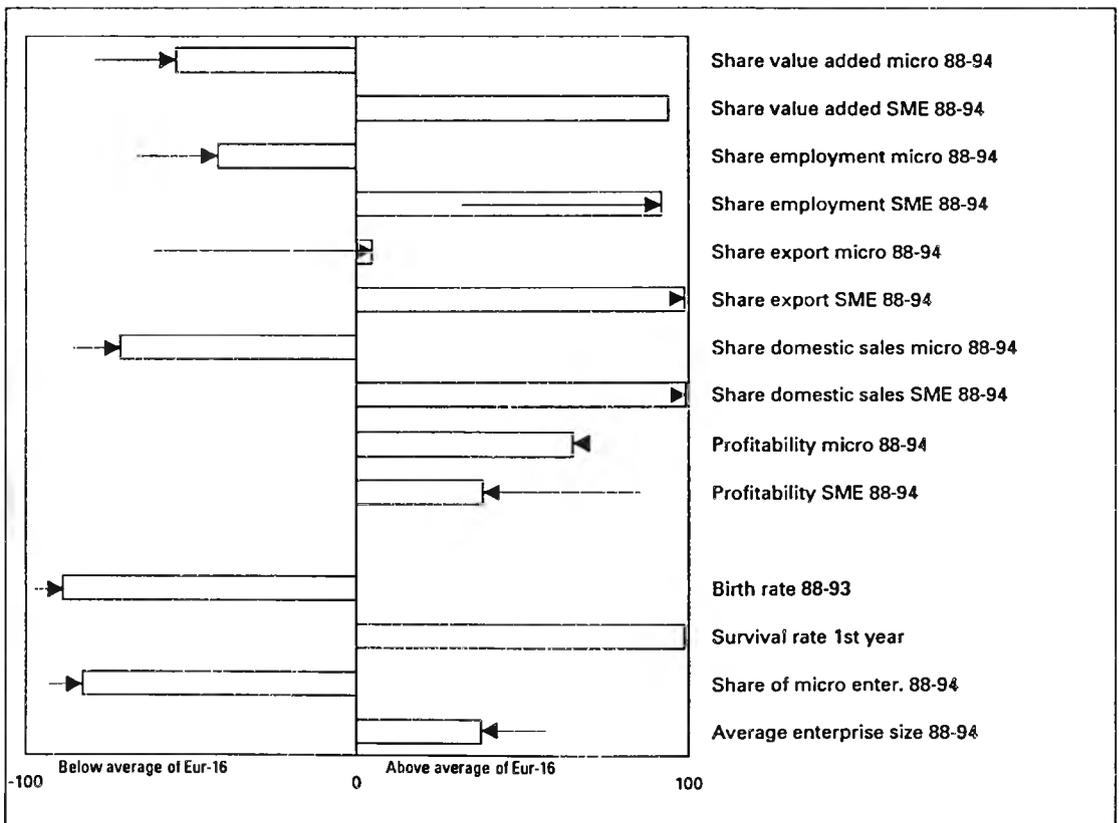
While Belgium's SMEs have a larger share of value added than SMEs generally have in the EUR-16, SMEs value added growth lagged behind the EUR-16-average in the 1988-94 period. The same holds for employment-growth, export-growth, and growth in profitability, these all lagged behind the EUR-16-average¹.

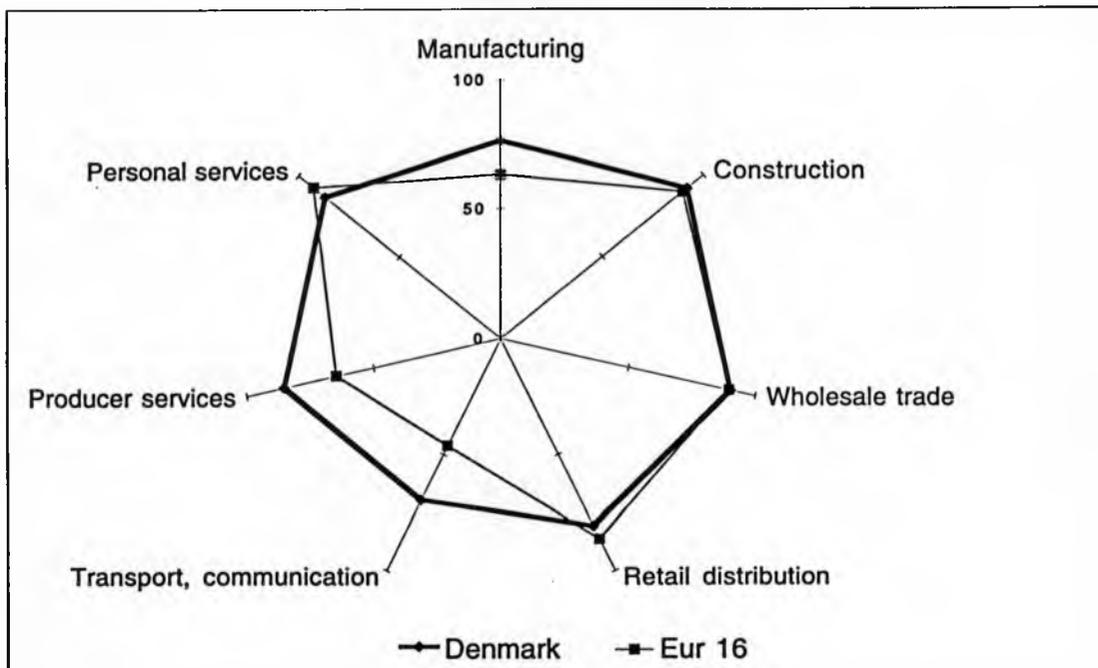
¹ For the methodology concerning the construction of the country profiles, see the Second Annual Report.

DENMARK BUSINESS ENVIRONMENT



DENMARK BUSINESS PERFORMANCE AND DYNAMICS





Denmark is one of the most prosperous countries in the EUR-16, although GDP per capita declined relative to the EUR-16-average in the 1985-93 period.

The Danish tax-burden is, although decreasing, the highest in the EUR-16. A relatively low share of government receipts are re-invested in the economy.

Gross R&D expenditure in Denmark increased substantially in the 1988-93 period, and currently amounts to slightly above the EUR-16-average.

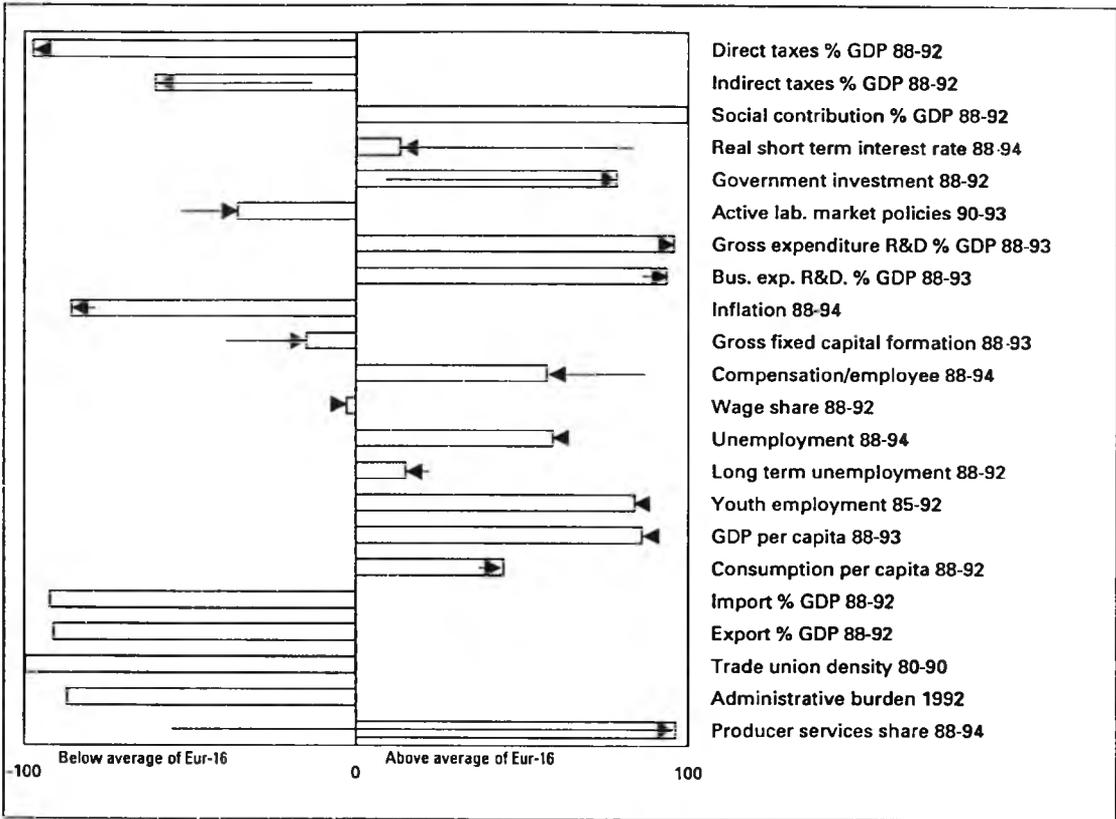
Unemployment in Denmark is above the EUR-16-average; but long term unemployment is well below the EUR-16-average.

The openness of the Danish economy is well below the EUR-16-average, despite an increase in the 1988-92 period.

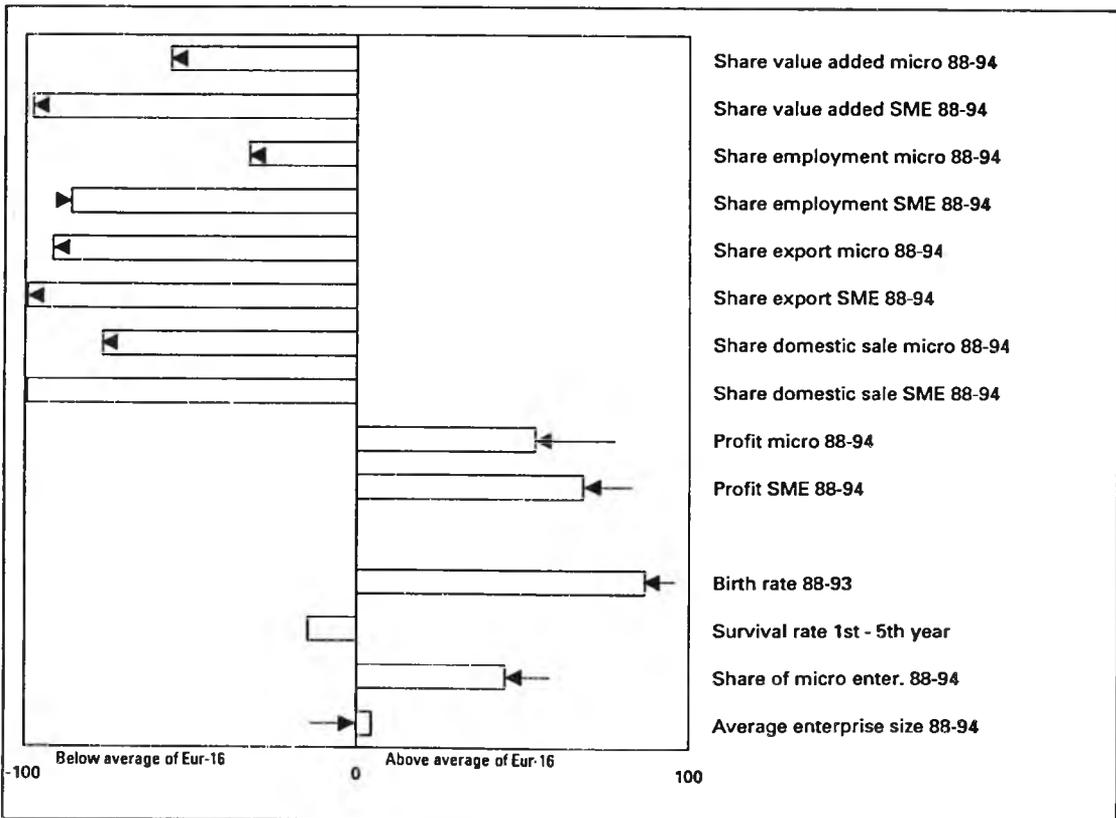
The Danish birth rate of new enterprises as a percentage of 1,000 inhabitants is much lower than the EUR-16-average, although it has been converging slightly with the EUR-16 average.

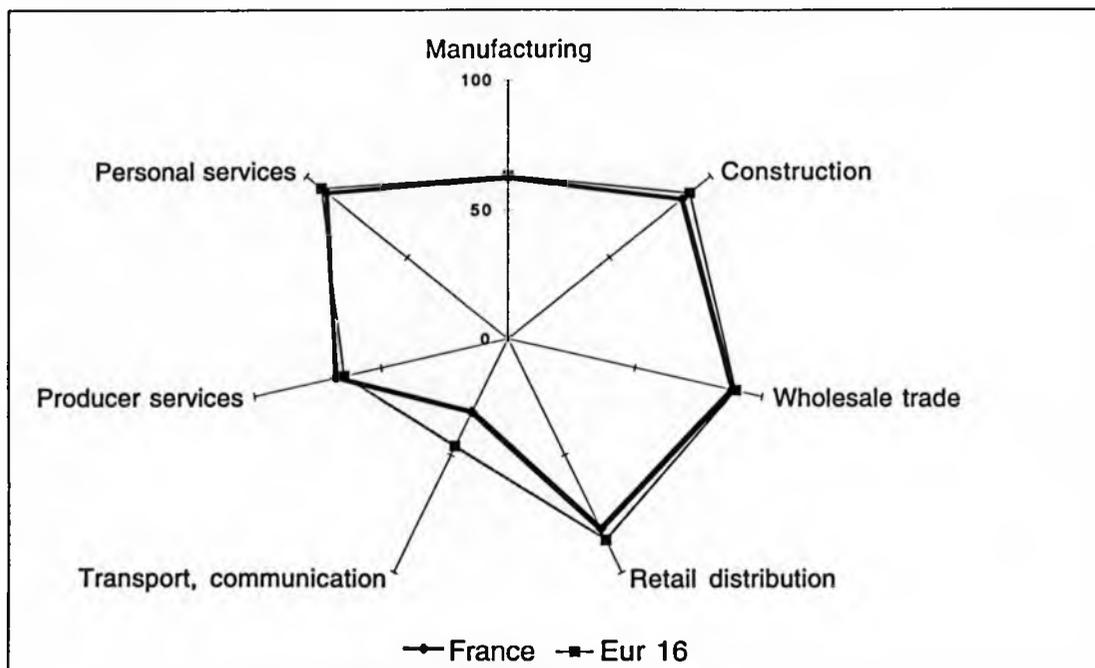
The performance of Danish SMEs is impressive, relative to the EUR-16-average. SMEs share of value added is well above the EUR-16-average, with the 1988-94 growth rate was near the EU-average. Employment growth of SMEs was well above the EUR-16-average, and Denmark's SME-employment share is well above the EUR-16-average. The share of SME-exports and the profitability of SMEs both are also above the EUR-16-average.

FRANCE BUSINESS ENVIRONMENT



FRANCE BUSINESS PERFORMANCE AND DYNAMICS





French GDP per capita is near the top of the EUR-16, despite a minor decline in the 1985-93 period.

The French tax-burden is slightly above the EUR-16-average, but has been converging on the lower EUR-16 level. A substantial and growing part of government receipts are reinvested in the French economy.

Gross expenditure on R&D is relatively very high in France, and a major part of this is through government expenditure on R&D.

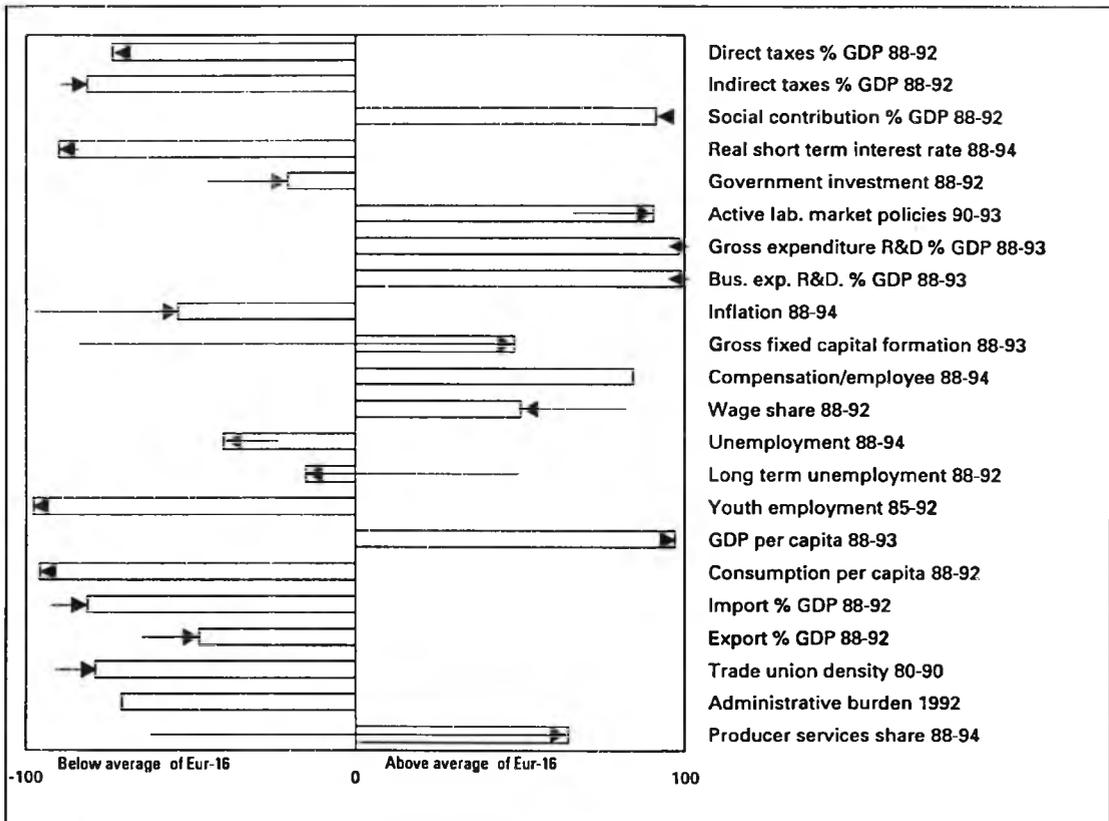
Unemployment, and long term unemployment in particular, are high, although declining relative to the EUR-16-average.

Like other large countries, the French economy is among the least open in the EUR-16, as measured by its level of imports/exports.

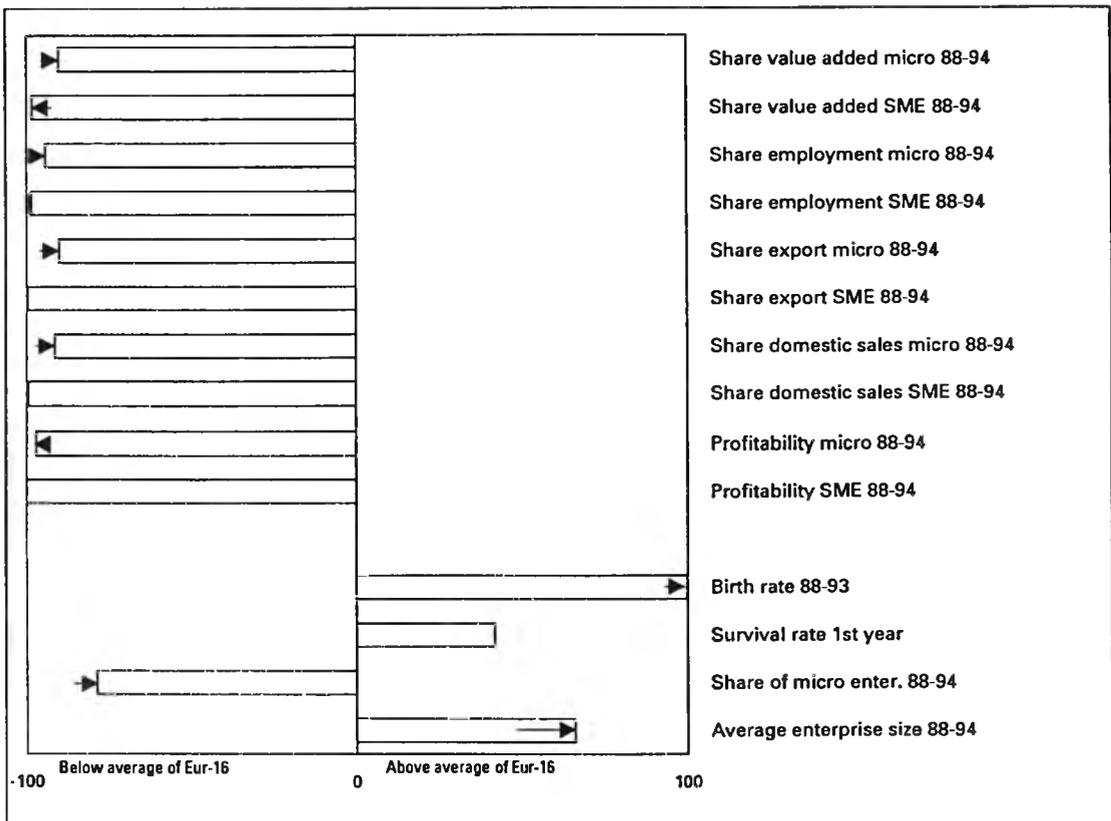
The new enterprise birth-rate per 1,000 inhabitants is well above the EUR-16-average, despite a minor decline in the 1988-93 period.

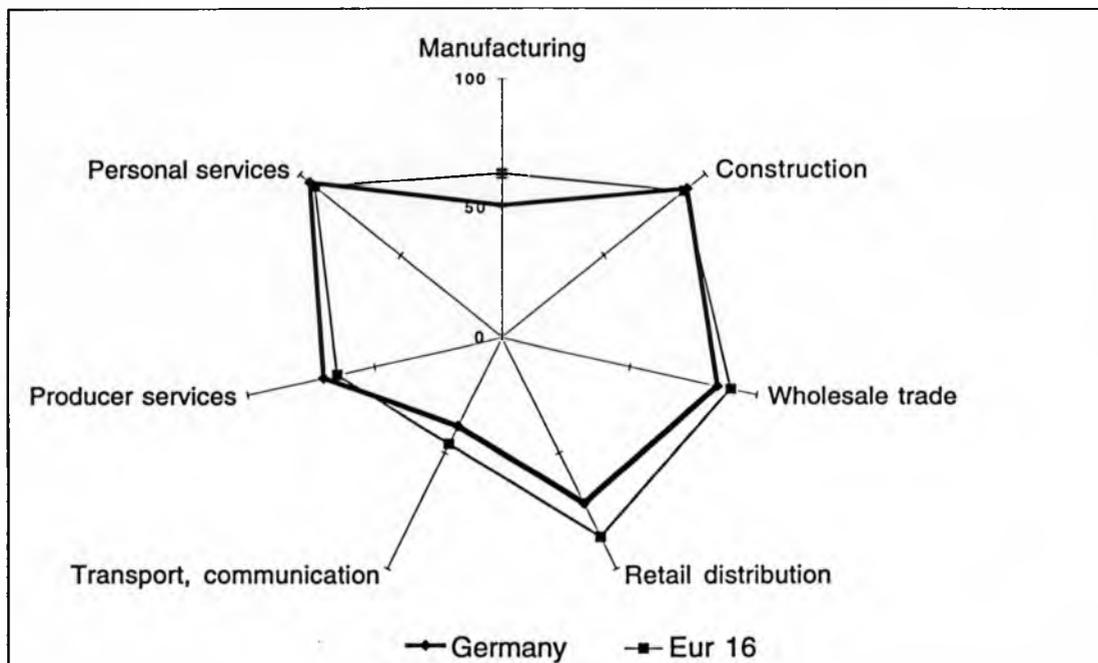
The importance of SMEs in the economy is rather low compared to the EUR-16-average. SMEs share of value added, their share of employment, and their share of exports, are well below the EUR-16-average. During the 1988-94 period, SME-employment-growth was also very modest. The only area in which French SMEs outperformed the EUR-16-average was in profitability.

GERMANY BUSINESS ENVIRONMENT



GERMANY BUSINESS PERFORMANCE AND DYNAMICS





Germany, the biggest economy of the EUR-16, is also one of the most prosperous. The German tax-burden is somewhat above the EUR-16-average and increased during the 1988-92 period; a relatively small part of these receipts is re-invested in the economy.

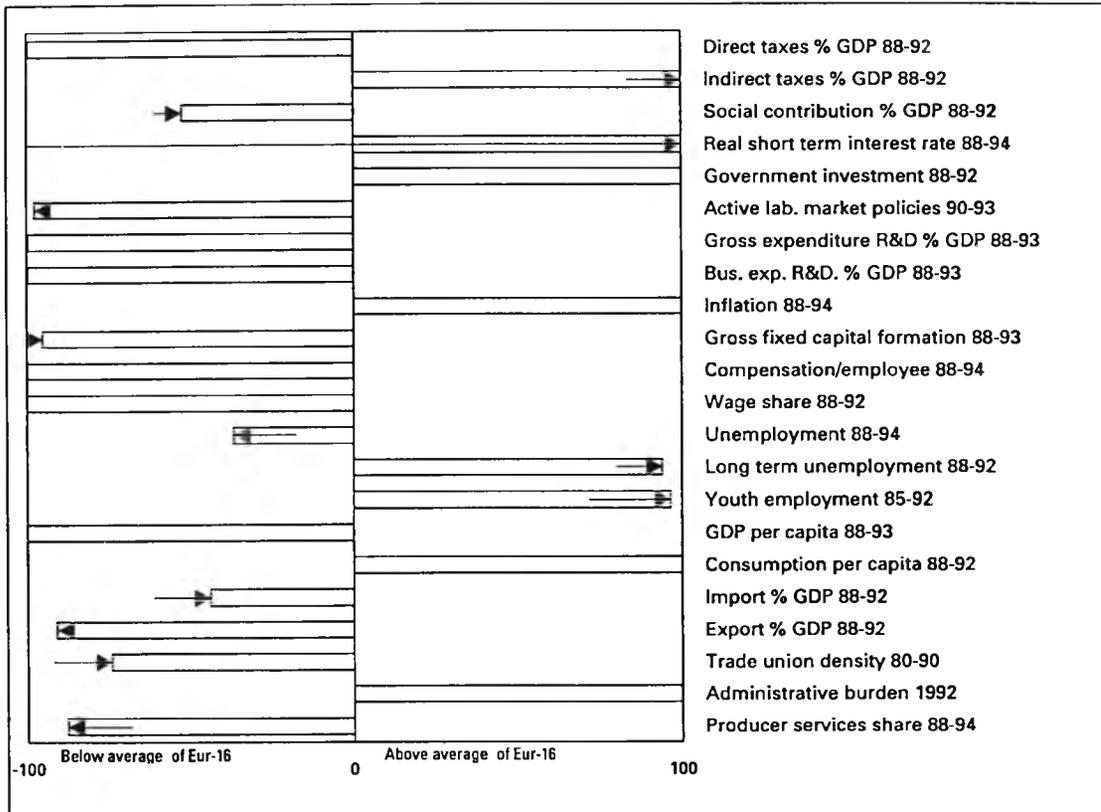
Gross expenditure on R&D in Germany is by far the largest in the EUR-16, despite a decrease in recent years.

Although there has been an increase in unemployment over the 1988-94 period, German unemployment, as well as long term unemployment, remain below the EUR-16-average.

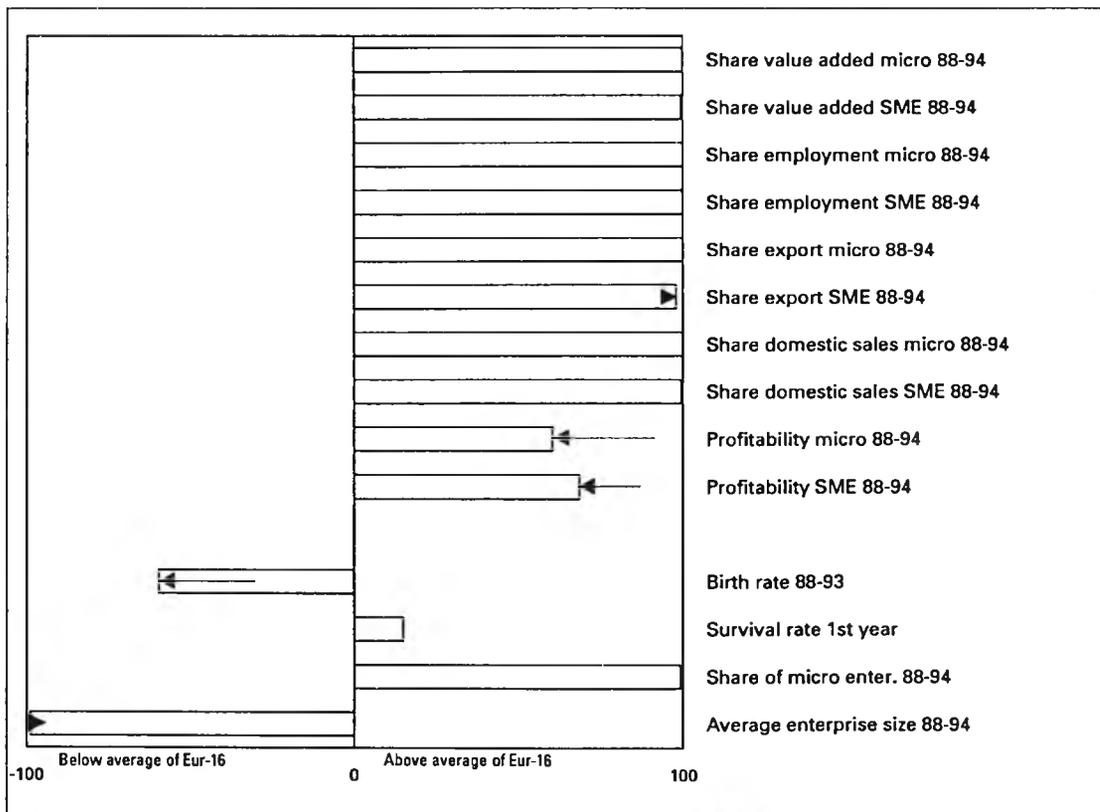
Like other large countries, Germany's level of imports/exports are relatively low, despite an increase in recent years.

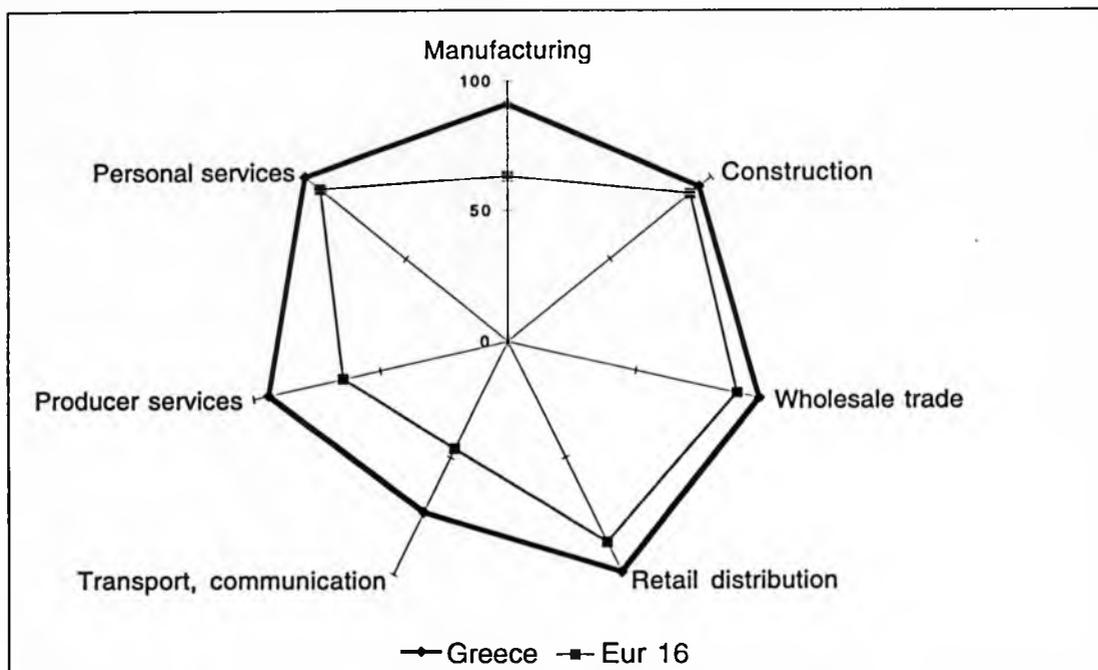
The German new entrepreneurship rate is among the highest in the EUR-16. Notwithstanding this, and the relatively good performance of German SMEs in the 1988-94 period, the importance of SMEs in Germany is relatively small, compared with the whole EUR-16. SMEs share of value added, their share of employment, and their share of exports remain well below the EUR-16-average.

GREECE BUSINESS ENVIRONMENT



GREECE BUSINESS PERFORMANCE AND DYNAMICS





GDP per capita in Greece is among the lowest in the EUR-16. Concerning government intervention in the economy, the Greek tax rate is, despite a substantial increase in the 1988-92 period, well below the EUR-16-average. Relative to the EUR-16-average, a large part of the government receipts are re-invested in the Greek economy.

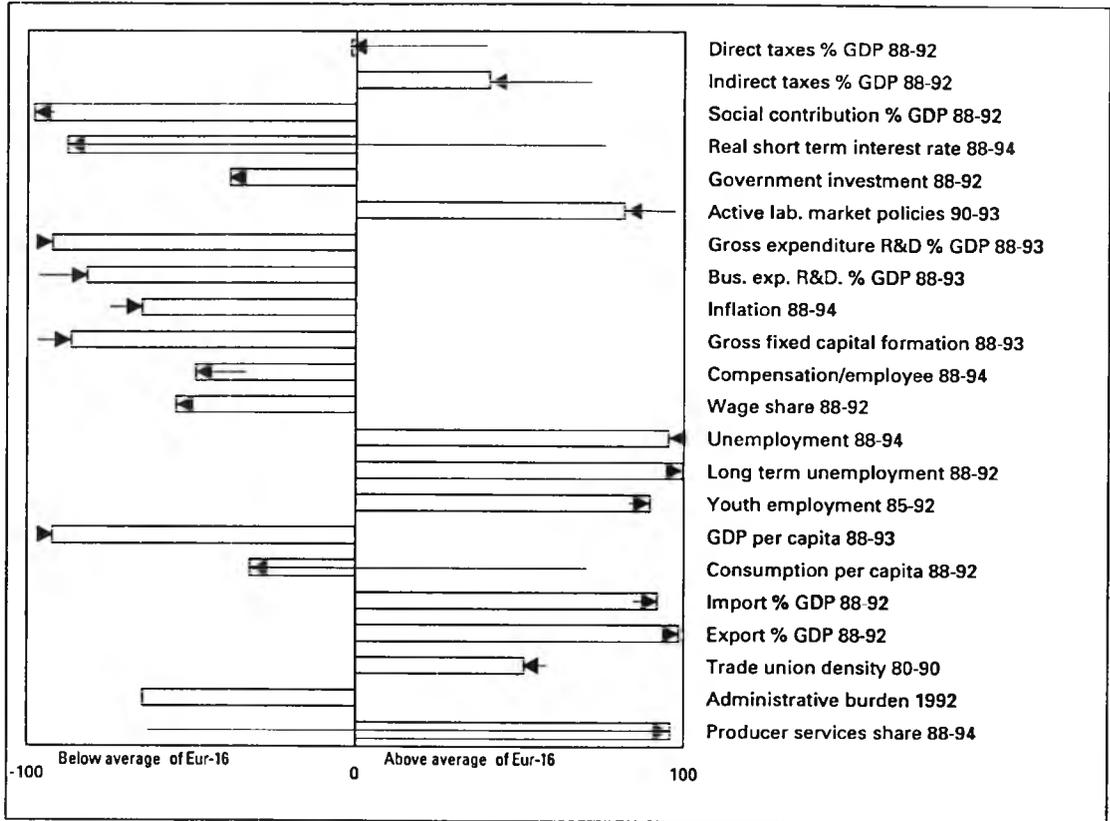
Gross expenditure on R&D as a percentage of GDP is very low in Greece.

Unemployment is below the EUR-16-average; but long term unemployment is well above the EUR-16-average.

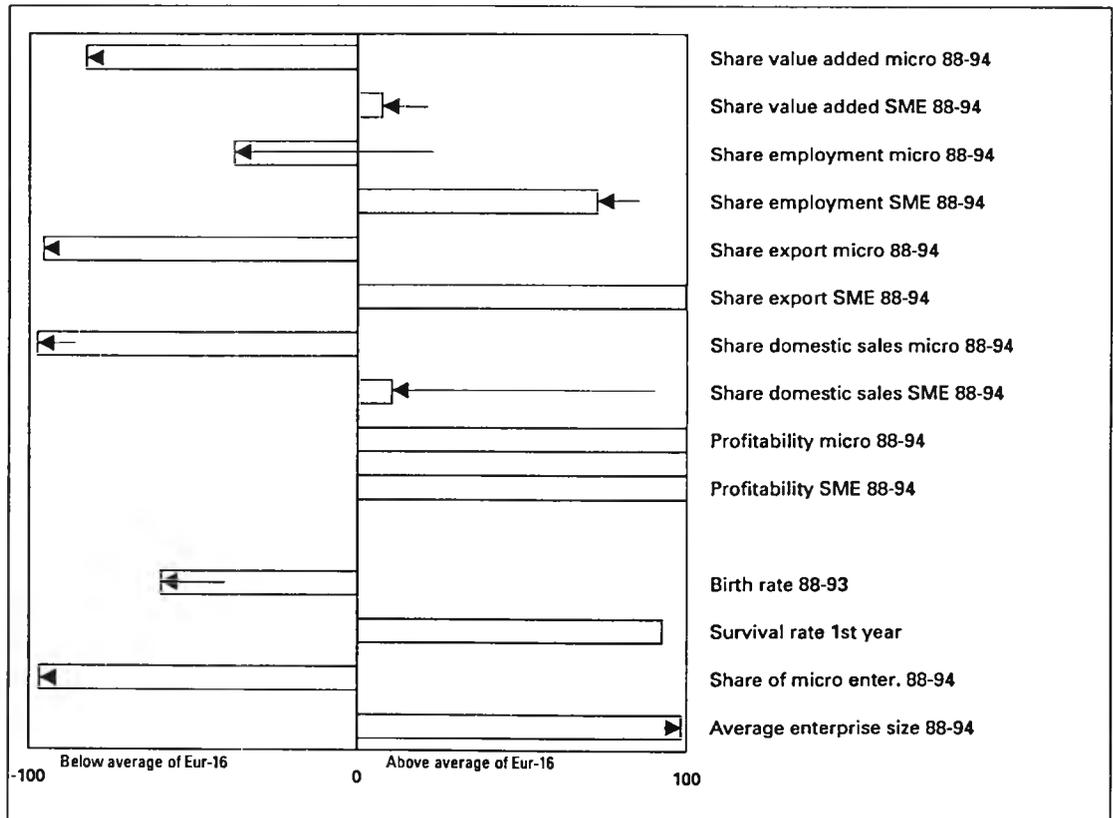
Compared with the other small countries in the EUR-16, the Greek economy is not very open, the level of imports and exports is substantially below the EUR-16-average.

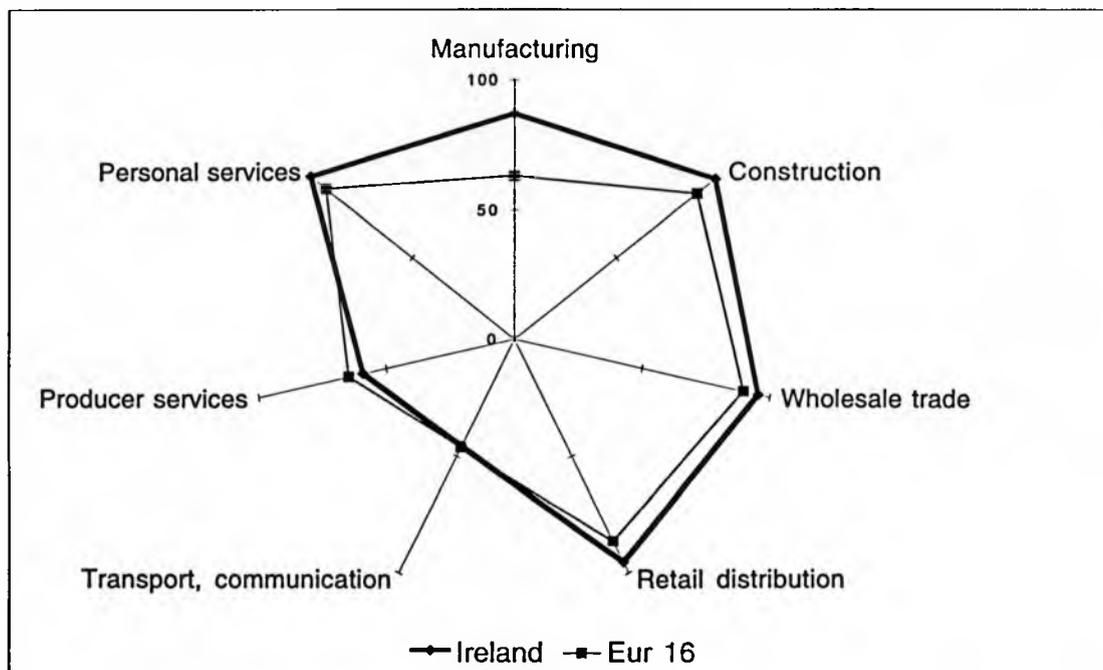
SMEs play a very dominant role in the Greek economy, from the viewpoint of their share of value added share, as well as from an employment perspective. However, the general performance of Greek SMEs was not very favourable in the 1988-94 period. An exception was employment-growth in SMEs, which was well above the EUR-16-average.

IRELAND BUSINESS ENVIRONMENT



IRELAND BUSINESS PERFORMANCE AND DYNAMICS





GDP per capita is rather low in Ireland, although it has moved towards the EUR-16-average over the 1985-93 period.

The Irish tax burden has traditionally been below the EUR-16-average, and decreased further in the 1988-92 period, so on this measure Ireland has diverged from the EUR-16-average. A relatively low share of government receipts are re-invested in the Irish economy.

Gross expenditure on R&D is well below the EUR-16-average, although there has been a relative increase over the 1988-93 period.

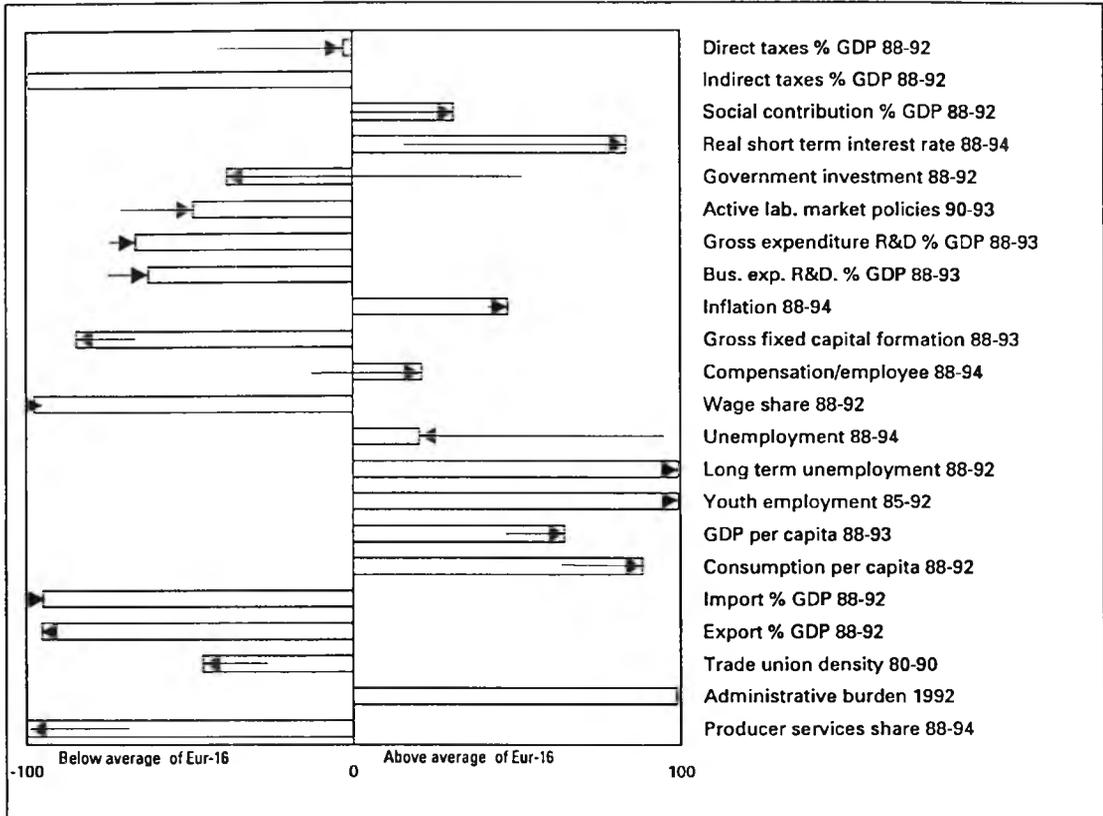
The Irish unemployment is considerably higher than the average in the EUR-16, this is also true of long term unemployment.

As with other small countries, the Irish economy is very open and becoming even more so, compared with the EUR-16 average.

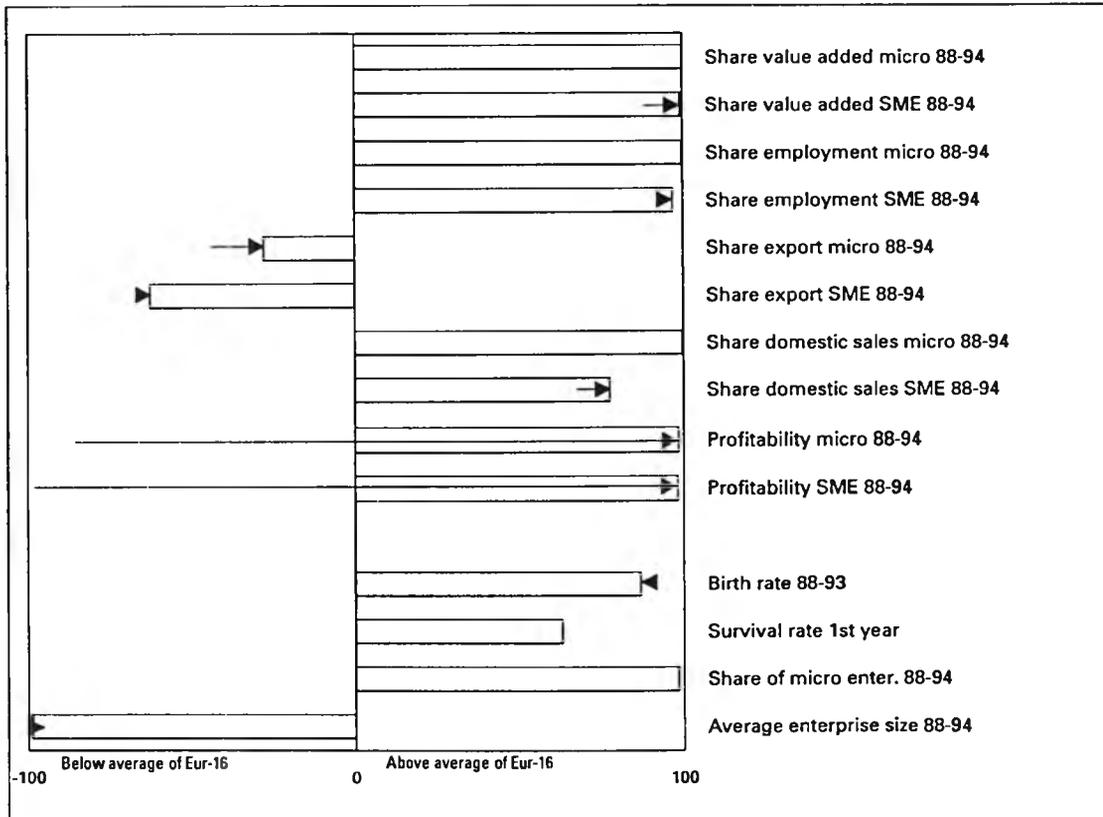
The estimated Irish new entrepreneurship rate is below the EUR-16-average and has been diverging away from the EUR-16 average in the recent years.

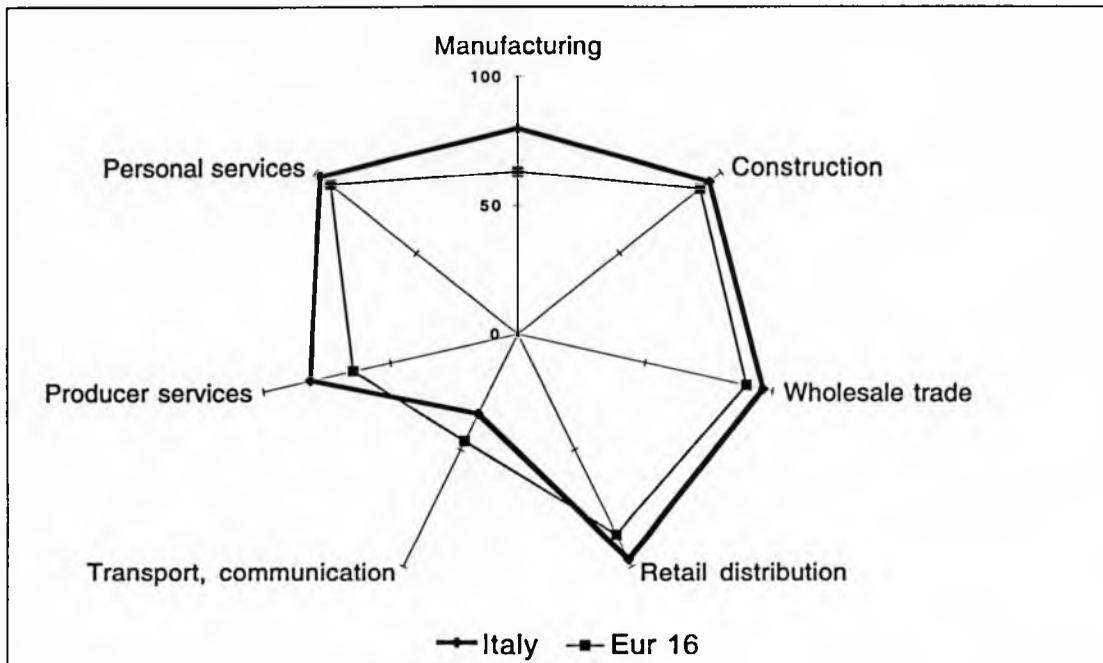
SMEs in Ireland have a slightly more important position in the economy than in the EUR-16 as a whole. Irish SMEs performed very well on almost all indicators in the 1988-94 period, compared with SMEs in other countries of the EUR-16. The only exception was employment-growth in Irish SMEs, which was negative in the 1988-94 period; the Irish SMEs must have been increasing their labour productivity enormously.

ITALY BUSINESS ENVIRONMENT



ITALY BUSINESS ENVIRONMENT





Italy's GDP per capita has been growing at a faster rate than the EUR-16-average level over the 1988-92 period, and has moved away from the EUR-16-average.

The Italian tax-burden increased sharply in the 1988-92 period, and has almost reached the EUR-16-average. At the beginning of the period a large share of the receipts were re-invested in the economy, but during the 1988-92 period government investment expenditure declined, and the rate of re-investment is now low.

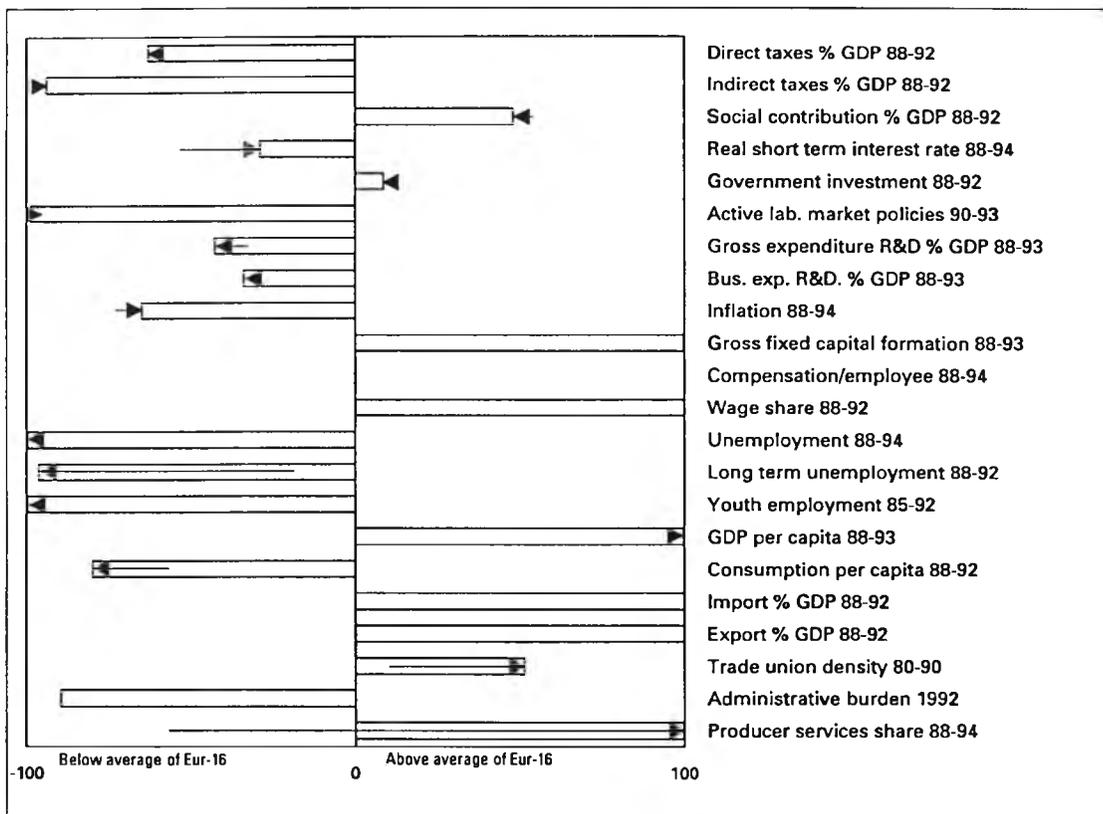
Gross expenditure on R&D as a percentage of GDP was well below the EUR-16-average, however Italy is converging in this aspect of its business environment.

Despite a decrease in the total unemployment over the 1988-94 period, a rarity in the EUR-16, Italian unemployment remains above the EUR-16-average. Long term unemployment remains much higher than the EUR-16-average.

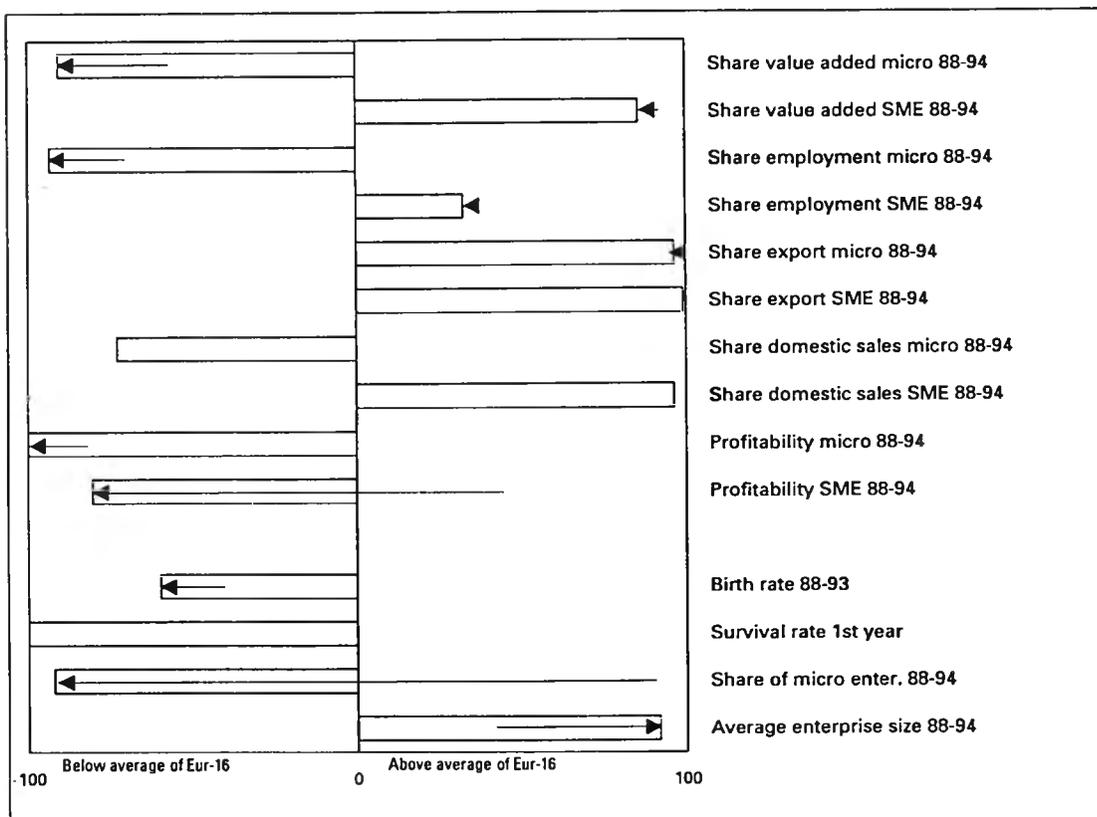
Like the other large EUR-16-economies, Italy is relatively closed to international trade.

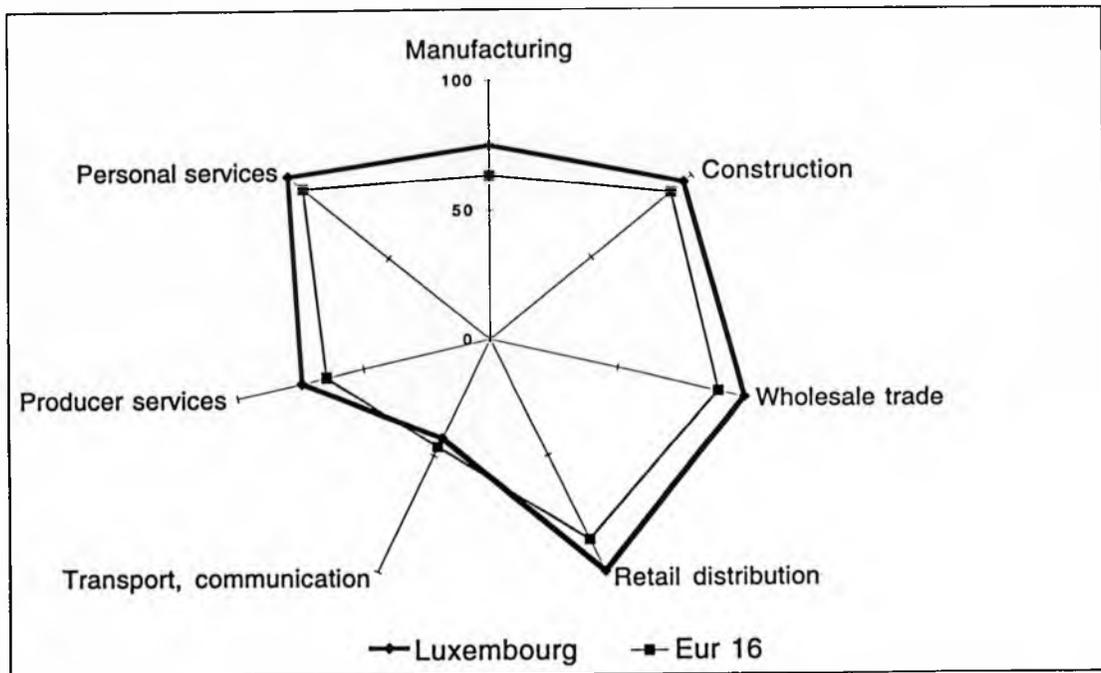
The Italian new enterprises birth rate per 1,000 inhabitants is, despite a relative decline, well above the EUR-16-average. Italy has an economy dominated by small scale activities; SMEs play, compared to the EUR-16-average, an important and increasing role. Despite this, the performance of SMEs was not at all impressive in the 1988-94 period. Value added growth lagged behind the EUR-16-average, and SMEs-export employment developments were negative. The only positive aspect of SME-performance, relative to the EUR-16 average, was their profitability.

LUXEMBOURG BUSINESS ENVIRONMENT



LUXEMBOURG BUSINESS PERFORMANCE AND DYNAMICS





Luxembourg by far is the most prosperous country in the EUR-16.

The overall tax burden, which increased in recent years, remains just below the EUR-16-average; and a relatively large share of receipts is re-invested in the economy.

Gross expenditure on R&D is below the EUR-16-average, and Luxembourg is even diverging in this aspect of the business environment.

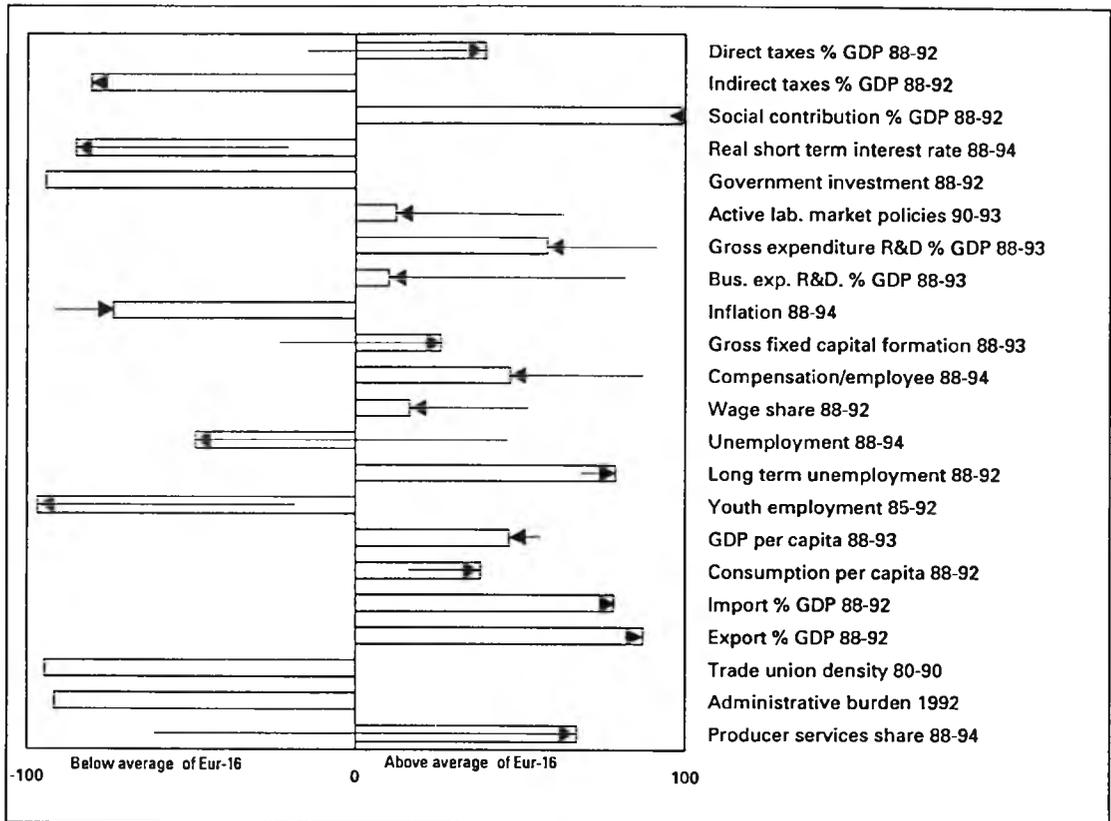
Luxembourg is the only Member State with full-employment, and long term unemployment is negligible.

Luxembourg has very high levels of imports/exports, and the country is by far the most open in the EUR-16.

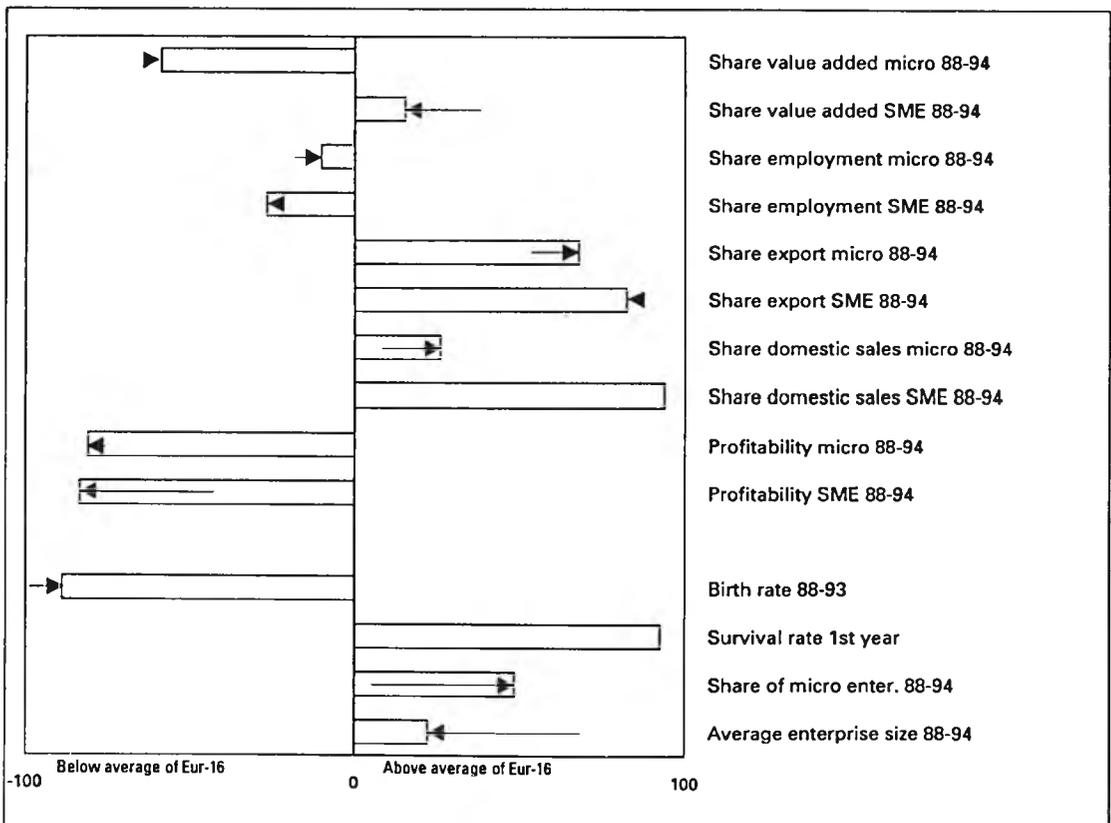
The estimated new enterprise birth rate per 1,000 inhabitants has decreased substantially last years, and the rate is now is well below the EUR-16-average.

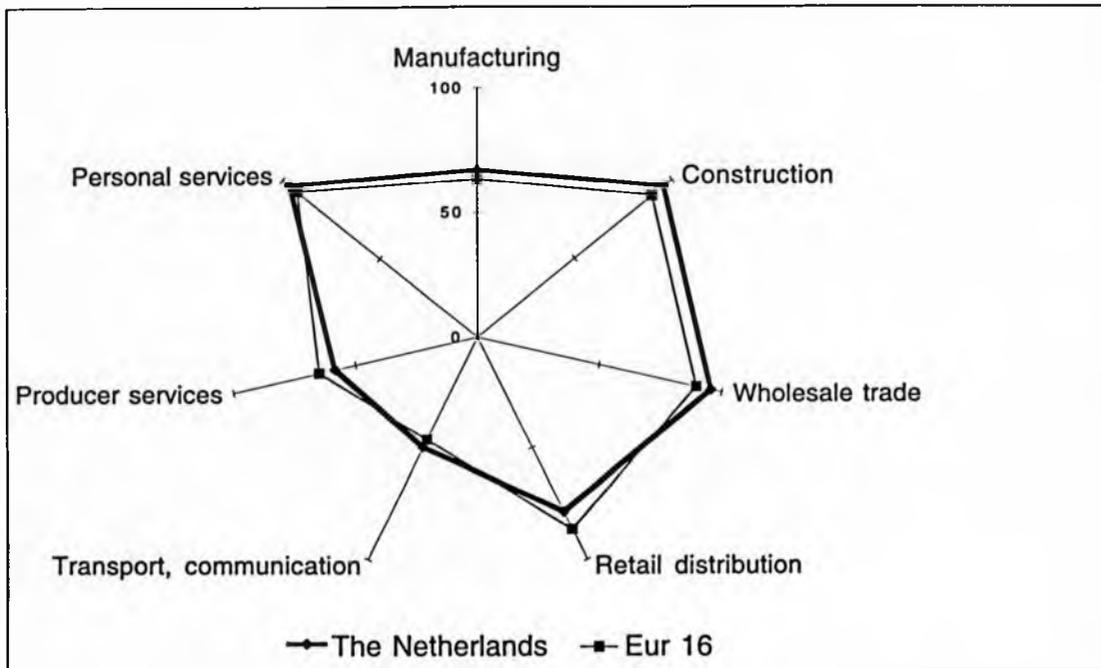
SMEs play a rather important role in the economy compared with the EUR-16-average, and SMEs value added growth and employment growth were especially high relative to the EUR-16-average over the 1988-94 period.

THE NETHERLANDS BUSINESS ENVIRONMENT



THE NETHERLANDS BUSINESS PERFORMANCE AND DYNAMICS





The wealth of the Dutch population, once amongst the most prosperous of the world, is declining, but nonetheless remains well above the EUR-16-average.

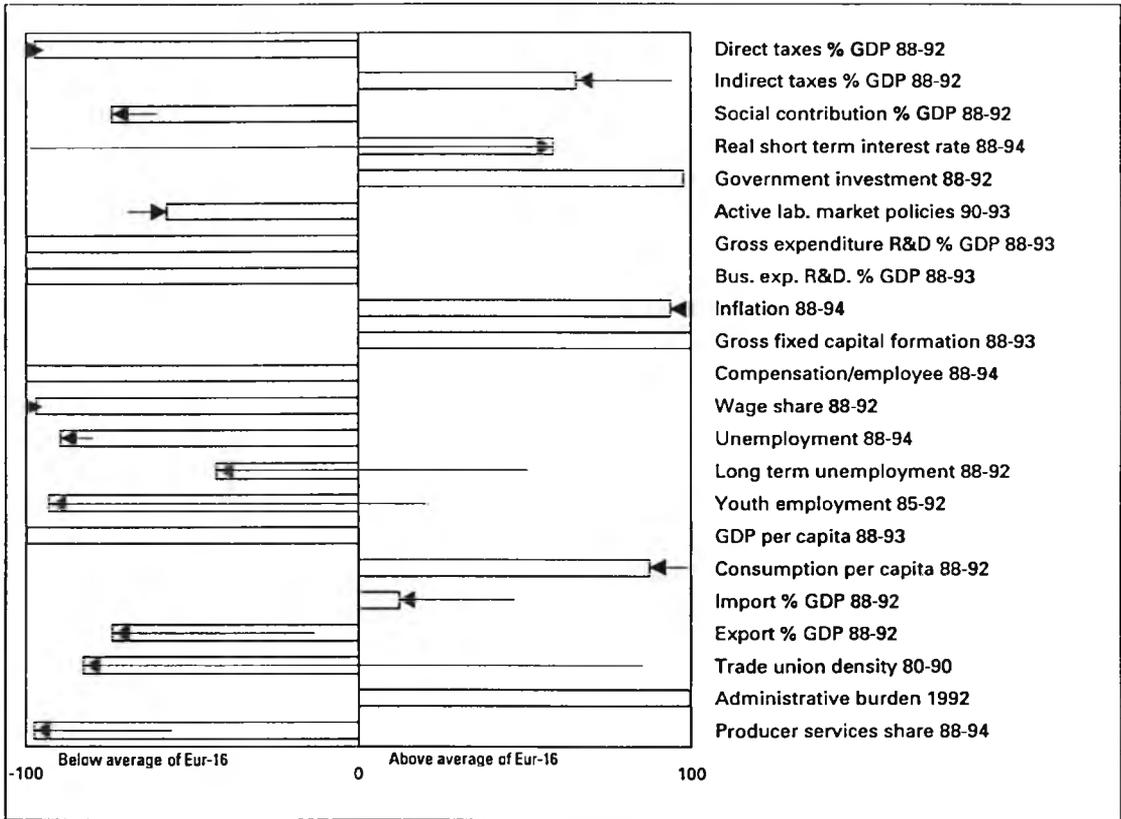
The Dutch tax-burden is, despite a decline, amongst the highest in the EUR-16. A relatively small share of the government-receipts is re-invested in the Dutch economy. And although relatively decreasing, gross R&D expenditure as a percentage of GDP remains above the EUR-16-average.

Dutch unemployment increased in the 1988-1994 period, but at a slower pace than the EUR-16-average, such that unemployment in the Netherlands is now below the EUR-16-average. Long term unemployment however, remains well above the EUR-16-average.

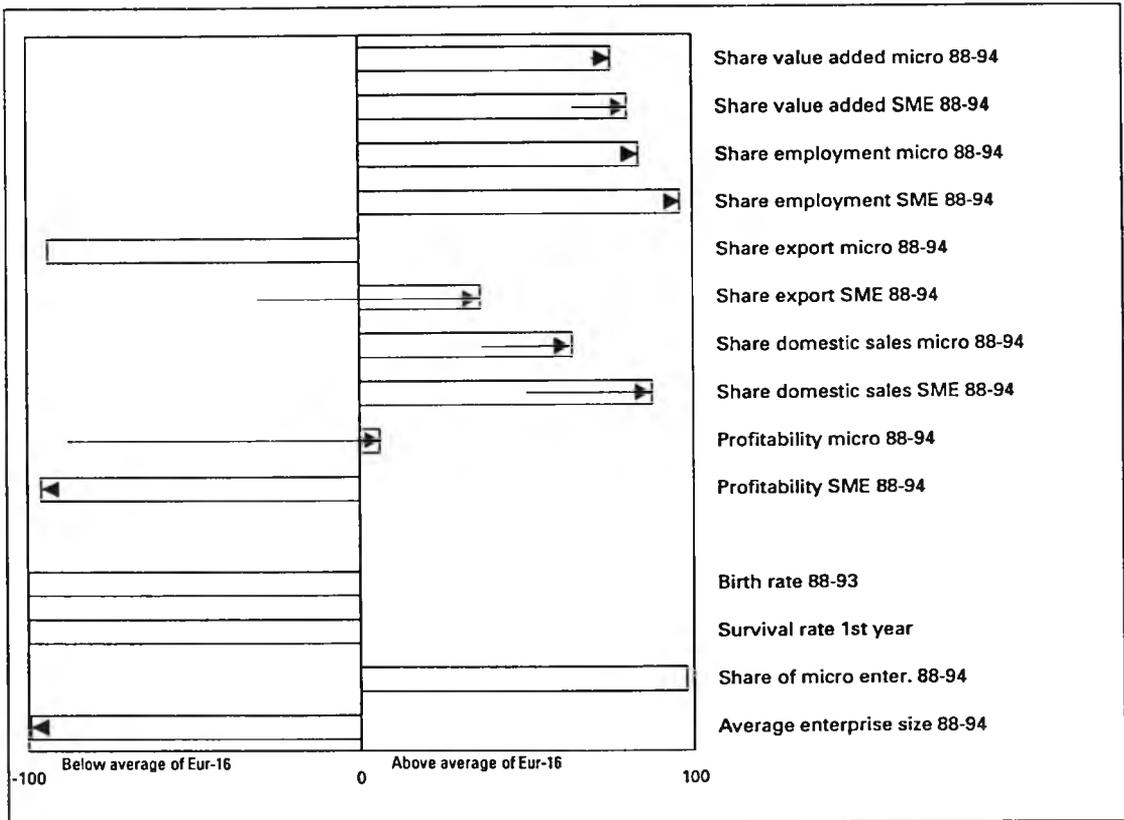
As with other small economies in the EUR-16, the Dutch economy is very open to international trade.

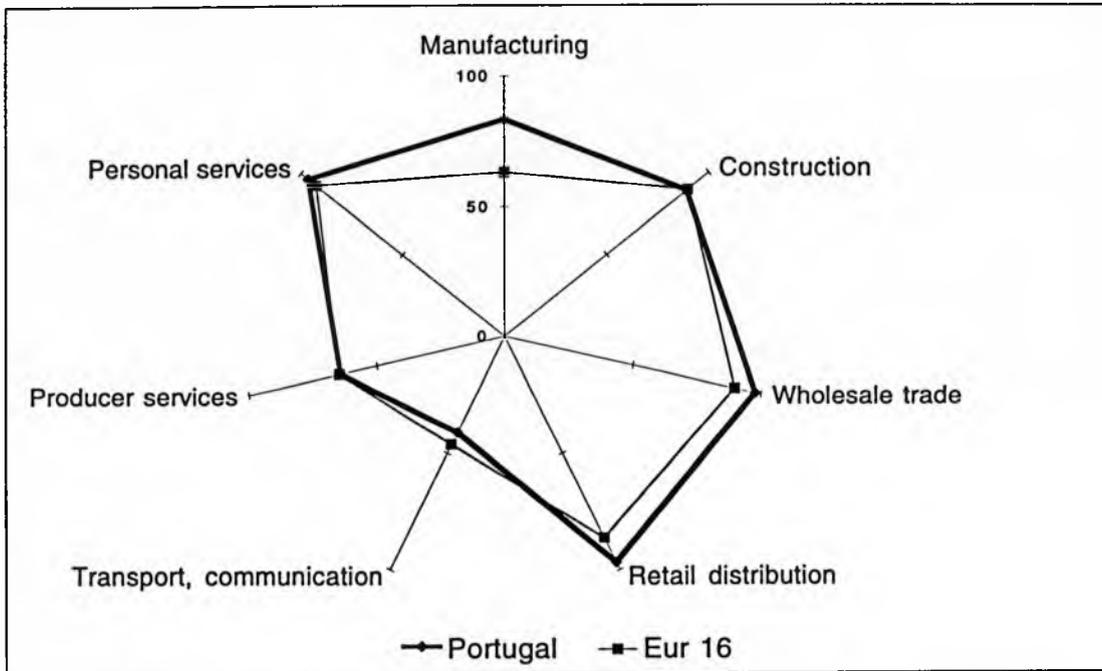
The rate of new entrepreneurship is, despite a relative increase, well below the EUR-16-average. The importance of SMEs is not great from an EUR-16 perspective. SMEs share of value added is just above the EUR-16-average, their share of employment is, despite growth in the 1988-94 period, still well below the EUR-16-average. And, although the profitability of SMEs has increased substantially in the last years, SMEs share of profits remains below the EUR-16-average.

PORTUGAL BUSINESS ENVIRONMENT



PORTUGAL BUSINESS PERFORMANCE AND DYNAMICS





Measured in GDP per capita Portugal is one of the poorest Member States of the EUR-16. The tax-burden, which decreased in the 1988-92 period, is well below the EUR-16-average; but government investment expenditure is very well above the EUR-16-average.

Gross expenditure on R&D as a percentage of GDP is very low in Portugal

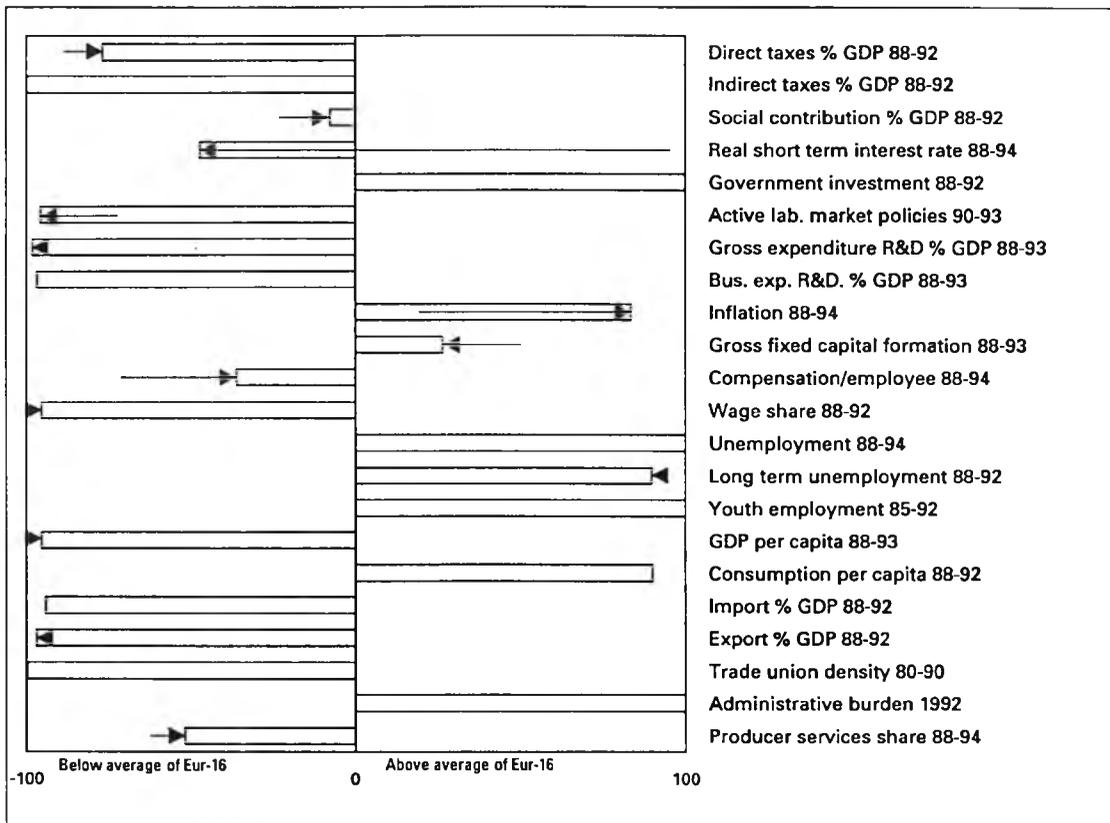
Official unemployment in Portugal is much lower than the EUR-16-average, as is long term unemployment, the latter decreasing rapidly in recent years.

Imports and exports as a percentage of GDP have been declining substantially in Portugal over the 1988-92 period.

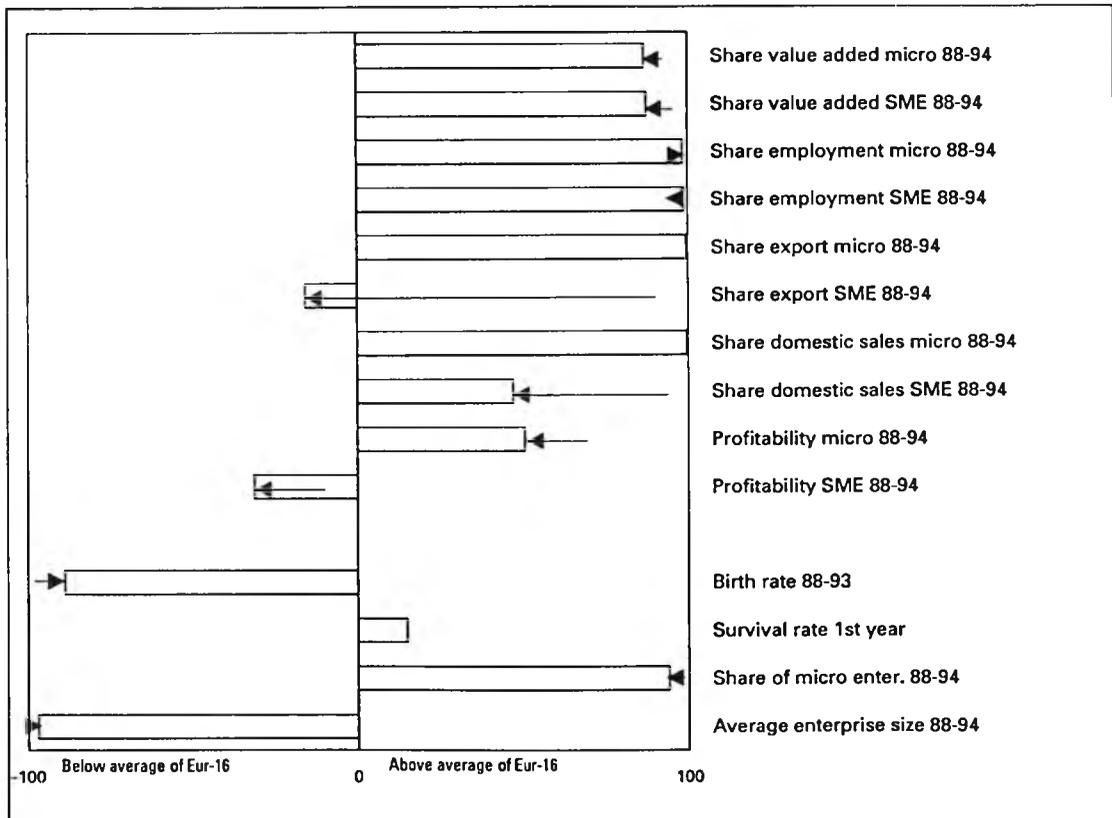
Concerning SME dynamics, the birth rate of new enterprises per 1,000 inhabitants is much lower than the EUR-16-average.

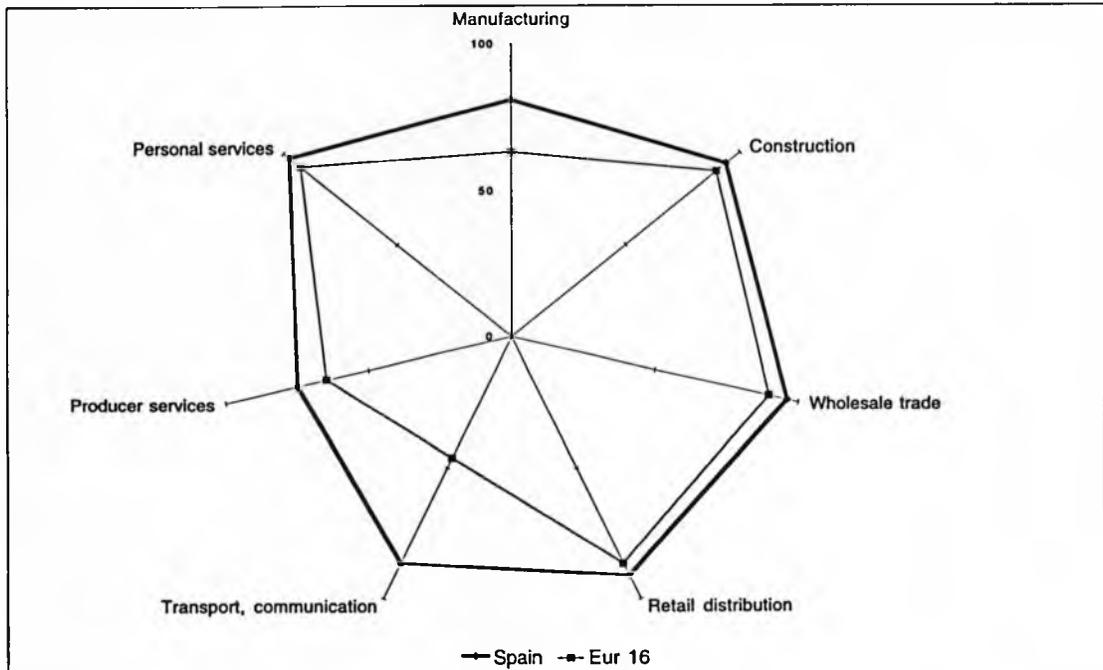
Concerning SME-performance, except for exports which declined in the 1988-94 period, all SME performance indicators were very positive in this SME dominated country. Growth in SME employment was particularly impressive, and was one of the highest in the EUR-16.

SPAIN BUSINESS ENVIRONMENT



SPAIN BUSINESS PERFORMANCE AND DYNAMICS





Spain's GDP per capita is among the lowest in the EUR-16, despite its converging trend.

The Spanish tax-burden increased substantially in the 1988-92 period, but remains well below the EUR-16-average. A relatively large part of government receipts is re-invested in the economy.

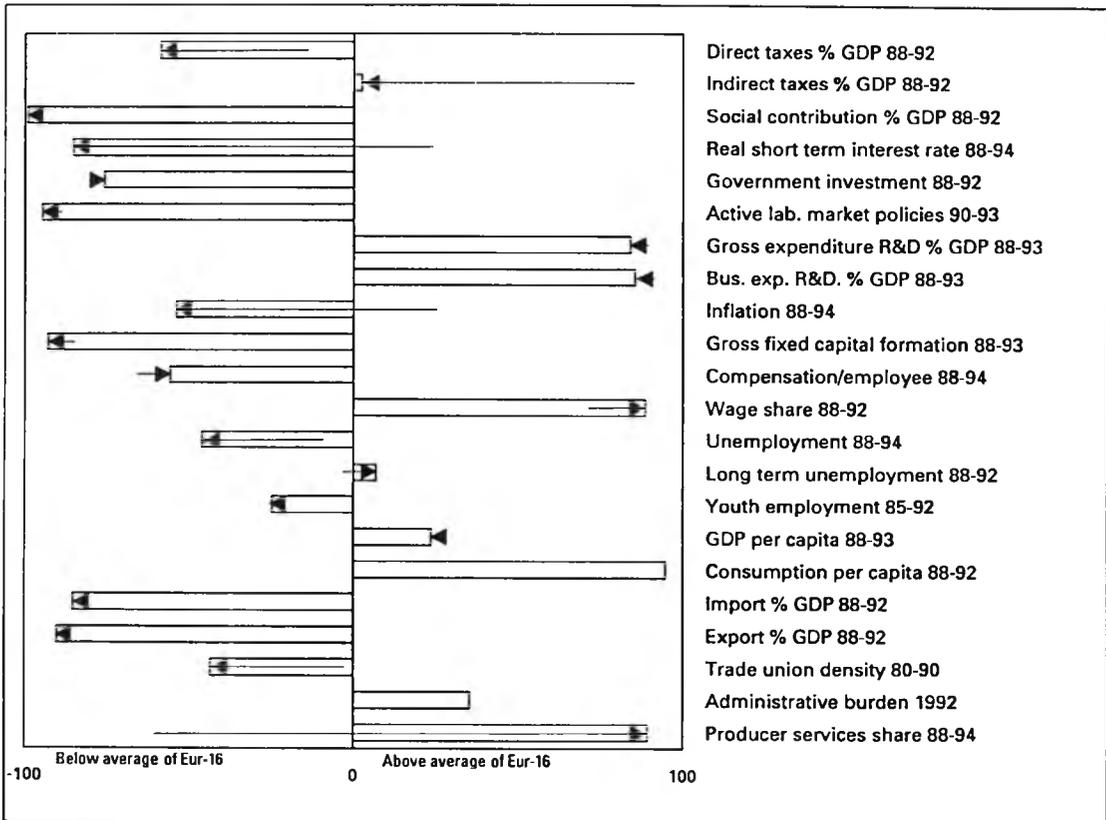
Gross expenditure on R&D as a percentage of GDP is well below the EUR-16-average and has even declined relatively.

The Spanish labour market situation is dramatic: unemployment is by far the highest in the EUR-16, and long term unemployment is also very high in Spain.

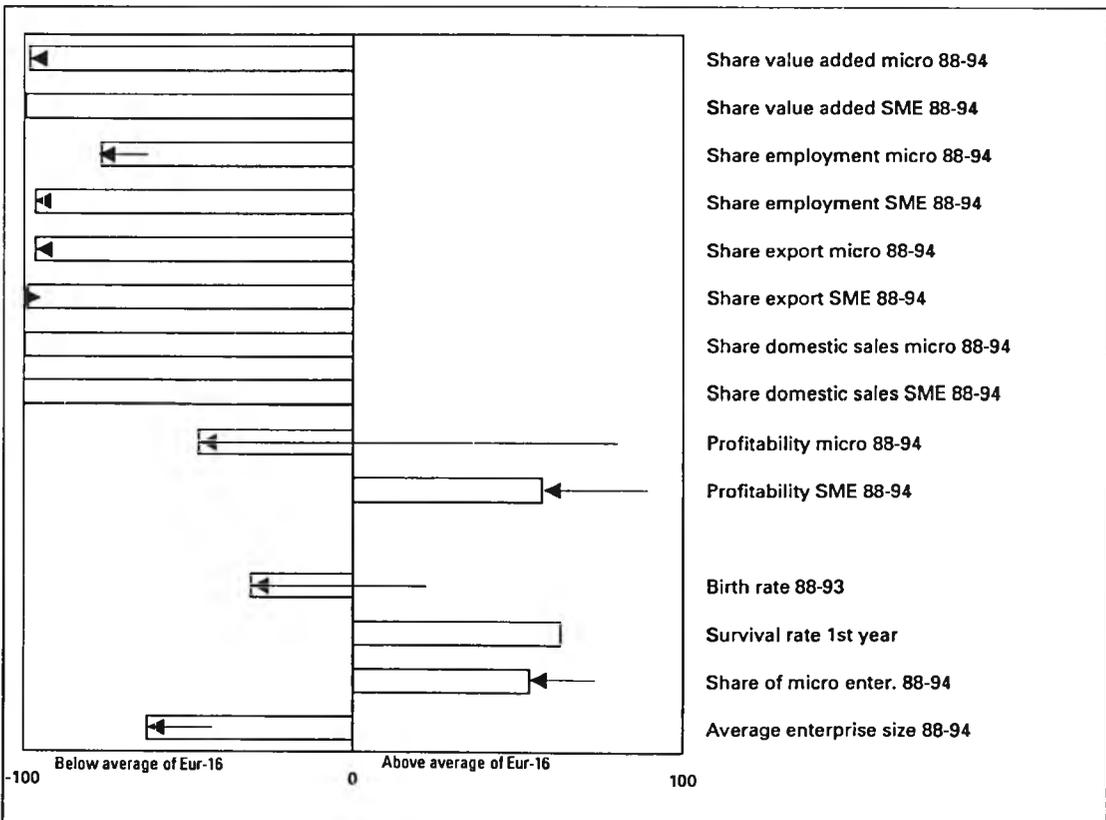
Like other large countries, the level of imports and exports is relatively low, and even declined over the 1988-92 period.

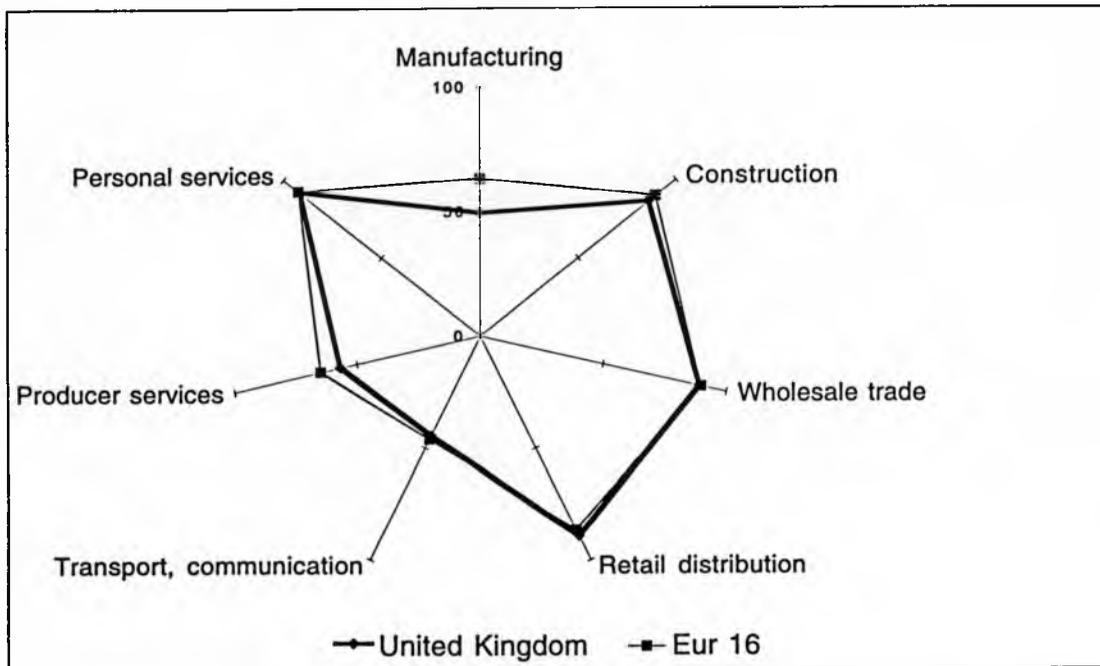
The new enterprise birth rate per 1,000 inhabitants is well below the EUR-16-average. The importance of SMEs is substantial in the Spanish economy, given their shares of value added and employment. Therefore the poor performance of the Spanish SME-sector over the 1988-94 period, with a decline of SME-employment, has been reflected in a poor national performance.

UNITED KINGDOM BUSINESS ENVIRONMENT



UNITED KINGDOM BUSINESS PERFORMANCE AND DYNAMICS





GDP per capita in the United Kingdom is just above the EUR-16-average, but in relative decline.

The tax burden is well below the EUR-16-average and has declined at the highest pace. At the same time government investment expenditure is relatively low, despite a small relative increase recently.

Gross expenditure on R&D as a percentage of GDP is well above the EUR-16-average.

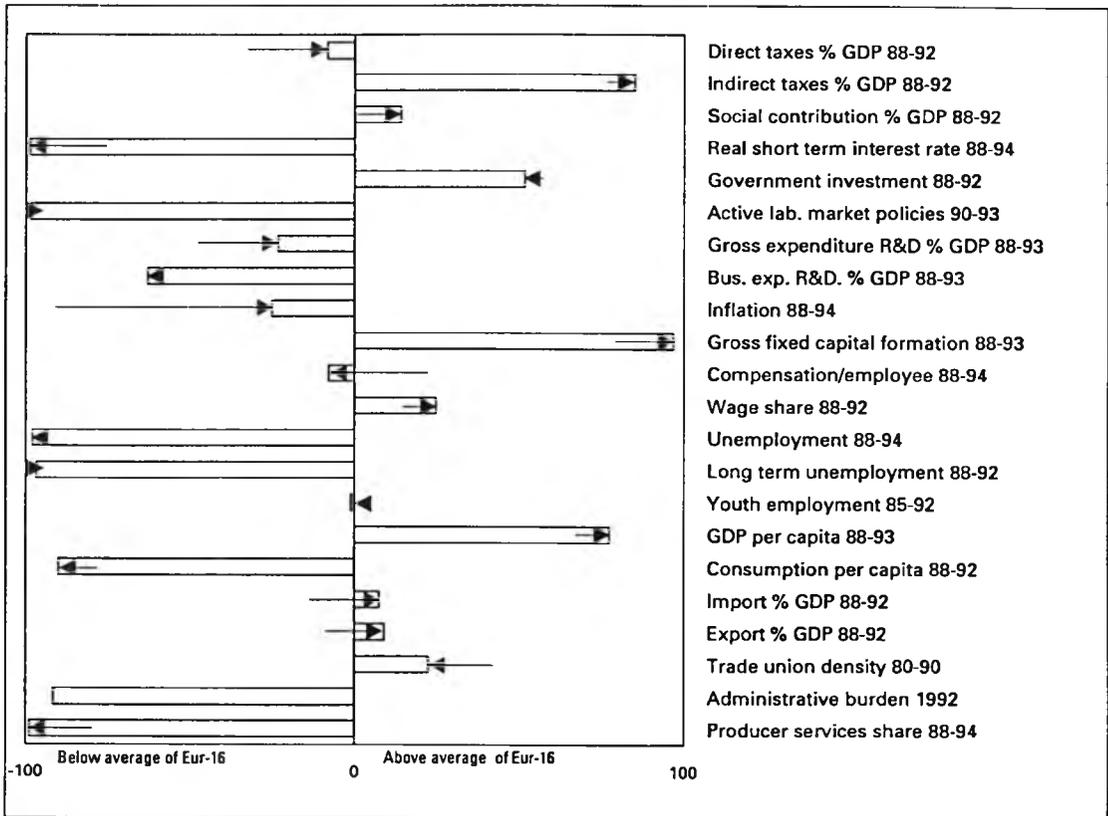
Unemployment in the United Kingdom, is below the EUR-16-average; and long term unemployment is just above the EUR-16-average.

Like the other large countries, the United Kingdom is relatively closed to international trade.

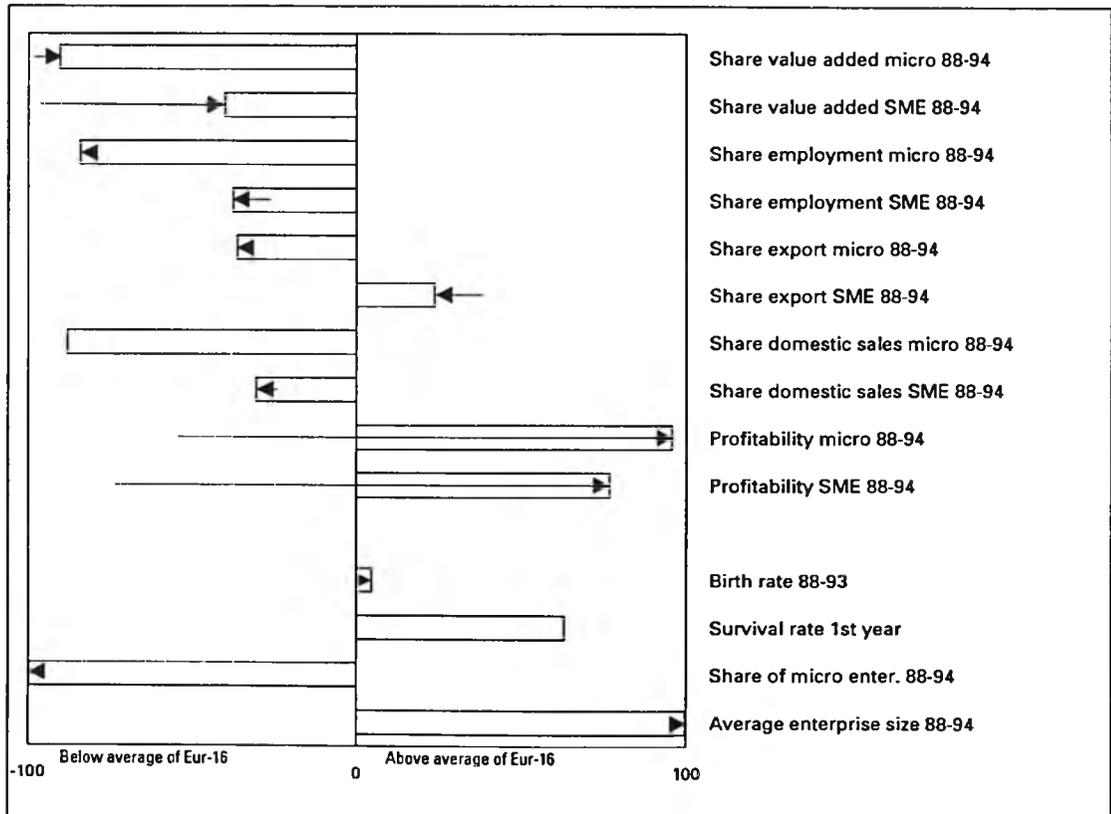
The rate of new entrepreneurship in 1988 was just above the EUR-16-average, by 1993 it had decreased to well below the EUR-16-average.

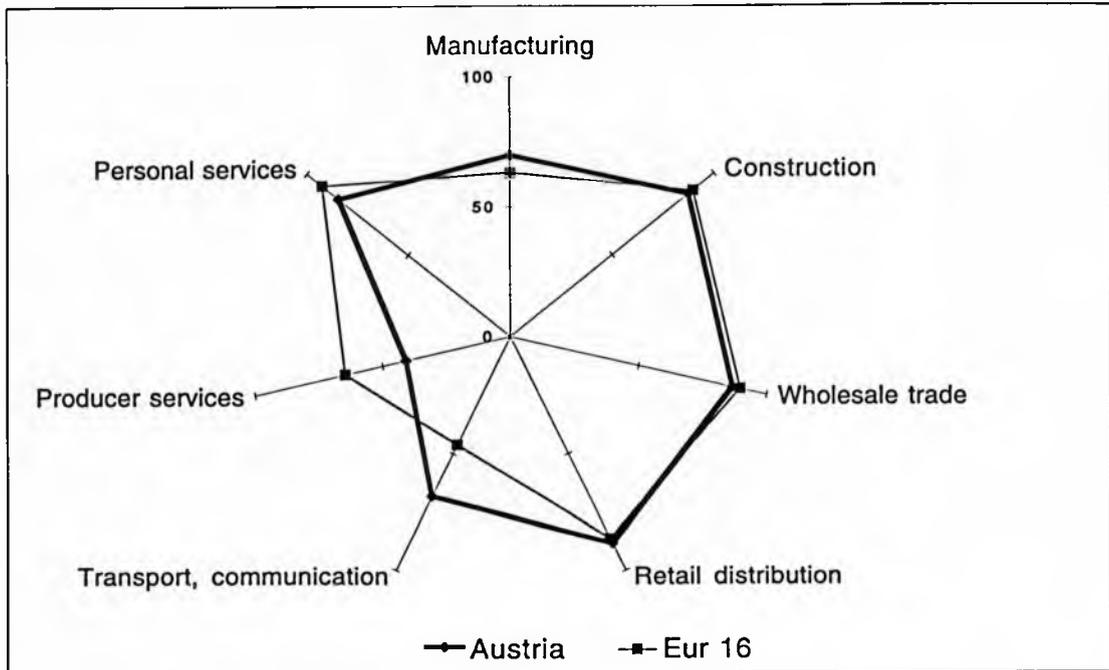
The United Kingdom is not a country in which SMEs have a very dominant role, at least from an EUR-16 perspective. Apart from exports, in which the United Kingdom's SMEs performed very well over the 1988-94 period, SME-performance was poor over the 1988-94 period: total turnover, and especially domestic turnover, decreased dramatically, as did SME-employment.

AUSTRIA BUSINESS ENVIRONMENT



AUSTRIA BUSINESS PERFORMANCE AND DYNAMICS





The Austrian GDP per capita is well above the EUR-16 average, and is also growing at a faster rate.

The tax burden in Austria is higher than the average of the EUR-16 and has increased in the 1988-92 period. Compared with the average of the EUR-16 a small share of government receipts is directly re-invested in the economy.

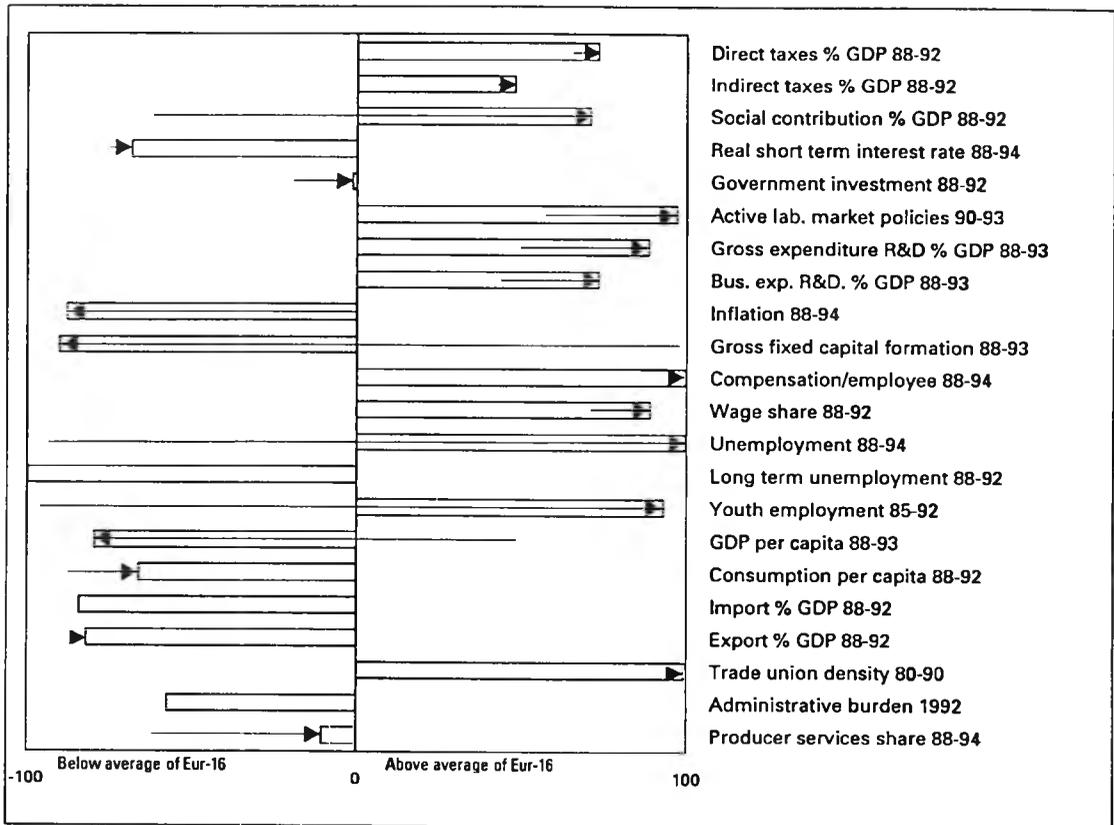
Gross R&D expenditure as a percentage of GDP is somewhat lower in Austria than the average of the EUR-16, although Austria is approaching the EUR-16 average.

The situation in Austria's labour market is much more favourable than in the EUR-16; not only is total unemployment, but long term unemployment is only a small fraction of the average in the EUR-16.

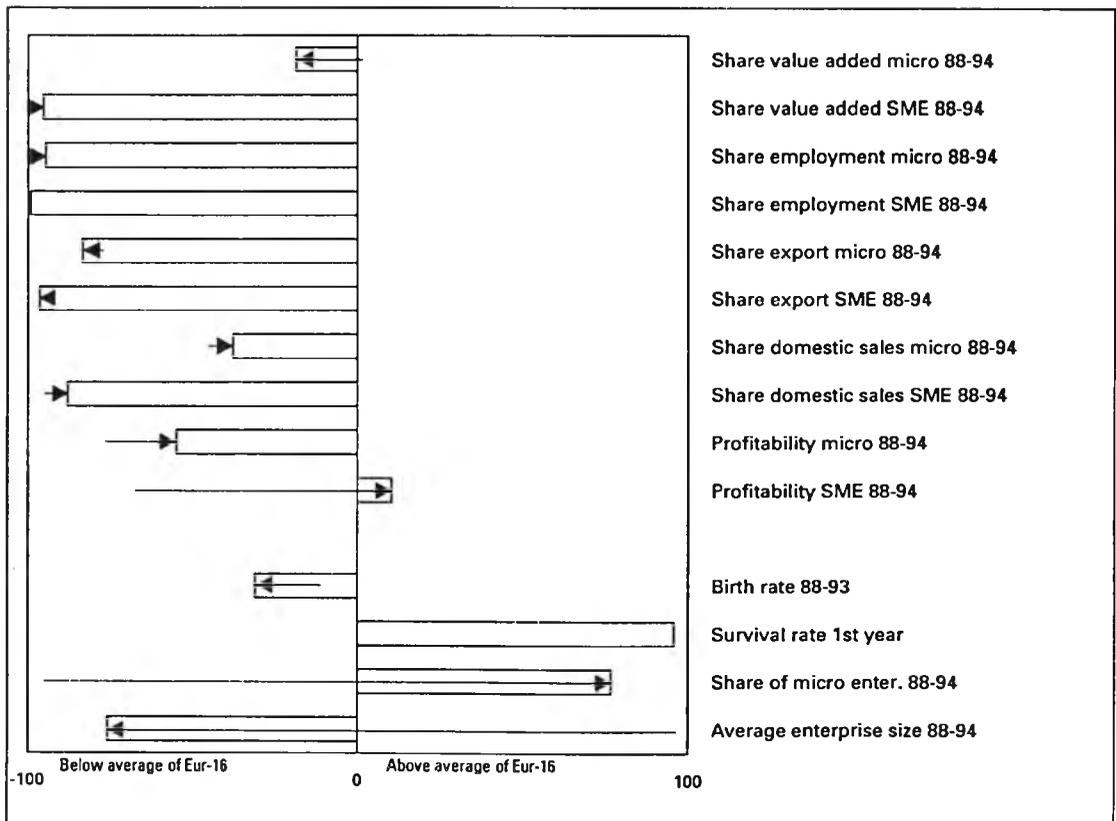
At the beginning of the 1988-92 period, Austria's import/export level was below the average of the EUR-16; but recently the openness of the Austrian economy has increased and the economy is now more open than the EUR-16 average.

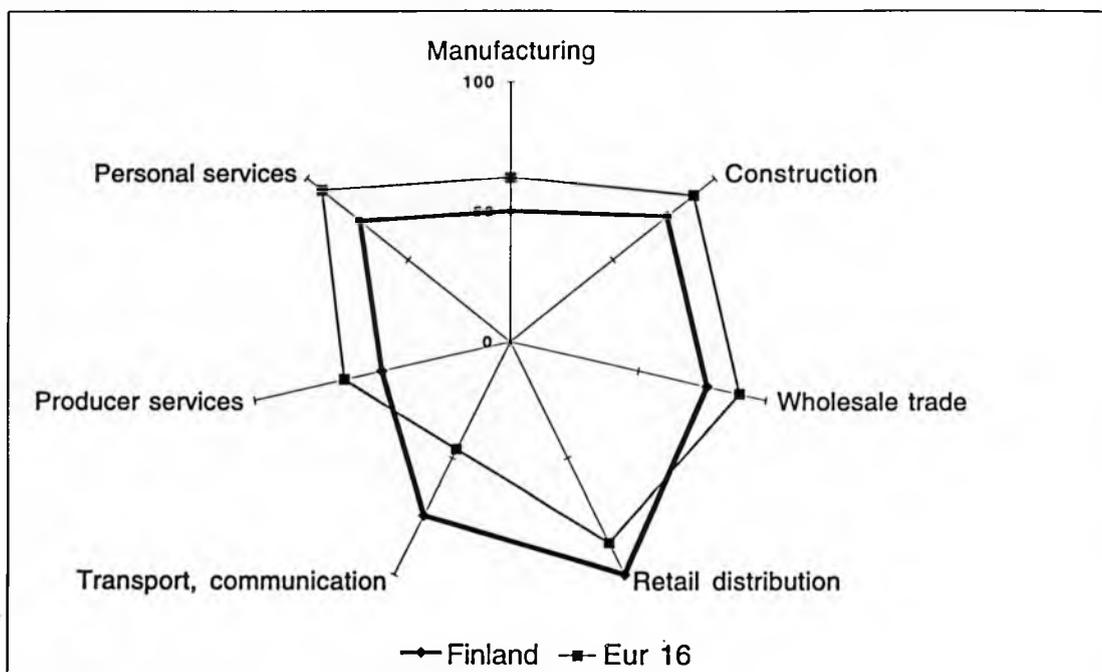
Concerning business dynamics, the new enterprise birth rate per 1,000 inhabitants is slightly higher than that in the EUR-16. Regarding SME-performance, value added in Austrian SMEs grew less rapidly than the SMEs of the EUR-16, but at the same time SME-employment grew much faster than the average of the EUR-16. Compared to the average of the EUR-16 the profitability of Austria's SMEs grew very rapidly.

FINLAND BUSINESS ENVIRONMENT



FINLAND BUSINESS PERFORMANCE AND DYNAMICS





Until recently Finland's GDP per capita was well above the average of the EUR-16, but recent economic problems were so severe that the Finland's wealth per capita has dropped below the average of the EUR-16.

The tax burden in Finland is well above the average of the EUR-16, and has grown substantially in recent years. Government investment expenditure has also been rising, but the Finnish government's investments are below the average of the EUR-16.

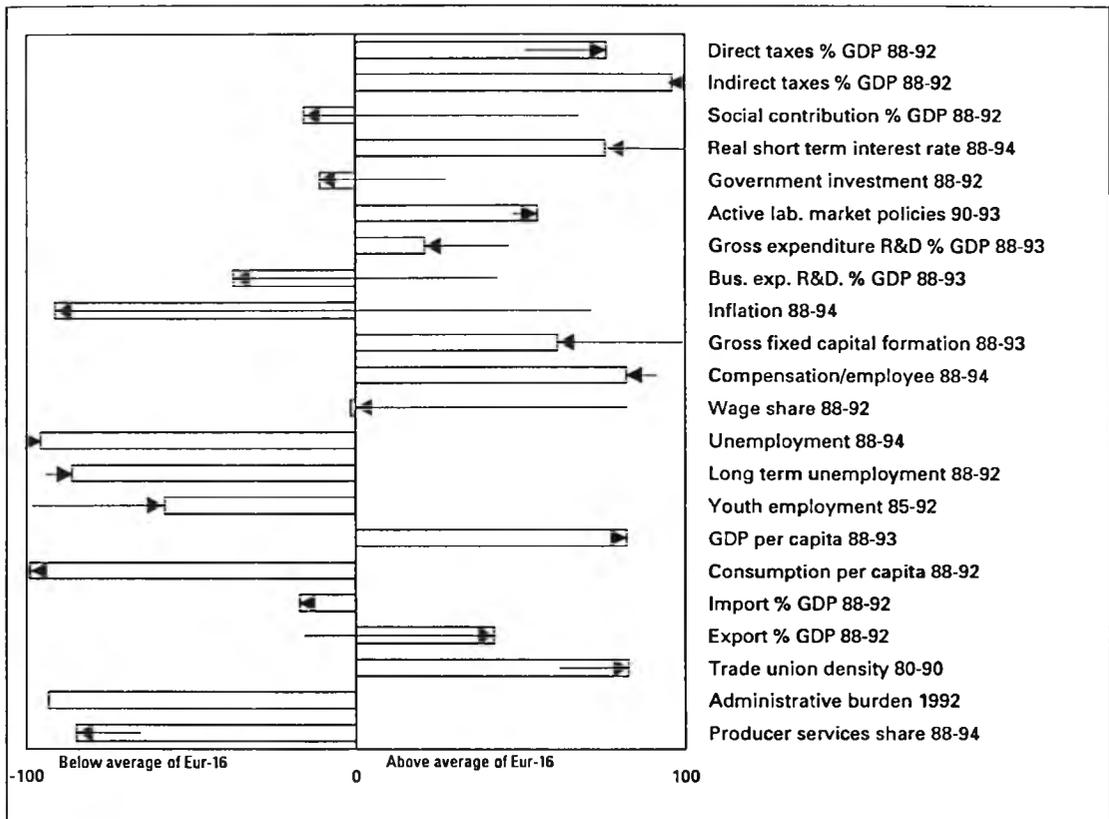
Gross expenditure on R&D as a percentage of GDP is well above the average of the EUR-16 in Finland, and the country has been diverging rapidly from the EUR-16 in this respect.

Due to severe economic problems Finland's unemployment, which is almost totally short term unemployment, expanded dramatically over the 1988-94 period, increasing from virtually none (full employment) to an unemployment rate of almost 20%.

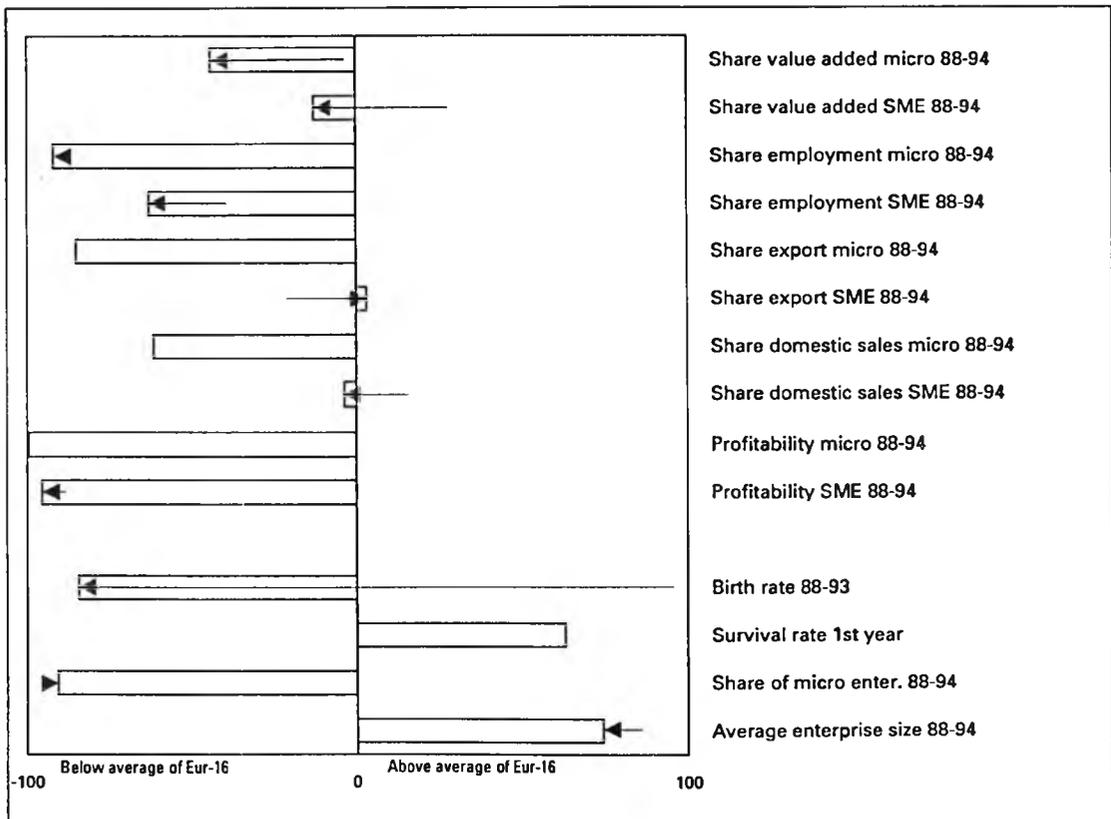
Exports and imports as a percentage of GDP are far below the average of the EUR-16.

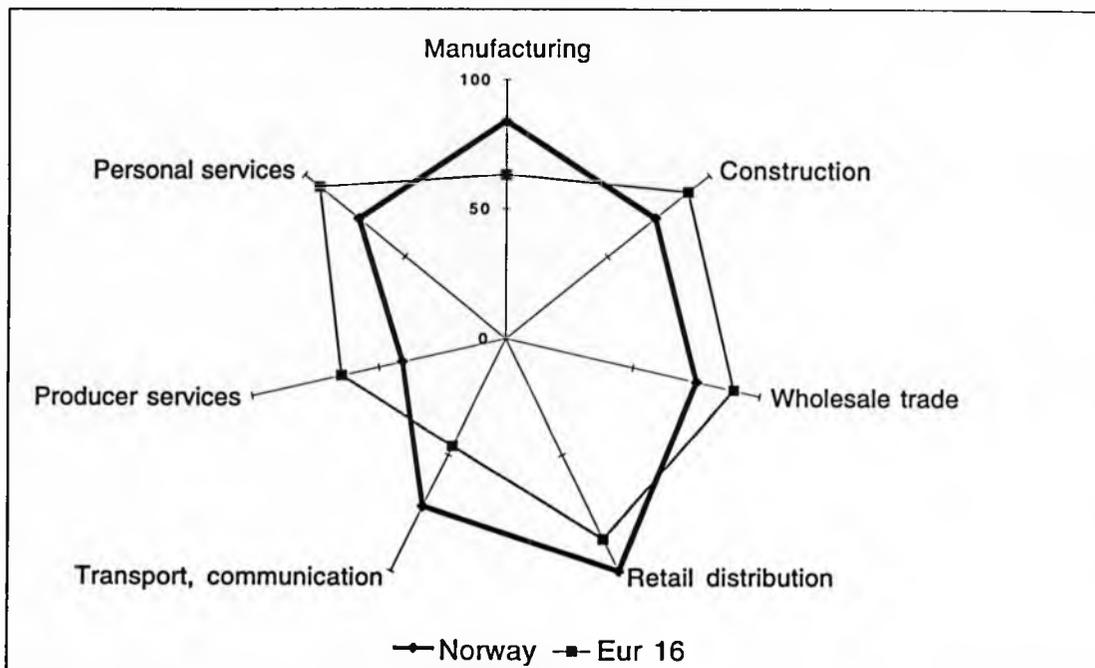
Concerning the dynamics of the Finnish enterprise sector, the rate of new entrepreneurship is well below the average of the EUR-16. And, due to the general economic problems, SMEs in the Finnish economy performed substantially worse than SMEs in the EUR-16. Value added and especially employment declined, but surprisingly the profitability of Finnish SMEs improved over the same period.

NORWAY BUSINESS ENVIRONMENT



NORWAY BUSINESS PERFORMANCE AND DYNAMICS





Norwegian GDP per capita is well above the average of the EUR-16 and is also growing faster. Although decreasing, the Norwegian tax burden is well above the average of the EUR-16. At the same time, government investment has declined sharply, and is currently below the average of the EUR-16.

Gross expenditure on R&D as a percentage of GDP is well above the average of the EUR-16, although Norway is experiencing a relative decline in this respect.

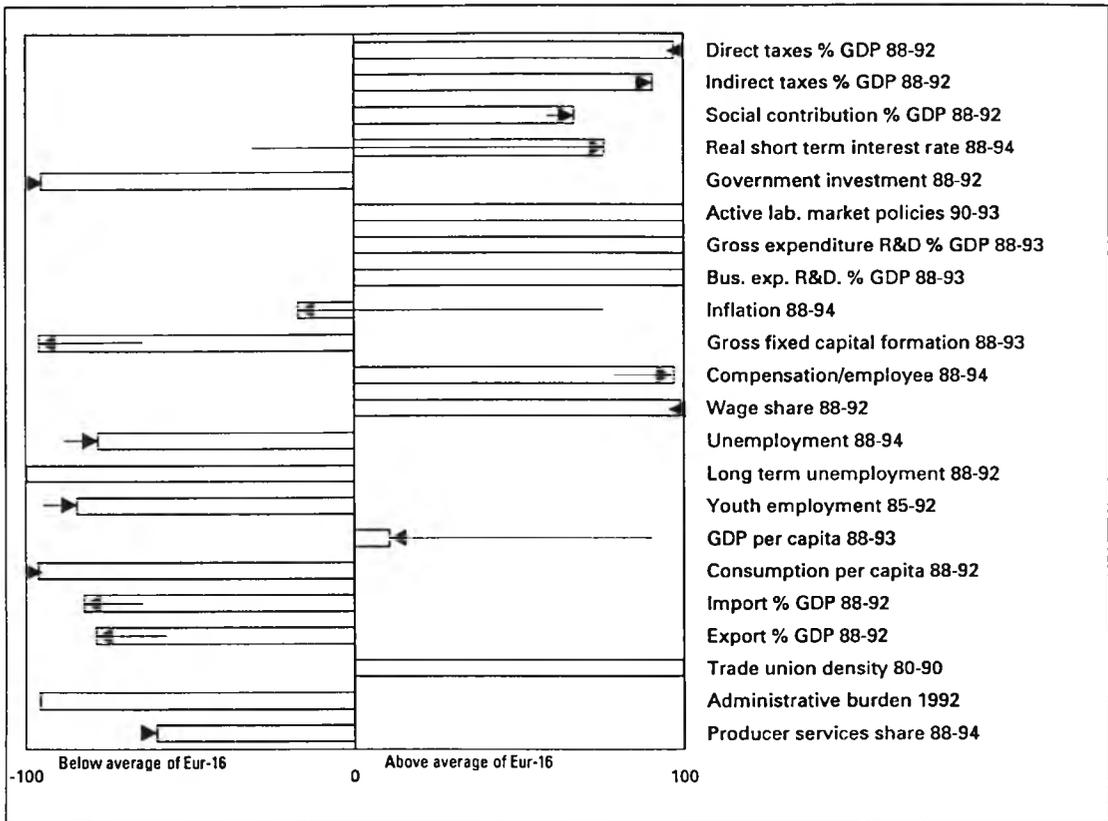
The Norwegian labour market situation is much more favourable than the average EUR-16 labour market; total unemployment, and long term unemployment, is much lower than the average of the EUR-16.

Concerning the openness of the economy, the level of imports/exports was, until recently, slightly below the average of the EUR-16, but over the 1988-92 period exports increased much faster than the EUR-16-average.

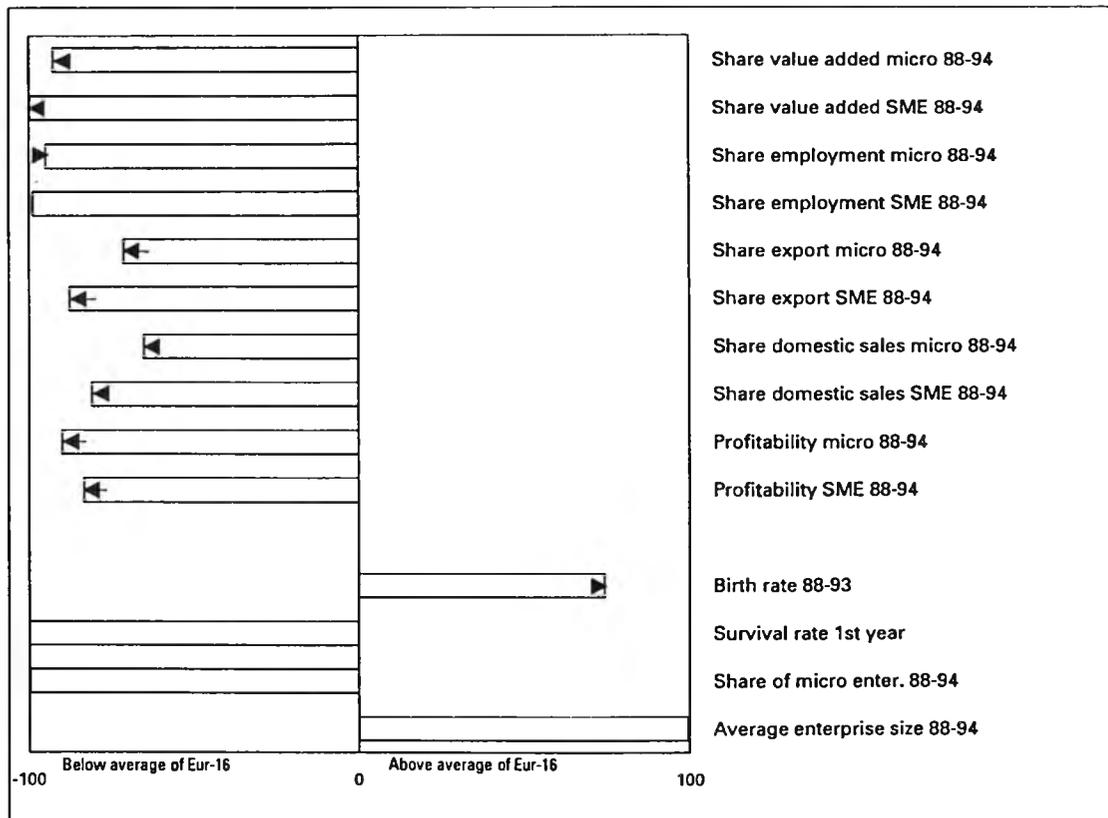
The new enterprise birth rate in Norway is currently well below the average of the EUR-16, but it was well above the average of the EUR-16 some years ago.

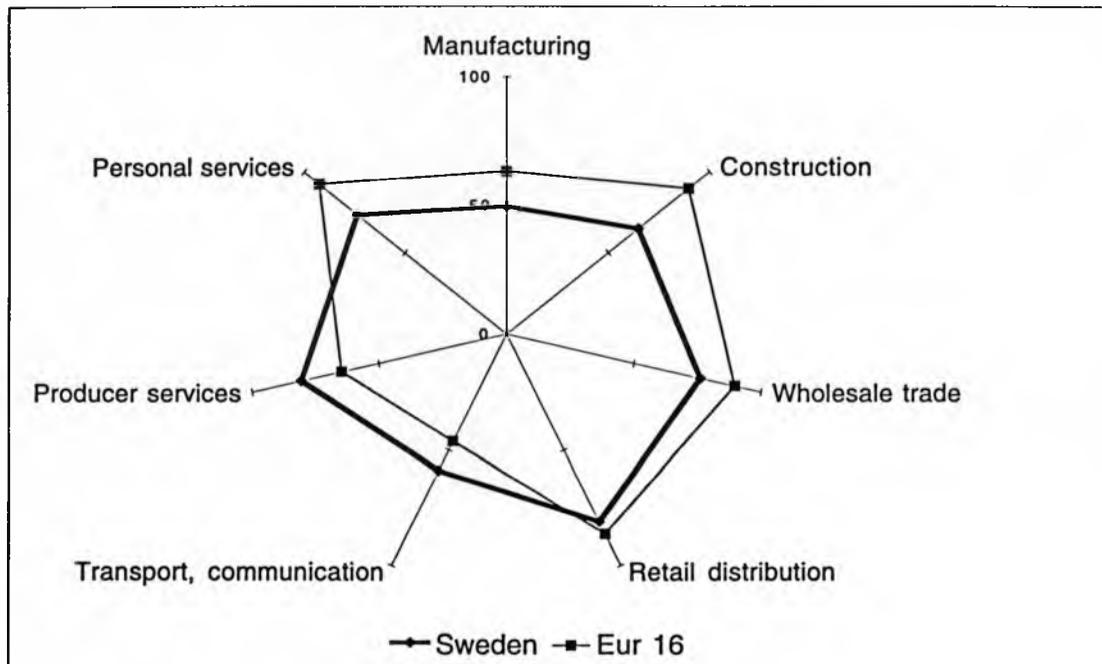
Regarding SME-performance in the 1988-94 period, Norwegian SMEs, except for their export performance, lagged behind the average of the EUR-16 in many respects. Growth of SMEs lagged behind the average of the EUR-16 and SME-employment growth was even more negative.

SWEDEN BUSINESS ENVIRONMENT



SWEDEN BUSINESS PERFORMANCE AND DYNAMICS





Until recently Swedish GDP per capita was among the highest of Europe, but severe economic problems led to relatively low real GDP-growth, which has led to a decline in the relative prosperity of the Swedish economy. Despite this Sweden remains above the average of the EUR-16.

The tax burden in Sweden is, despite a large decrease in recent years, the highest in Europe. A relatively small share of government receipts are re-invested in the economy.

Gross expenditure on R&D as a percentage of GDP is by far the highest in Europe.

And, despite, from a Swedish viewpoint, a dramatic increase of unemployment, Swedish unemployment, and long term unemployment, remains well below the average of the EUR-16.

Swedish imports and exports are below the average of the EUR-16, and in this respect Sweden is diverging from the average of the EUR-16.

The birth rate of new enterprises per 1,000 inhabitants is well above the average of the EUR-16. Regarding SME-performance, Swedish SMEs lagged substantially behind the average of the EUR-16. Not only has growth in value added been much lower in the 1988-94 period, but SME-employment also decreased. At the same time the profitability of Sweden's SMEs improved, but to a lesser extent than the average of the EUR-16.

Appendix 2 Convergence analysis (country level)

In the Second Annual Report of the European Observatory for SMEs the issue of convergence and divergence was tackled by the calculation of rates of convergence and divergence for main variables representing the business environment and the performance of SMEs. The significance of the trends over the period were also measured. That analysis revealed that most aspects of the business environment analysed showed a tendency towards convergence (also see Appendix 3).

The major advantage of that one dimensional analysis was that the rate of convergence or divergence of single indicators was calculated, which gave detailed information on the behaviour of specific variables. At the same time this type of analysis supplied little information on the position and development of individual countries, and left the interaction of different variables out of the analysis. Since, apart from the rate of convergence of single indicators in the EU-12, it is essential to know:

- the rate of convergence between the Member States of the EU-12;
- the degree of coherence between the Member States of the EU-12;
- the position of individual Member States within the socio-economic configuration;
- the direction in which the EU-12 as a whole is moving;
- the direction of movement of individual Member States;
- and the position and distance of the EFTA-4 countries relative to the EU-12;

a multi-dimensional analysis was therefore developed.

Using the multivariate technique of Multi-Dimensional Scaling the question of whether the Member States of the EUR-16 are converging or diverging,¹ has been assessed.

The technique of multi-dimensional scaling is very well suited to the kind of convergence analysis presented in this chapter, since, without going into detail, the technique computes distances between countries.

The procedure has been as follows. First, the domains of the Business Environment, SME Dynamics, and Business Performance of SMEs have been created, each domain consisting of some ten indicators, which best represent the domain given the availability of comparable data for the 16 countries. It should be kept in mind that all indicators used are measured as levels for two points in time (in most cases 1988 and 1994) and not as percentage changes, since the latter measurement would say virtually nothing about convergence or divergence in this kind of analysis.

On each area an MDS-analysis was carried out, this provided, apart from data-reduction, a graphical plot for the positions of the 16 countries relative to each other, and their movements over the 1988-94 period (relative to other countries). These plots thereby give information as to whether the EU-12 countries are converging or diverging and whether the EFTA-4 countries are approaching (becoming increasingly similar) or, alternatively, are digressing from (becoming increasingly dissimilar to) the EU-12.

Finally, the features of the graphical plots, which are the characteristic output of MDS-analysis, have been translated in statistics (Euclidean distances), which give numerical information concerning convergence or divergence.

¹ See: Susanne Pfeil, Die Konvergenz der wirtschaftlichen Entwicklung in den Staaten der Europäischen Gemeinschaft, Universität Erlangen-Nürnberg 1993.

1 Fiscal and monetary policies

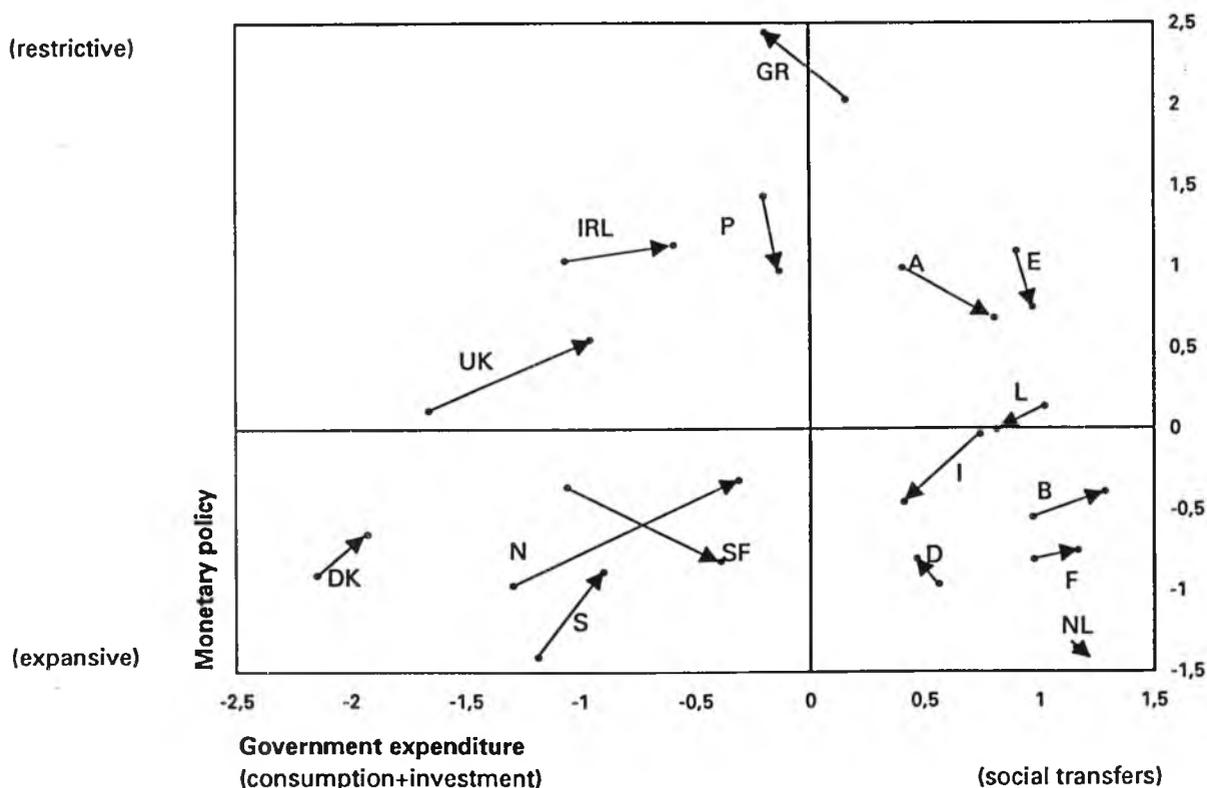
Fiscal and monetary policies are converging substantially in the EU-12, and the EFTA-4 countries are moving towards the EU-12, more or less in anticipation of their entry into the Union in 1995.

As can be seen from the plot, the countries of the EU-12 and of EFTA-4 are not only converging, they are also moving in the same direction: towards a greater emphasis on social transfers and a lower emphasis on government-consumption and government-investment expenditure. Concerning monetary policy there is no clear-cut movement in the group of 16 countries, mirroring the dual movement of interest rates and money supply.

The position of individual countries in the plot is also of interest: the Nordic countries, which have a tradition of direct government interference in the productive areas of the economy combined with a relatively expansionary monetary stance, have moved towards the EU-12. It is also interesting to see that Germany, the economic superpower of Europe, is surrounded by its neighbours (the Netherlands, Belgium, Luxembourg, and Austria).

	EUR-16	EU-12	EFTA-4
Government exp.	convergence	convergence	approaching
Monetary policy	convergence	convergence	approaching
Total	convergence	convergence	approaching

Figure 17.15 Fiscal and monetary policies; country plot



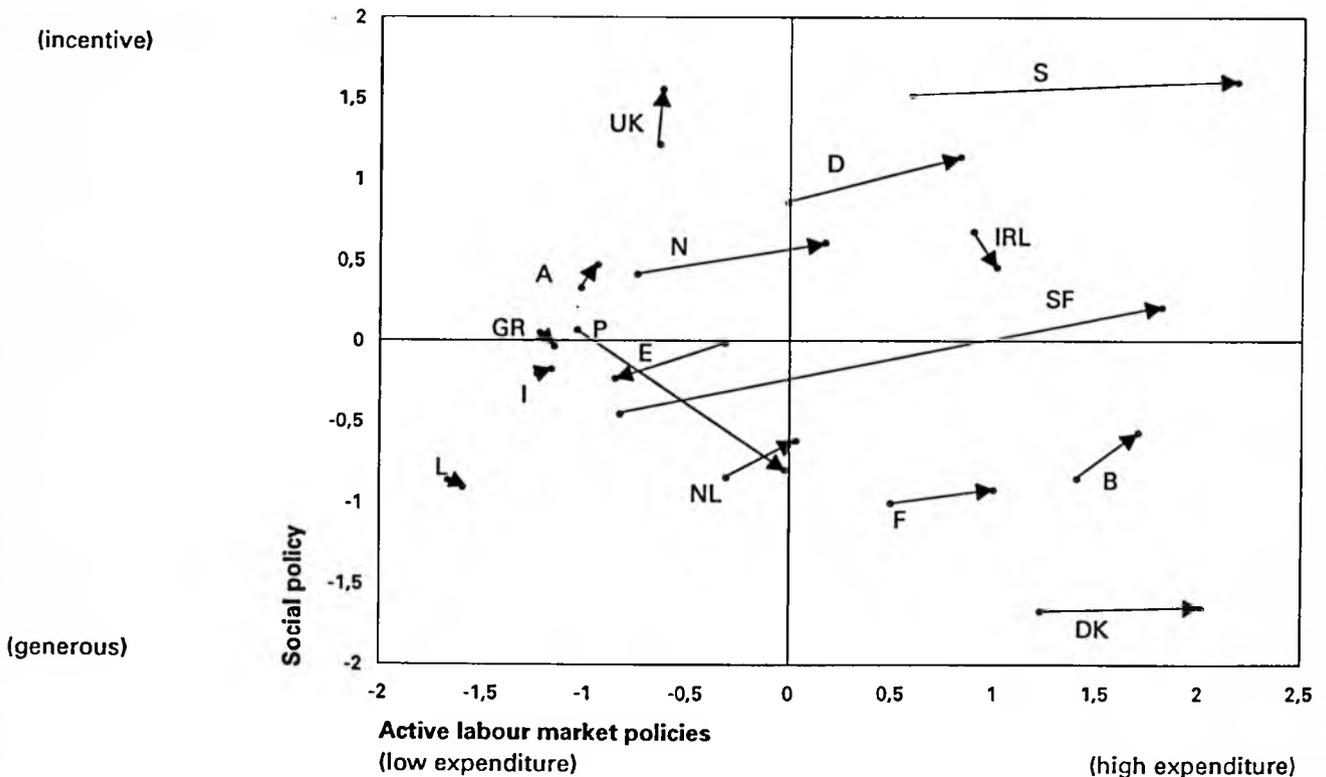
2 Labour market policies

Labour market policies have two dimensions, an active dimension (directed at the stimulation of the unemployed into the formal labour process, and stimulating employment growth) and a passive dimension (which provides financial compensation for unemployment, disability, and other forms of formal inactivity for people of working age), a dichotomy which is confirmed by the multi-dimensional scaling analysis.

For both dimensions a massive divergence can be seen. Also, it can be seen that almost all countries have moved towards a more active policy stance. The stance on social policy differs between countries: the United Kingdom, the Netherlands and Belgium for example have introduced incentives into their social security systems, whilst other countries have remained stable or have become more generous.

	EUR-16	EU-12	EFTA-4
Active policies	divergence	divergence	digression
Social policies	divergence	divergence	digression
Total	divergence	divergence	digression

Figure 17.16 Labour market policies, country plot



3 Burdens on business

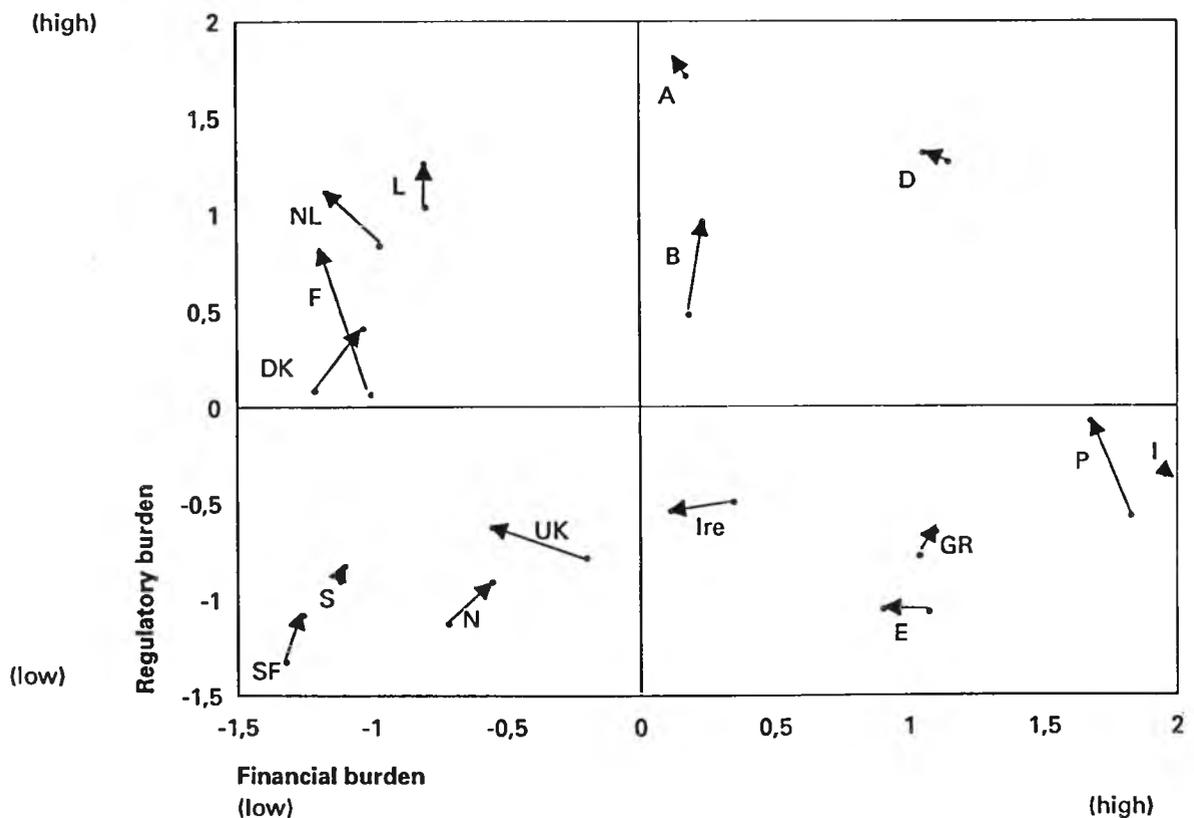
Apart from the benefits private enterprises gain from government intervention (such as a qualified labour force, physical infra-structure, a legal infra-structure, capital transfers and so on) these market agents also have to bear a burden which is caused by state intervention. This burden can theoretically and empirically be divided into two dimensions: a financial burden, and a regulatory burden (see chapter 15).

Concerning the financial burden on private enterprises, there was a slight convergence in the EU, while the EFTA-4 countries were also moving towards EU-12. Regarding the regulatory burden, there was considerable divergence; but the EFTA-4 countries are approaching the EU-12.

General trends are hard to detect, but it can be seen that the regulatory burden has increased in most countries inside the EU-12, and in the EFTA-4-countries.

	EUR-16	EU-12	EFTA-4
Financial burden	convergence	convergence	approaching
Regulatory burden	divergence	divergence	approaching
Total	divergence	divergence	approaching

Figure 17.17 Burdens on business, country plot



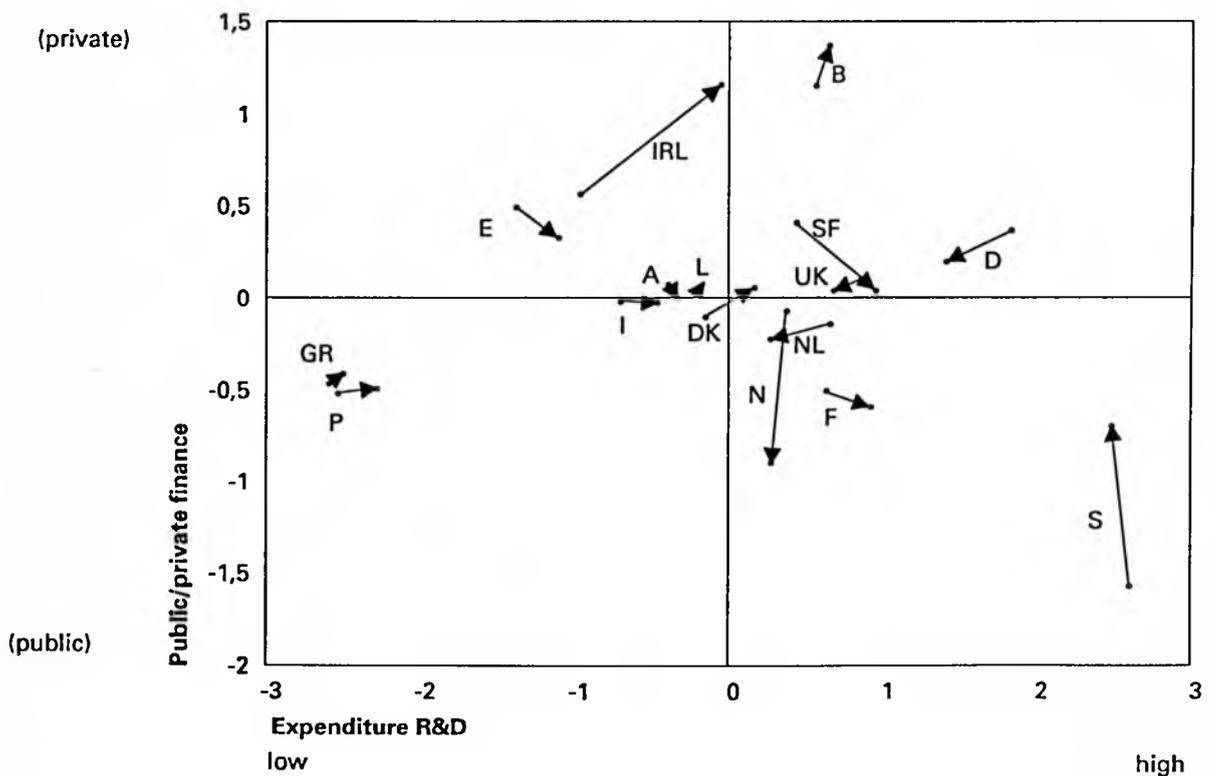
4 Technology and innovation

Efforts on research and development can be divided into two dimensions, namely the intensity of the R&D effort (total expenditure on R&D), and the source of that effort (public/private finance). Concerning total expenditure on R&D, the countries of the EU-12 are converging; but the EFTA-4 countries haven't closed on the EU-12 on this dimension. Regarding the source of the funding, there was some divergence in the EU-12, while the EFTA-4 countries have approached the average in the EU-12.

The plot also shows that the EU-12 is moving in the direction of larger R&D efforts, but southern countries still lag substantially behind. Regarding the source of the funding, there is no clear movement in the EU-12 or in the EFTA-4 countries as a whole.

	EUR-16	EU-12	EFTA-4
Expenditure R&D	convergence	convergence	..
Public/private fin.	..	divergence	approaching
Total	convergence	convergence	approaching

Figure 17.18 Technology and innovation; country plot



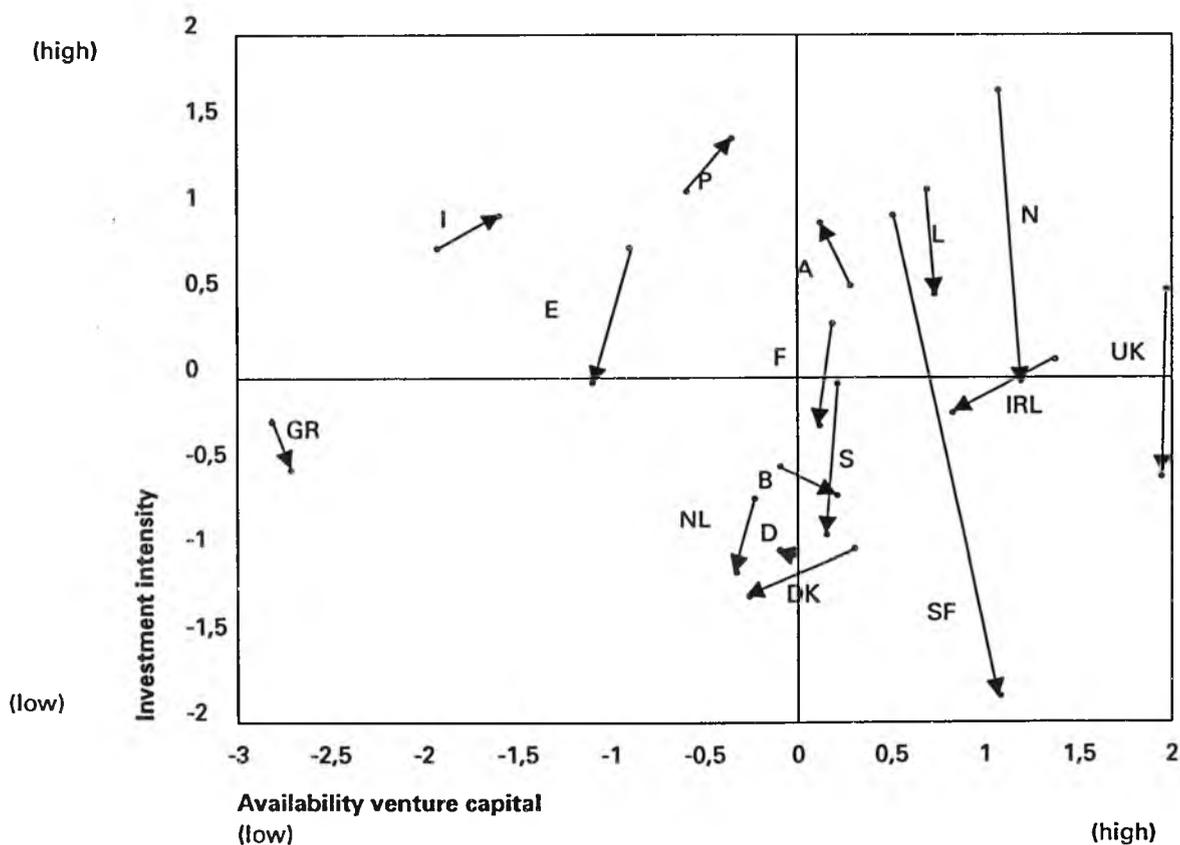
5 Capital and finance

The situation in the capital and financial markets can be divided into two dimensions, the availability of venture capital and the investment intensity. In general the EU-12 shows a convergence in its capital and financial markets, whilst the EFTA-4 countries are moving away from the EU-12. Looking at the two dimensions independently, it becomes clear that the EU-12 is converging on the dimension of the availability of venture capital, but is diverging slightly on the dimension of the investment intensity in the economy. The EFTA-4 countries are moving away from the EU-12 in both areas.

Notwithstanding this convergence or divergence, the group of 16 countries as a whole, and the three Nordic EFTA-4 countries in particular, are moving towards a lower investment intensity in their economies.

	EUR-16	EU-12	EFTA-4
Venture capital	convergence	convergence	digression
Investment intensity	divergence	divergence	digression
Total	divergence	convergence	digression

Figure 17.19 Capital and finance; country plot



6 Labour market

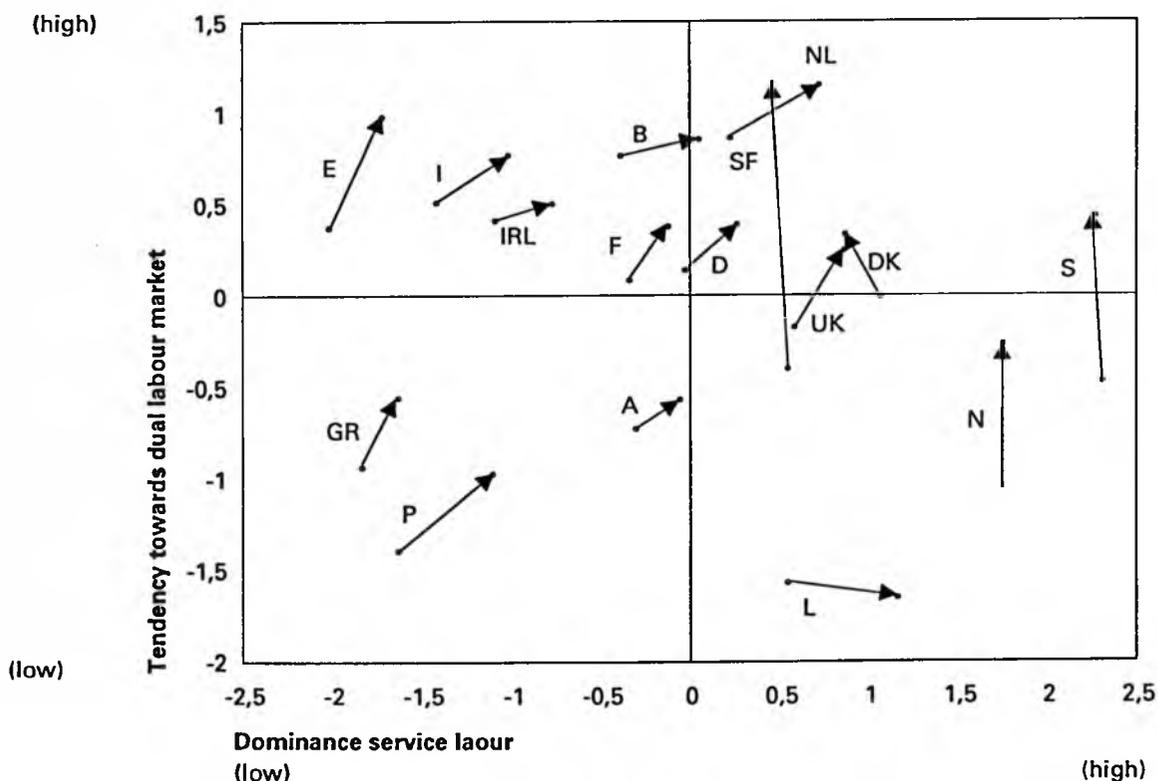
Labour market conditions are converging in the EU-12 but the EFTA-4 countries are not becoming notably more similar to the EU-12, but Finland and Austria in particular are already rather similar to the EU-12.

Labour market have two dimensions, the dominance of (white collar) service employment and a tendency towards a dual labour market (i.e. a labour market in which a large share of the population of working age are (long term) unemployed, otherwise involuntarily inactive or have involuntary part-time jobs; c.f. the German 'Zweidrittelgesellschaft' or the French 'société à deux vitesses'). Concerning the first dimension the EU-12 is converging, but regarding the second, it is diverging.

In general it can be detected that all countries are increasing the dual nature of their labour market (mass unemployment and increasing part time employment); at the same time as white collar service employment is increasing in importance almost everywhere.

	EUR-16	EU-12	EFTA-4
Service labour	convergence	convergence	..
Dual labour market	divergence	divergence	..
Total	convergence	convergence	..

Figure 17.20 Labour market; country plot

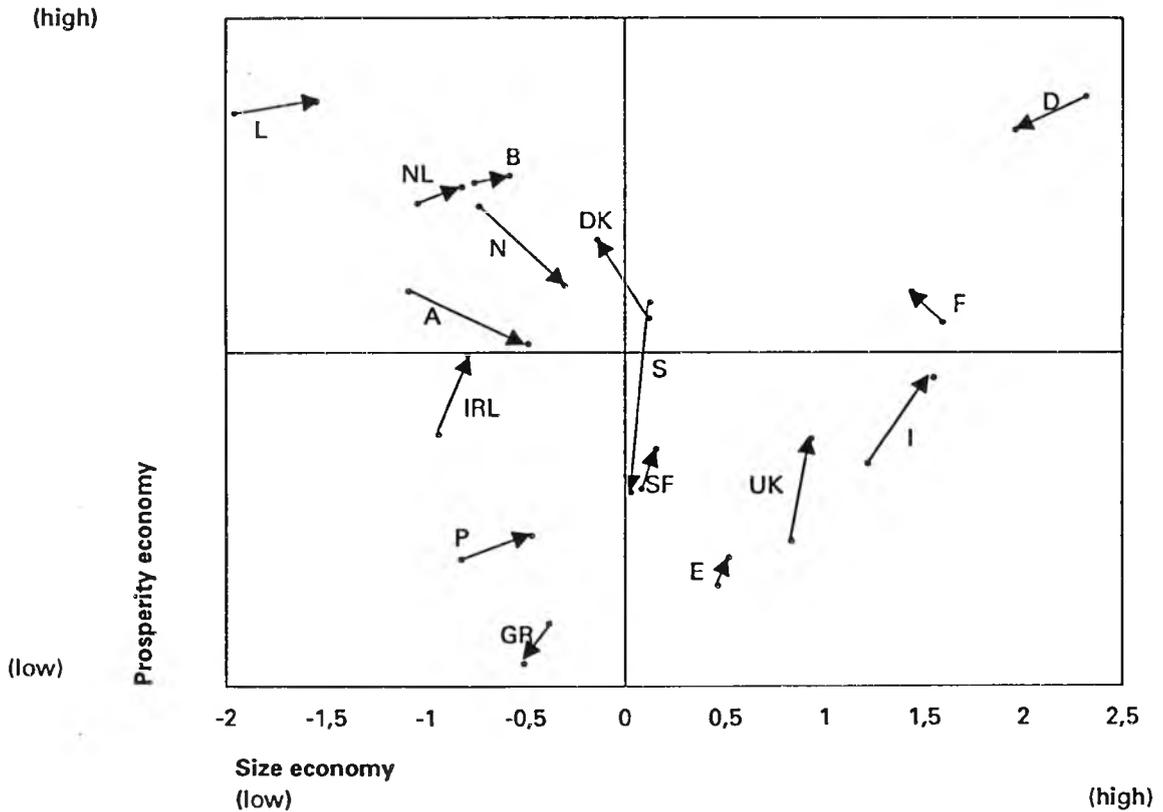


7 Economic strength

Economic strength can be divided two dimensions: the size of the economy, and the prosperity of the economy. In general, the EU-12 is converging on this area, an outcome which was a major objective of the process which led to the creation of the internal market. At the same time, the EFTA-4 countries already share the characteristics of the EU-12 and are moving further towards the centre of gravity of the EU-12.

	EUR-16	EU-12	EFTA-4
Size economy	convergence	convergence	approaching
Prosperity	convergence	convergence	approaching
Total	convergence	convergence	approaching

Figure: 17.21 Economic strength; country plot



8 Industrial relations

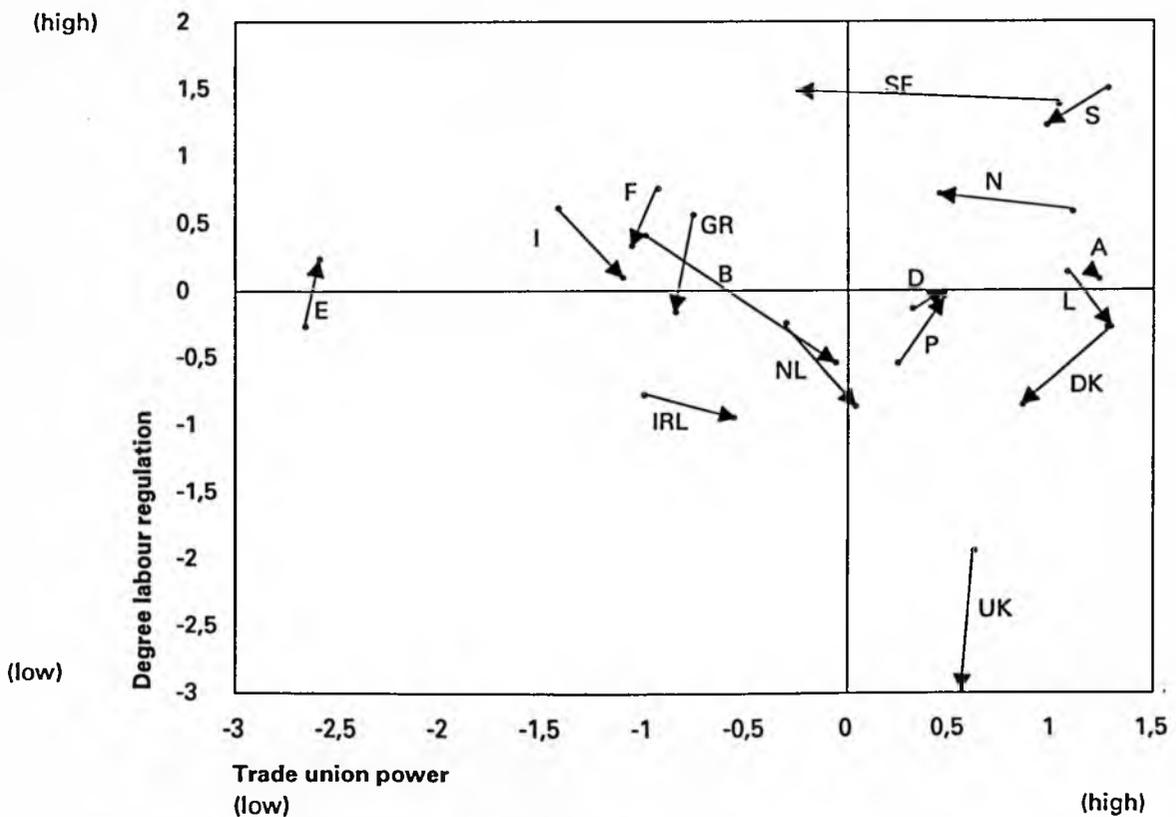
Since productive labour is the most important input in the production process of SMEs, the characteristics of industrial relations are assumed to be of importance for the functioning and performance of SMEs. Industrial relations have, theoretically and empirically, two dimensions: trade union power (being a function of the trade union density rate (membership of trade unions as a % of the working population) and the rate of unemployment) and the degree of labour regulation.

Concerning the issue of convergence, a complicated picture arises: the EU-12 is diverging in general in the area of industrial relations, which is explained by the divergence of labour regulation within the EU; but regarding trade union power, the EU-12 is converging. The EFTA-4 countries are moving towards the EU-12 in terms of trade union power, but they are neither converging nor diverging with relation to labour regulations.

General developments are the reduction in union density rates, and increasing unemployment, leading to a lowering of trade union power in most countries. In the EU-12 countries the degree of labour regulation is falling; but the EFTA-4 countries remain apart: in comparison with the twelve EU-12 countries they are traditionally characterised by high trade union power and a high degree of labour regulation.

	EUR-16	EU-12	EFTA-4
Union power	convergence	convergence	approaching
Labour regulation	divergence	divergence	..
Total	convergence	divergence	approaching

Figure 17.22 Industrial relations, country plot



9 Business dynamics

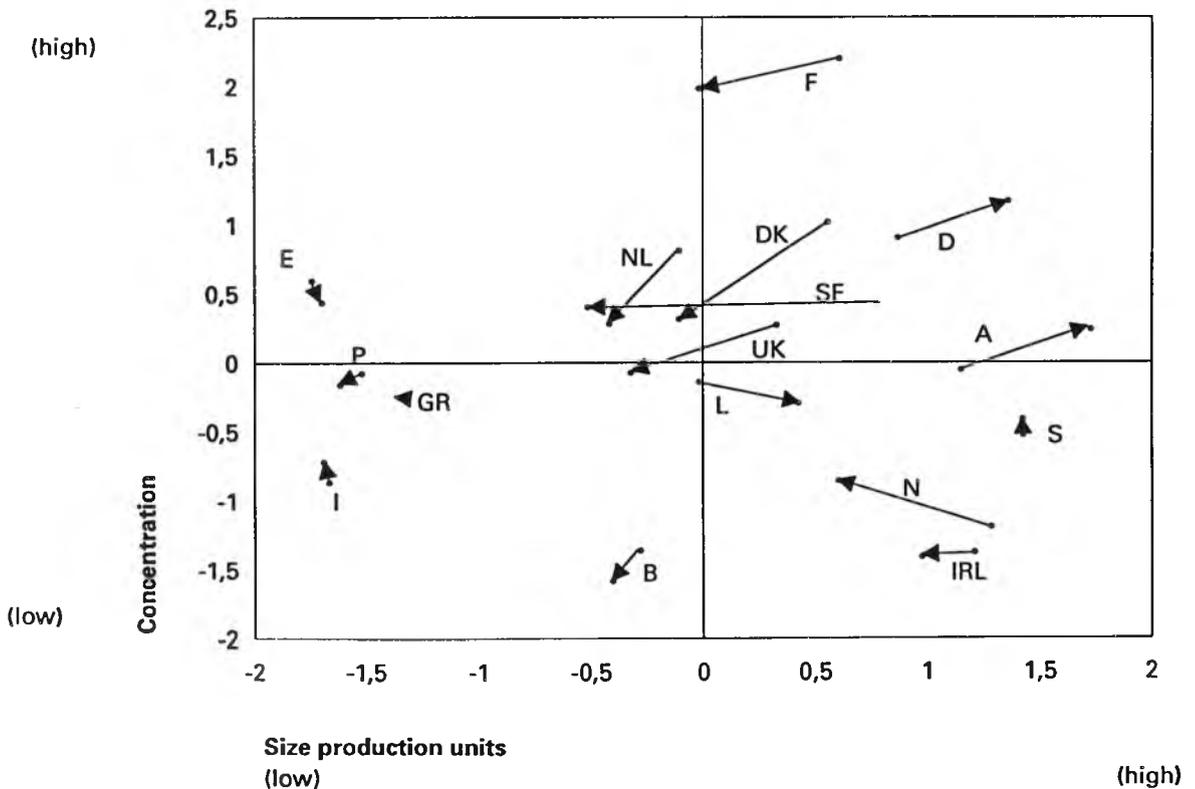
Business dynamics are concerned with the intensity of business entry and exit activity and are largely determined by two factors: the average size of production units in the market and the degree of concentration. In general it can be stated that the EU-12 is converging in this area, which is explained by converging tendency on the concentration dimension; furthermore the EFTA-4 countries are approaching the EU-12 in this respect.

On the average size of units dimension the EU-12 countries are diverging.

In general, most countries are moving towards a smaller size of production.

	EUR-16	EU-12	EFTA-4
Size production units	divergence	divergence	..
Concentration	convergence	convergence	approaching
Total	convergence	convergence	approaching

Figure 17.23 Business dynamics, country plot

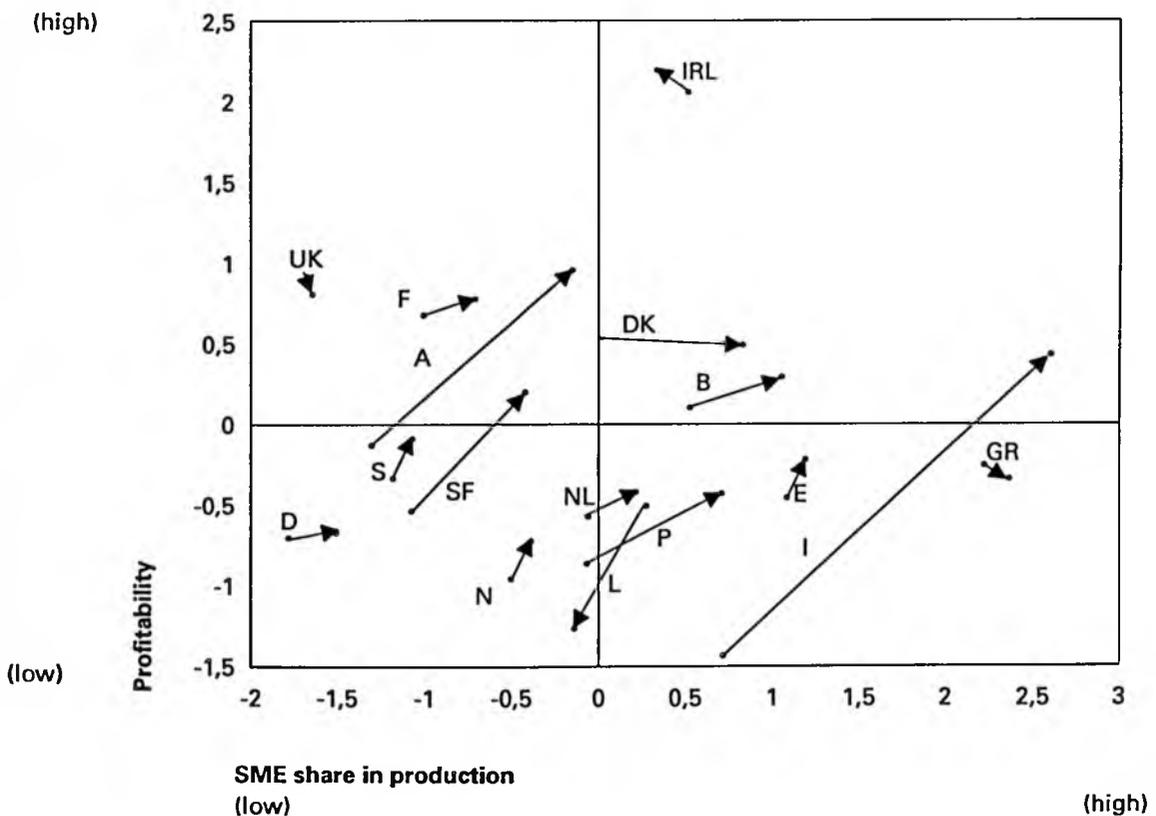


10 SME performance (business goals)

SME-performance is improving substantially from an entrepreneurs point of view: profits are rising steeply and the share of value added in the total economy is growing. These developments are, however, unevenly spread. SMEs share of the total economy shows some divergence in the EU-12, mainly due to some extraordinary behaviour by Italian SMEs; in the meantime, the EFTA-4 countries are approaching the centre of gravity of the EU-12. Regarding profitability, some overall convergence can be detected.

	EUR-16	EU-12	EFTA-4
Share in production	divergence	divergence	approaching
Profitability	convergence	convergence	approaching
Total	divergence	divergence	approaching

Figure 17.24 SME performance (business goals), country plot

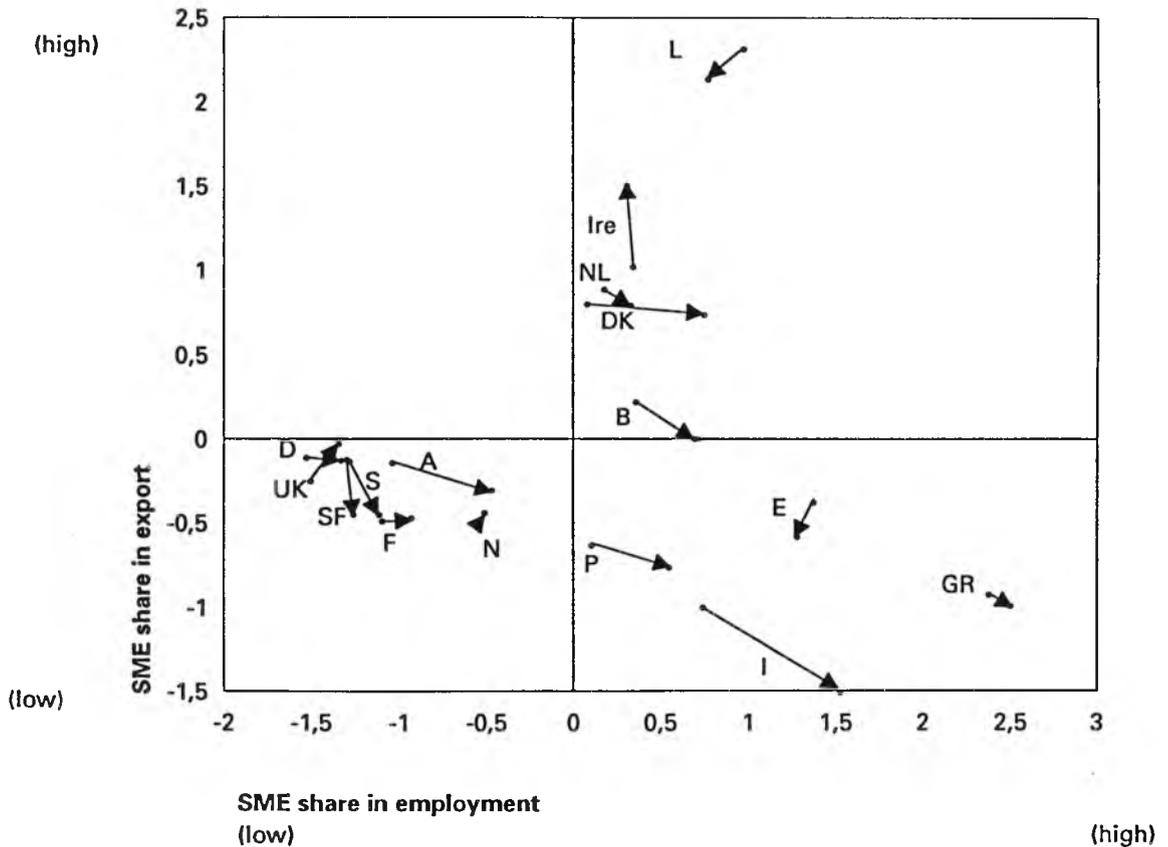


11 SME-performance (societal goals)

SMEs employment and export performances are also improving. The plot shows that the EU-12 is diverging somewhat on both these dimensions, again this is mainly due to the deviant performance of the Italian SME-sector. The EFTA-4 countries are approaching the EU-12.

	EUR-16	EU-12	EFTA-4
Share in employment	divergence	divergence	approaching
Share in exports	divergence	divergence	approaching
Total	divergence	divergence	approaching

Figure 17.25 SME performance (societal goals), country plot



Appendix 3 Variables list and convergence analysis at variable level

Domain / indicator	Convergence / divergence* (- = neither significant convergence, nor significant divergence)
Fiscal and monetary policy	
Indirect taxes (% GDP)	Convergence
Direct taxes (% GDP)	Convergence
Social contributions (% GDP)	-
Real short interest rate	-
Liquidity ratio	-
Government consumption expenditure	Convergence
Government investment expenditure	Convergence
Government social transfers expenditure	-
Government R&D expenditure	-
SME tax facility policy	-
SME financing policy	Convergence
SME R&D stimulation policy	Convergence
SME subcontracting policy	Convergence
SME export stimulation policy	Convergence
Labour market policy	
Replacement ratios	Convergence
Public expenditure labour market office (% GDP)	-
Public expenditure labour market training (% GDP)	Divergence
Public expenditure active labour market policies (% GDP)	Divergence
Public expenditure passive labour market policies (% GDP)	-
Participation active labour market measures (% labour force)	-
Participation in training	-
SME employment/labour market policy	-
SME training policy	-
SME start-ups policy	Convergence

* For the methodology regarding the analysis of convergence and divergence at variable level, see the Second Annual Report.

Domain / indicator	Convergence / divergence (- = neither significant convergence, nor significant divergence)
Burdens on business	
Corporation tax rate	-
Gap corporation tax rate/income tax rate	-
Minimum capital limited liability company	-
Administrative simplification strategies	-
Business licensing	-
Level administrative burden	-
Technology and innovation	
Gross expenditure R&D per capita	-
Gross expenditure R&D as % GDP	Convergence
Gross civil expenditure R&D	Convergence
R&D personnel per 1,000 labour force	Convergence
R&D scientists and engineers per 1,000 labour force	-
Gross expenditure R&D financed by industry	-
Gross expenditure R&D financed by government	Convergence
Business enterprise expenditure R&D as % GDP	Convergence
Higher education expenditure on R&D as % GDP	Convergence
Non-resident/resident patent applications	-
% Gross expenditure R&D performed by private business	-
Technology balance of payments: coverage ratio	Convergence
Capital and finance	
Inflation	Convergence
Share prices	-
Gross fixed capital formation	-
Venture capital	Convergence
Leasing	Convergence
Factoring	-
Payment periods	-
Capital income share	Convergence
Rate of return	-

Domain / indicator	Convergence / divergence (- = neither significant convergence, nor significant divergence)
Labour market	
Long term unemployment	Convergence
Share white collar workers	Convergence
Share of migrants	Divergence
Part-time employment	-
Employment rate	Convergence
Unemployment rate	-
Compensation per employee	-
Share of service in employment	Convergence
Wage share	-
Monthly outflow unemployment	-
Monthly inflow unemployment	-
Educational level labour force	-
Economic strength	
GDP per capita	Convergence
Consumption/GDP	-
Share GDP 16 countries	-
Export (% of GDP)	Convergence
Import (% of GDP)	Convergence
Trade balance	Convergence
Competitive position	Convergence
Foreign direct investment	-
Public procurement	-
Industrial relations	
Youth unemployment	Convergence
Trade union density	-
Bargaining coverage rate	-
Level of wage bargaining	-
ILO conventions ratified	-
Index of labour standards	-

Domain / indicator	Convergence / divergence (- = neither significant convergence, nor significant divergence)
Business dynamics	
Legal form enterprise	-
Producer services level	-
Share of micro enterprise	-
Average enterprise size	-
New entrepreneurship rate	Convergence
Acquisitions	-
Success factors start ups	-
Obstacles start ups	-
Survival rate	-
SME-performance	
Gross operating surplus as % of value added (micro)	-
Gross operating surplus as % of value added (SME)	Convergence
Share of value added (micro)	Divergence
Share of value added (SME)	-
Share of turnover (micro)	-
Share of turnover (SME)	-
Share of employment (micro)	-
Share of employment (SME)	-
Share of export (micro)	-
Share of export (SME)	-
Share of export in value added (micro)	Convergence
Share of export in value added (SME)	-

Source: Eurostat, OECD, elaborated by EIM Small Business Research and Consultancy.

18 POLICY ISSUES

Co-ordinated by EIM Small Business Research and Consultancy

18.1 INTRODUCTION

In this Third Annual Report of the European Observatory for SMEs, the performance of SMEs and craft trades were analysed more in depth in relation to the development of the business environment. The business environment covers: infrastructure, labour markets, the availability of technological knowledge, the regulatory and legal framework and capital markets. The business environment also comprises the functioning of markets, their inputs (e.g. labour and capital) and outputs (goods and services). The functioning of markets or the intensity of competition will be focused on explicitly in this review of policy issues.

This analysis of policy issues is placed in the general context of the Europeanisation of both the business sector and the business environment. This Europeanisation has been strongly induced by EC policy established at the end of the eighties with the elimination of non-tariff trade barriers. The European integration process emerging in the European Union has influenced the business sector directly and indirectly through the business environment and the functioning of markets. Important incentives for lowering the direct costs of production and for the functioning of markets came through the reduction of costs of international trade and the opening up of markets. This was accomplished by a free movement of persons, goods and capital, regulations on public procurements, etc.

The business environment has also been influenced by EUR-16 policy which has focused on improvements to basic business environment factors for both SMEs and LSEs, such as supporting R&D, providing information and counselling, and making the European capital market more transparent.

The performance of SMEs is determined by the developments of the business environment and functioning of markets (or competition in markets), both of which have been influenced by the European integration process. Concerning the relationship between the performance of SMEs and the functioning of markets the following can be said: markets with low entry barriers (that may be low capital intensity, a low regulation density, and/or a high competition rate) provide ample opportunities for starting SMEs, while markets with high entry barriers tend to provide privileged circumstances for existing firms.

Although more research is required to fully understand these relationships, some aspects of the functioning of markets will be discussed in section 18.2.

The European integration process has affected both the functioning of markets and the business environment, and consequently the way in which SMEs have performed. It should, however, be stressed, that the business sector anticipated the European unification process in a boom period, which was immediately followed by a 'recessionary' period at exactly the time that business was expecting to benefit from this process. However, 1994 could be seen as the first year of the recovery of the business cycle, and recovery influences SMEs differently from large scale enterprises. Although the recovery benefits both SMEs and LSEs, employment creation has notably picked up most rapidly in larger firms.

In the previous reports much attention was devoted to policy recommendations aimed at stimulating the growth of SMEs and craft trades, and the creation of jobs. In this report more emphasis will be put on policy issues that refer to the basic relationships between the SME performance, the functioning of markets, and the business environment in a more unified Europe.

These policy issues refer principally to the European level of policy making and can be seen as a contribution for policy making in the framework of the Integrated Programme in favour of SMEs and the Craft Sector which aims to provide 'a set of Community measures into a concerted approach to match activities conducted at the micro economic level with the macro economic policies of the White Paper'. However, these issues may be useful for national and regional policy approaches as well, so that different national circumstances and the local needs of SMEs can be taken into account.

18.2 FUNCTIONING OF MARKETS

Competition in markets seems to differ widely by sector and by country as can be learned from entry, exit, and survival rates, discussed in the chapter on Business Dynamics. In the labour market, factors influencing competition can be identified as of relevance to SMEs. These differences in competition, or the functioning of markets, both affect, and are affected by, the position of SMEs. The precise role of SMEs itself varies by country and by industrial sector.

Eliminating the non-tariff trade barriers within the European Union in recent years has focused on the stimulation of competition within Europe, reducing costs of production in order to improve the competitiveness of European business in global markets, and to enable them to act more internationally. The markets have become more internationalised, at least Europeanised, and, in spite of the negative impacts on the SME sector by, for example, the harmonisation of norms and standards, the small business sector has benefited from these developments. They have increased their share of exports rapidly, and have been affected by this internationalisation through more competition in their home markets.

This internationalisation of business, provoked by the European integration policy, consequently requires new policies in respect to the functioning of these more Europeanised markets. In the past, market or competition policy was principally a national issue, but with the increasing internationalisation a more internationally oriented market or competition policy is required. A well balanced approach between national and supranational policies is needed that will enhance the competitiveness of the SME sector in the broadest sense.

The process of cross border trade deregulation has been followed by a strong tendency to deregulate markets more thoroughly, both at national level, and at European level.

This deregulation policy, that aims to remove rigidities in business operations, is primarily focused on the better functioning of markets. This leads to an immediate reduction in the administrative costs on firms, in particular SMEs. However the ultimate aim is to create more competition in local, national, and international markets, and to thus create a more efficient enterprise sector. This should lead to a stronger competitive edge in European business within world markets, and consequently to more opportunities to create jobs.

The functioning of markets depends on both government regulations and the actions of the business sector. Government regulations directly or indirectly influence production costs and, consequently, the prices of goods and services (e.g. environmental levies), they also dictate the conditions under which markets have to function (e.g. dismissal procedures/business licensing). In addition, the business sector has also organised itself in such a way that competition has been reduced at the local, national or European market levels, by the use of strategies which are intended to strengthen the competitive positions of individual companies in world markets. Co-operation between firms, mergers, and take-overs, that lead to concentration in certain sectors have been a strategy of both small and large enterprises.

Sometimes this co-operation takes place at the project level, but the whole range of business activities (e.g. franchise chains) may also be involved. These concentration tendencies take place not only within countries but also across borders. This phenomenon of concentration is a dynamic concept, leading to reactions in the markets by other players that further influence the level of concentration. This raises difficulties in the timing of appropriate policy interventions that are intended to influence competition, both at a national and European level. Causes of these concentration tendencies leading to reduction of competition can be found in competition-reducing strategies of individual firms, changes in the business climate (e.g. an increase of labour costs, the increasing capital intensity of R&D activities), but also include the co-operation stimulating policy measures from national and European governments. These co-operation policies are geared to the creation of larger entities by focusing on raising efficiency through reaping the full benefits of economies of scale and to improve the competitive position in (global) markets. Such concentration processes may, however, distort the functioning of markets by hampering new firms to enter the market, at least on local, regional, and national scale, where small business mainly operate. On the other hand, co-operation between small businesses can frequently be the only response that small firms have to the increasing dominance of larger companies, as it allows them to become more competitive and to provide a counter-balancing power in the market. Contractual relations which structure and reinforce the co-operation between small firms, and also between small and large firms, should be considered when redesigning international competition policies. It should for example be questioned whether the same exemptions from competition rules should apply for these, as exist for franchising systems.

A well balanced strategy for the design of policies in the area of deregulation and competition policy should be pled for. In policy to be developed the role that SMEs play in increasing competition should be taken into account. New and viable SMEs are not only an indicator of the intensity of competition in markets, but also, and more importantly, of the renewal of trades through more competition. Conflicting features of the deregulation policies which lead to reduced entry barriers on one hand but also to business strategies geared to the formation of larger entities on the other, should be well considered within the aim of having markets function optimally. Policy changes should be stimulated to lower the artificial entry barriers imposed by governments in an attempt to protect existing firms rather than to optimise the functioning of markets. Moreover, policies should be designed for new firms and existing firms which enable them to become viable and achieve sustainable growth. With respect to this, special attention should be paid to bankruptcies and closures of small firms due to, for example, problems with the transfer of enterprises. This leads to a loss of capital and jobs, and also to a reduction of compe-

tition. For example fiscal arrangements should be made to ease the transfer (or succession of ownership) of firms.

Instruments for competition policies, optimising the functioning of markets with the ultimate objective of creating higher wealth, should be found in the domain of fiscal, legal and legislative framework. Furthermore the way companies are developing competition-reducing strategies as well as in the business environment leading to distortion of markets, should be focused on. The position of the small business sector should be considered given the strength of SMEs as stimulators of competition and as job creators.

18.3 BUSINESS ENVIRONMENT

In the previous reports of the Observatory, several policy instruments to influence the business environment have been discussed. In particular those that relate to the creation of a viable and healthy small and medium-sized enterprises and craft sector enabling growth and job creation, have been discussed.

In this report attention has been paid to the question if a converging business environment between countries and/or regions as found in the convergence analysis is contributing to a better European business performance, or, whether a certain diversity in local, regional and national business environments is better for stimulating competition between firms. If firms are considered to be entities rooted in their local, or regional, environment, their competitive strength is the result of both a combination of production factors assembled by the firm (its business operations) and the conditions under which they operate (the business environment). It is this mix that determines performance, in terms of output growth and job creation. Policies influencing either the business operations, or the business environment, should be well balanced. For example a labour policy which leads to a certain wage system that is not in balance with the available technological knowledge, the skills or educational level of the labour force, will easily lead to unbalanced price setting which might have a damaging effect on the competitive position if the introduced technology is not capable of offsetting the wage increase in increased labour productivity.

It is with respect to this that policies for the SME sector should have a strong orientation to the direct environment or action radius of the SMEs. As the action radius is widening, at least for a certain category of SMEs (see chapter 5 on Export and Internationalisation), this calls for policy approaches geared to a spatially wider environment than before.

Careful attention should also be paid to current policies developed at the national, regional or local level that do not take account of this well balanced mix, which lead to distortions in the markets, either in the national context or on the EUR-16 level.

Some additional aspects of the business environment will now be discussed drawing on the findings of the issues addressed in the chapters of this report.

Legal framework

More policy attention should in particular be devoted to the legal framework in which SMEs operate, the availability and use of modern infrastructure, the administrative burdens, the availability of producer services, and the supply of management and entrepreneurial training.

The business environment should provide opportunities for SMEs to start, survive, and to expand (rapidly), allowing the business sector to create more employment.

Certain distortions in competition are arising through differences in the legal forms that are applied in Member States. These include differences in the tax burdens and differences in entry barriers. The same holds for the results of the analysis of norms and standards, and quality insurance; it can be questioned whether these are really aiming at protecting consumers or clients by improving product quality or whether it is a 'new form' for protectionism. However it should be realised that consumer behaviour dominates market economies and that consumer policies challenge entrepreneurs to become creative and innovative.

Attention should be paid to the way the SME sector, operating and competing in an ever broader spatial environment, is influenced by these legal aspects. The differences in the legal forms of business need to be examined in order to identify factors that disturb competition. In addition the further development of legal forms should be stimulated for internationally operating businesses, such as the EEIGs, the European Co-operative Society, and other legal forms that facilitate international co-operation but which are also a potential factor for concentration and, consequently, a reduction in competition.

Infrastructure

Concerning the infrastructure available in the EUR-16 new openings should be created for the utilisation of new technological possibilities and for the internationalisation of the business sector which has been induced by the European integration process. This is of special interest to the new Member States of the EUR-16 and to the more peripheral countries. SMEs located in these areas have, by definition, less access to market demand, resulting from income and production agglomerations in the core regions of Europe. Cross border trade must also be stimulated by improving infrastructure throughout the enlarged Union.

This infrastructural development should comprise of not only the traditional system of roads, railways, and waterways, but also the more modern systems of telecommunications and the information technology infrastructures.

These essential internationally oriented improvements should be combined with easy business access to the main infrastructures at the local and regional level. As SMEs are scattered across the regions and comprise an ever larger part of the business sector in many peripheral areas, special attention in physical planning and infrastructure policy should be devoted to SMEs and their needs, so as to enable them to play their role in the more open and spatially larger Europe. Here a plea should be made for the assessment of the expected impact of specific infrastructure on SMEs before they are introduced.

The small business sector needs these infrastructures but does not use them sufficiently; therefore better access and the more effective use of modern infrastructure should be encouraged.

One aspect of the debate on modern telecommunication and information infrastructures is the opportunities and challenges to new firms. In general, in the telecommunications sector privatisation is being encouraged, which should not only comprise the privatisation of the large formerly state-owned enterprises, but also an anti-monopolistic policy to give opportunities to new entrepreneurs.

Administrative burdens

Another issue that has already received some attention concerns the unnecessary administrative procedures on business. In many countries initiatives have been taken to control these. Different strategies can be found across Europe, leading to different outcomes regarding the size of these burdens on SMEs. These burdens can be either financial, or psychological, or both. As the analysis showed, SMEs have received specific attention in national policies in only a few countries, while research in this area shows that burdens on the SMEs and in particular on the micro enterprises are disproportionately high. A special policy trajectory should be developed to focus on this issue and to develop appropriate strategies for reducing the impact of administrative procedures on enterprises, and in particular the micro, small and medium-sized businesses. More concerted action should be taken through the exchange of experiences gained in the Member States. According to the analysis special attention at the national level seems to be required on VAT/excise duties, corporation tax, annual accounts, wage taxes, and social premiums. At the EUR-16 level burdens that need special attention also include the VAT/excise duty system, and the import/export procedures. These areas have already been subject to some improvement through the process of European integration, but burdens are still felt by SMEs.

Instruments to improve the situation can be reached by developing an objective and comparable Administrative Burden Indicator as discussed in the preceding Observatory report. Such an indicator could be used as a target for policy makers in the design of their policies, just as the major economic indicators are used in the development of monetary and fiscal policies like budget deficit and tax and social premium rates.

The use of new technologies such as EDI, and considering the use of relatively new organisational concepts for the collection of social premiums for example should be stimulated to combat the burden of administrative procedures.

Another way of controlling this phenomenon is to evaluate present laws and regulations systematically, and/or to assess *ex ante* new laws and regulations for their administrative consequences. As mentioned previously the deregulation policies have a direct impact on these administrative burdens.

Producer services

SMEs are involved in highly competitive business environments for which the use of producer services is a crucial competitive factor: they promote access to technological, management and marketing information. The demand for services by SMEs remains

relatively low. Small firms are characterised by the internal provision of services, and seem not to be benefiting from the specialist knowledge found in the producer services sector. Apart from the low formal competence of managers and entrepreneurs, which is behind the low use of producer services, there are also regional disparities on the supply side. Services are highly concentrated in central urban regions; so SMEs located in more peripheral areas are faced with a low availability of adequate producer services, business confidence in which can only be gained through personal contact. Improving the business environment for SMEs should be approached by increasing the availability and use of producer services. The few policy instruments already applied in some Member States can be used to gain a fuller understanding of this.

Education system

To further improve the business environment for SMEs, education-systems should be better geared to the stated needs of entrepreneurs in the near future. It should be recognised that education systems tend to lag behind real business activities, and trainees may already be behind business practice on completion of their course. Therefore apart from the formal educational systems, the business sector itself should be activated to develop adequate training facilities to keep both entrepreneurs and employees up to date to new business developments. Education is too theoretical, it is not sufficiently multidisciplinary and too little emphasis is put on the development of personal skills. The education system is therefore not developing adequate opportunities for cultivating an entrepreneurial spirit.

In education attention is concentrated on large institutions and on the wage earning culture, which together with a lack of familiarity with entrepreneurship and SMEs amongst teaching staff leads to an inadequate appreciation of small firm issues. Consequently, entrepreneurs have to supplement their education with a broad range of informal and formal learning after completing their formal education. In response to this it should be envisaged to establish the Academy, as suggested by the participants and adopted by the Commission during the 'Conferences for Craft and Small Enterprises' in Avignon (1990) and Berlin (1994), at to assign the role to it of accreditation of national training institutes for entrepreneurs and employees in order to upgrade the quality of these training institutions. It goes without saying that a special policy trajectory should be started to make the education system at all levels more appropriate to business life and to open up the development of entrepreneurship aspirations. This will create entrepreneurs who are better educated, and who, as the analysis in Chapter 12 showed, will have a greater feeling for developments in the business environment and the market and are more growth-oriented.

ANNEXES

ANNEX I ABOUT THE OBSERVATORY REPORT

European Union policy to stimulate the business environment and to promote small and medium-sized enterprises (SMEs) in the non-primary sector has increased the demand for research and detailed information on this sector within Europe. In particular, comparative analysis across all Member States is now required. Until the beginning of 1992, however, research on SMEs and the craft trades was conducted in the Member States in an uncoordinated way by research institutes, trade organisations, and universities, and moreover, the scope and extent of SME research differed between Member States. As a result a structured overview of the European SME sector, in both quantitative and qualitative terms, was not available.

The singular importance attached to SMEs and the craft trades by the European Union is based on sound economic and social reasoning. SMEs and craft enterprises are generally important providers of new jobs, particularly in construction, the distributive trades, and other service sectors.

SMEs also seem to be more responsive to market needs, more adaptable to change, and more innovative in their ability to meet customer demands than LSEs. The role of SMEs and craft enterprises in providing indigenous subcontracting facilities to larger high-technology enterprises competing in world markets is particularly significant. Therefore, SMEs and the craft trades play a critical role in the competitive base of the European Union relative to the other major trading areas in the industrialised and industrialising world.

For these reasons the Directorate-General XXIII (Enterprise Policy, Distributive Trades, Tourism and Co-operatives) of the Commission of the European Communities decided in 1992 to establish a European Observatory for SMEs which would present an independent report each year. The First Annual Report of the European Observatory was published in May 1993, the Second was published in April 1994. The present volume is the Third Annual Report.

Each annual report provides an *overview of the state of affairs and perspectives* on several SME-fields, as well as on the sector in general. The overview contains both quantitative and qualitative information on SMEs and the craft trades. Emphasis is placed on the identification of bottlenecks and opportunities in order to discuss issues relevant to policy makers.

However, there are also other important topics which deserve more attention than can be given within the overview, and with this in mind each annual report contains at least one *'theme study'* on a subject of particular relevance to SMEs: either on a particular sector or a specific aspect of SME activity. In the First Report the theme study was the Internationalisation of SMEs, in the Second Report it was the Craft Trades, and in the present volume two theme studies are included: a study of Administrative Burdens, and a study on the Producer Services sector.

Members of the Reference Group

AIP, Associação Industrial Portuguesa, Portugal
APCM, Assemblée Permanente des Chambres de Métiers, France
CCACC, Comité de Coordination des Associations de Coopératives de la CE
CECD/FEWITA/Eurocommerce, Confédération Européenne du Commerce de Détail/
Federation of European Wholesale and Trade Associations
CECOP, Comité Européen des Coopératives de Production et de Travail Associé
CEDI, Confédération Européenne des Indépendants
CEPYME, Confederación Española de la Pequeña y Mediana Empresa, Spain
CGPME, Confédération Générale des Petites et Moyennes Entreprises, France
CGPMEAC, Confédération Générale des Petits et Moyens Entrepreneurs, Artisans et
Commerçants de Grèce, Greece
Chambre de Métiers, Luxembourg
CNA, Confederazione Nazionale Artigianato, Italy
CNAMS, Confédération Nationale de l'Artisanat, des Métiers et des Services, France
CONFARTIGIANATO, Confederazione Generale Italiana dell'Artigianato, Italy
CONFINDUSTRIA, Comitato Nazionale per la Piccola Industria della Confindustria, Italy
EMSU, European Medium and Small Business Union
ETUC, Confédération Européenne des Syndicats/ETUC
EUMC, The European Union of Small and Medium-sized Companies
EUROCHAMBRES, Association of European Chambers of Commerce and Industry
(observer)
EUROGROUP, European Group for Small Business and Craft
European Commission, Directorate-General XXIII (observer)
EUROPMI, European Committee for Small and Medium-sized Independent Companies
EVCA, Europe's Venture Capital Association
FABRIMETAL, Belgium
Federation of Master Builders, the United Kingdom
Fédération des Artisans, Luxembourg
FPB, The Forum of Private Business, the United Kingdom
Håndværksrådet, Danish Federation of Small and Medium-Sized Enterprises, Denmark
Koninklijke Vereniging MKB Nederland, the Netherlands
NCMV, Nationaal Christelijk Middenstandsverbond, Belgium

OECD, Organisation for Economic Co-operation and Development, Paris
SEPLIS, European Secretariat for the Liberal Professions, Belgium
SFA, Small Firms Association, Ireland
SME-Intergroup of the European Parliament
UCM, Union Syndicale des Classes Moyennes de Belgique, Belgium
UEAPME, European Association of Craft, Small and Medium-sized Enterprises
UNICE, Union of Industrial and Employers' Confederations of Europe
UN/ECE, United Nations/Economic Commission for Europe, Geneva
YES, Young Entrepreneurs for Europe
ZDH, Zentralverband des Deutschen Handwerks, Germany

ANNEX II NEW PARTNERS

Co-ordinated by EIM Small Business Research and Consultancy

1 INTRODUCTION

As mentioned in the Introduction to this Third Annual Report, this document provides information on 16 countries: the twelve 'existing' Member States of the European Union, the three new Member States: Austria, Finland, and Sweden, and an additional country: Norway. Officially the project has been commissioned by Directorate-General XXIII of the European Commission for 12 Member States, but during 1994 it was decided - in consultation with DG XXIII - to include the possible new Member States as well. Thanks to the willingness and co-operation of national authorities in these four countries it has been possible to prepare a 16-country report. The authorities concerned are:

- Austria: Federal Ministry of Economic Affairs
- Finland: Ministry of Trade and Industry
- Norway: Norwegian Research Council
- Sweden: Swedish National Board for Industrial and Technical Development (NUTEK)

Although Norway did not join the European Union, it is nevertheless included in this report as it continues to participate in other DG XXIII activities, particularly through the framework of the European Economic Area.

Apart from the information on the 4 'new' countries presented in the different chapters of this Report, it was thought useful to present some additional information in this Annex. The aim of this Annex is:

1. To cover the information already published in the First and Second Annual Reports on the '12' (section 2 and 4).
2. To present some additional - qualitative and quantitative - information to enable the reader to become better acquainted with the economies of these 'new' countries (section 3).

The information presented in this Annex has largely been prepared by the four new partners in the European Network for SME Research:

Austria: Institut für Gewerbe- und Handwerksforschung, Vienna

Finland: Institute for European Studies, Turku School of Economics and Business Administration, Turku

Norway: Agder Research Foundation, Kristiansand

Sweden: Swedish National Board for Industrial and Technical Development (NUTEK), Stockholm

Special attention should be given to the notes in the text boxes of this Annex, as some of the information presented in section 3 is not comparable with that in other parts of the Annex, and the rest of the report. This is due to the use of data derived from national sources instead of harmonised international data sources.

2 GENERAL INFORMATION

It should be stressed that - wherever possible - this report has made use of data provided by Eurostat in its publication 'Enterprises in Europe'. Eurostat data is the **only source of harmonised data on enterprises by size class** in the 16 countries included in this Report. As far as Eurostat-data are not fully comparable between countries (especially as a result of gaps in these data) additional estimates have been made by EIM. For further details on these estimates, see Appendix 1 to Chapter 1. This means that data used in the report may differ from that commonly used in the individual countries. In some cases the differences are considerable. Discrepancies may stem from differences in the definition of enterprises, the way enterprises are registered and the treatment of establishments.

The harmonised approach has the considerable advantage of providing comparable data between countries but the disadvantage that national experts may not always recognise the data as it applies their country.

Tables 1 and 2 present some basic data on the EFTA-4 and EU-12 countries: a first quantitative assessments of the differences between the EU-12 and the EFTA-4 (see also Table 2.11 of the Second Annual Report).

The whole area covered by the EFTA-4 countries is about half the area covered by the 12 EU countries, but is about seven times less populated: the population density per sq. km is 21 for the EFTA-4 countries and 139 for the EU-12.

Table 1 Basic data EFTA-4 and EU-12, 1990

Country	Population (x 1,000)	Inhabitants per sq. km	Area (1000 sq. km)
Austria	7,718	92	84
Finland	4,986	15	338
Norway	4,241	13	324
Sweden	8,559	19	450
EFTA-4	25,504	21	1,196
EU-12	327,612	139	2,364

Source: Economic Survey OECD.

According to Table 2, GDP per capita in the EFTA-4 countries, except for Finland, is higher than in the EU-12. The level of direct and indirect taxes as a percentage of GDP is higher than the EU-12 average in all the EFTA-4 countries.

The percentage of export as percentage of GDP in Austria and Norway is remarkable high compared to the EU-12-average, although much more than in Belgium, Ireland, Luxembourg and the Netherlands.

Labour force participation and the employment rate are much higher than in the EU-12.

Table 2 Macro economic indicators, various years

Macro economic indicators	Austria	Finland	Norway	Sweden	EU-12
GDP, billion ECU, current prices, 1993	154.9	70.5	88.1	159.0	5317.9
GDP per capita, thousand* ECU, current prices, 1993	19.6	14.0	20.6	18.4	15.4
Employment rate, 1993	66.9	60.2	72.2	73.6	58.7
Labour force participation, 1993	69.9	73.3	76.8	79.2	66.2
Imports % GDP, 1992	38.3	25.6	35.9	26.2	37.4
Export % GDP, 1992	39.6	27.0	43.2	27.9	33.1
Direct taxes % GDP, 1992	14.5	17.3	17.5	20.4	13.9
Indirect taxes % GDP, 1992	15.9	15.1	16.8	16.3	13.8
Inflation, 1994 *	3.0	1.7	1.5	3.1	3.0

* Private consumption deflators.
Source: OECD.

3 THE POSITION OF SMEs IN THE NEW COUNTRIES

3.1 Comparable data about SMEs in the 4 countries

With regard to the business, the non-primary private enterprise sector in the EFTA-4 countries is - according to Eurostat data - more oriented towards large scale enterprise than in the EU-12 countries. The size-class structure of employment in the EFTA-4 countries is quite different from the average of EU-12. Nevertheless, SMEs presence in Austria and Norway more closely resembles the EU average than the other countries. In the EFTA-4 countries 34% of the employment is in large scale enterprises while in the EU-12 countries this is only 28% (see Table 3). This difference is confirmed by the higher average firm size which is 12 in the EFTA-4, and 6 in the EU-12. This means that on average enterprises in the EFTA-4 countries are twice as large the enterprises in the EU-12. The EFTA-4 countries reflect the pattern as the large countries (France, Germany, Italy, the United Kingdom) in the EU as indicated in the First Annual Report of the Observatory¹ (see also Table 2.8 of the Second Annual Report).

¹ Large countries present on average 68% of SME, 32% of large enterprises and an average firm size of 6.6 employees.

Table 3 Enterprises by country, 1990

Country	Number of enterprises (1,000)	Enterprises per 1,000 inhabitants	Average enterprise size	Employment share (percentage)				
				0-9	10-99	100-499	0-499	>=500
Austria	182	24	12	23	29	19	71	29
Finland	114	23	12	17	25	17	59	41
Norway	125	30	10	20	31	20	71	29
Sweden	146	17	13	18	27	17	62	38
EFTA-4	566	22	12	19	28	18	66	34
EU-12	15,780	48	6	32	25	15	72	28

Source: Eurostat/EIM Small Business Research and Consultancy.

The percentage of micro enterprises in the EFTA-4 is 84% of all enterprises, while for the EU-12 it is 93%.

A higher labour productivity (value added per person employed) for both SMEs and large enterprises was found in EFTA-4 relative to the EU-12. The labour productivity for SMEs in EFTA-4 and EU-12 amount respectively to 36,000 and 30,000 ECU and for large enterprises to 44,000 and 40,000 ECU.

Table 4 shows the patterns of the composition of sales by sector in the EFTA-4 and the EU-12 countries. The sectoral composition of total sales does not differ too greatly between EFTA-4 and EU-12, except for the manufacturing sector (see also Table 6.4 in the First Annual Report).

Table 4 Percentage distribution of sales by sector, all size classes, 1990

Country	Energy/ Extraction	Manufac- ring	Construction	Trade	Other services	Total non- primary
Austria	8	30	6	37	19	100
Finland	5	32	5	30	27	100
Norway	3	20	9	35	33	100
Sweden	6	34	7	37	16	100
EFTA-4	6	30	7	35	22	100
EU-12	8	27	6	36	23	100

Source: Eurostat/EIM Small Business Research and Consultancy.

The data presented in the following section 3.2 are mainly derived from national sources, this means that they sometimes differ considerably from the Eurostat data presented in section 3.1 of this Annex as well as in other chapters of this Report.

3.2 SME characteristics in the four new countries

3.2.1 Austria

As in the EU-12, SMEs dominate the Austrian economy. More than 99% of all enterprises are SMEs. The average enterprise size is about 12 employees, which exceeds average size of enterprise in the EU-12. Compared with southern European countries especially, Austria has comparatively fewer micro enterprises (firms with less than 10 employees).

Total number of enterprises, and micro enterprises in particular, has increased in the period from 1988 to 1993. Since employment grew at a similar rate, average firm size has remained stable.

Entrepreneurship in Austria is a professional option that seems to be chosen with great care. This may be the reason why survival rates of new businesses in Austria slightly exceed survival rates in other countries. Developments in business law are characterised by a strong tendency towards liberalisation. For a growing number of trades, qualifying exams or master exams are no longer necessary; other forms of education or experience are now accepted as equivalents.

Nevertheless, the (dual) system of apprenticeships not only plays an important role in the education system but remains the most important source of skilled labour for the craft sector. It is also important for industry, retailing and tourism. Roughly half of all fifteen-year-olds choose a vocational apprenticeship after completing their compulsory schooling.

The sectoral structure of the Austrian economy is reflected in the organisation and institutional set-up of its economic chambers. Obligatory membership - in the economic chambers for entrepreneurs, and in other chambers for employees - guarantees that all partners are well represented in the social bargaining process. Chambers in Austria are also obliged by law to fulfil various public services. There are a wide variety of institutions such as advisory boards in which both sides of industry are represented and where the social bargaining process takes place.

Economic development during 1994 in Austria is characterised as showing a slow recovery after a moderate recession. Since the second half of 1992, small and medium-sized enterprises suffered from the economic downswing, which originated mainly in exports and industry as early as 1991. Enterprises and trades dependent on industrial development - for example subcontractors - were directly affected, while others - such as those in construction and services - were not hurt at all. Increasing unemployment, small pay increases, and a general feeling of uncertainty decreased consumers consumption.

Major tax reforms became effective in 1994. These simplified the tax system and reduced personal income taxes, although somewhat increasing capital gains and corporation tax rates. The recovery in 1994 was most evident in industrial manufacturing, construction and foreign trade; by contrast tourism and consumer-oriented sectors were still affected by slow private consumption of consumer goods. Private investment showed little upswing.

All sectors of the private economy in Austria, especially crafts, services, and tourism are dominated by SMEs, although large enterprises contribute sizeable proportions of total employment in industrial manufacturing and transport.

According to national sources, about 2 million people in Austria in 1993 were employed in private enterprises. SMEs employed more than 70% of all private non-primary employment.

Even the *industrial manufacturing* sector is dominated by SMEs. Total employment in industrial manufacturing has been decreasing steadily since the mid-1980s. Large enterprises cut back employment at three to four times the rate of SMEs.

According to national sources, in the late 1980s *crafts and services* became the economic sector with the most enterprises (36%) and the most employees (29%). Especially after 1988, the number of enterprises and employees increased considerably. Crafts alone contribute about 26% of all private enterprises and 22% of private employment. Large enterprises are almost non-existent in this sector.

Due to the heterogeneity of the sector, developments in the various branches differed considerably, as can be seen in the following graph.

While developments after World War II were mainly unfavourable for this sector, the situation changed in the 1980s. Not only consumer behaviour and new values, but also technical developments, began to favour SMEs, and the formation of new craft and service enterprises. New activities, for example business services such as consulting, developed rapidly, but even traditional trades such as construction, were able to adjust their services to new demands and thus to grow. Only in a few crafts have structural problems could not be overcome; these crafts include tailoring and shoe repair.

The increasing speed and complexity of technical developments, extending to production processes, new materials, new information systems affect manufacturing enterprises in particular. Access to external information sources, R&D networks, more co-operation, and the application of new technologies need to be publicly supported in order to assist modernisation and to reduce size related disadvantages of SME.

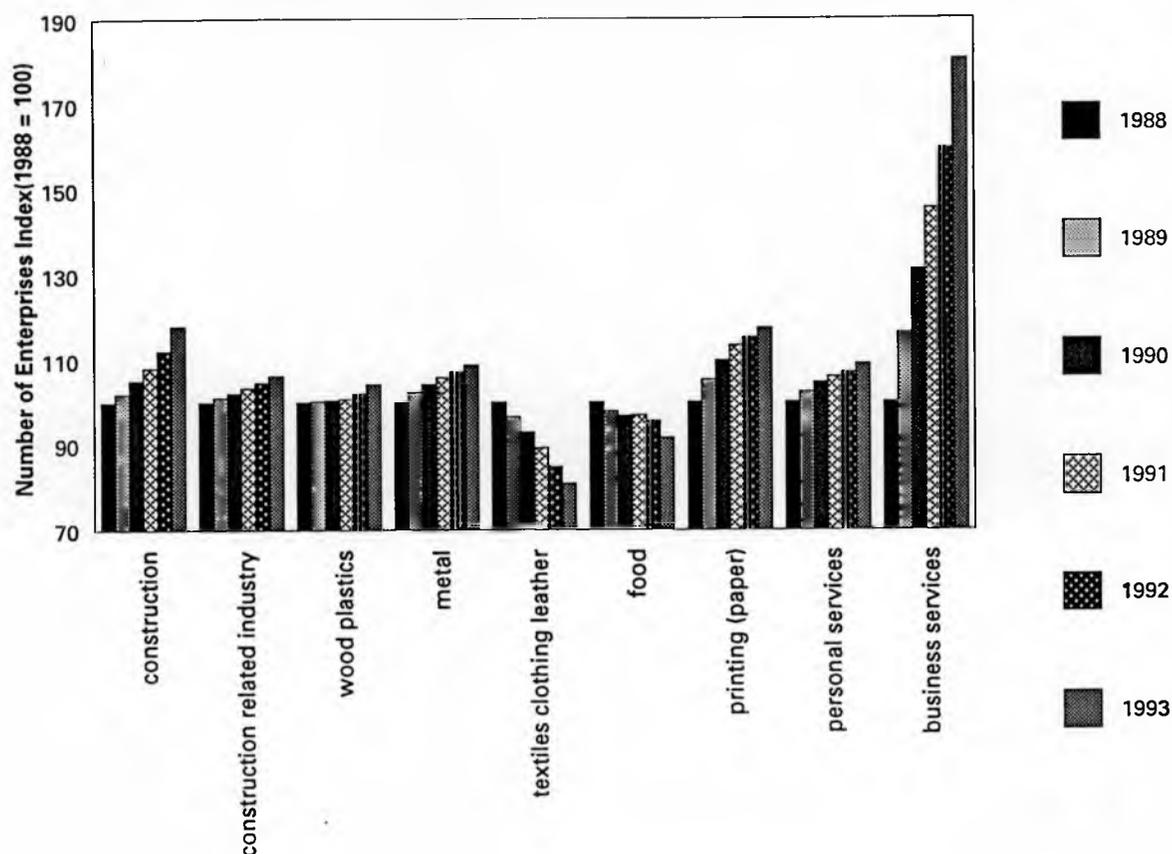
Retailing, a sector that has grown steadily since 1981, is dominated by micro enterprises - except for a few activities such as the retailing of food and electronics.

After crafts retailing is the most important source of vocational training through apprenticeships.

However, the development of the profit situation has not been satisfactory for most of the SMEs in retailing. According to national sources, in the last fifteen years the average trade margin has only increased from 27% to 31%. This was more than offset by an increase in costs. In general operating costs increased from 27% to 32% of turnover. While these are average figures, they suggest that many retailers achieved negative results.

Figure 1

Development of various sectors of crafts and services in Austria, 1988-1993



Source: IfG, 1995.

Table 5 Retail Trade in Austria, 1993

	EU average	minimum	maximum	Austria
Number retail stores	273,797	3,520	929,700	63,387
Share of retail from the total number of firms (%)	26.1	11.1	34.5	20.0
Share of the retail from the total number of employees (%)	10.0	7.4	12.9	9.8
Number of retail stores per 1,000 inhabitants	9.6	6.1	17.5	8.0
Number of employees per retail store	4.0	1.9	8.7	4.6
Turnover per retail store (ECU)	406,000	114,000	813,000	549,776
Turnover per employee (ECU)	100,000	44,000	150,000	120,953

Source: LP International 18, 1994. p.3, figures: Institute for trade, University of Economics Vienna.

Food retailing in Austria is characterised by a degree of concentration which is higher than in all other European countries. The top ten retailing companies accounted for a market share of 98% in 1993. However, small units still dominate the number of enterprises. According to a recent study, 96% of all Austrian food retail stores have less than 400 m² store space. Corresponding figures are 77% for Great Britain, 89% for France, 90% for Germany, and 97% for Italy. Despite the high degree of concentration, easy access for consumers is still guaranteed for the large number of small stores located in residential areas.

This phenomenon - at first apparently contradictory - can be partly explained by the fact that one square meter of store space serves only slightly more than 3 Austrian inhabitants. In Great Britain, Spain, and the Netherlands, considerably larger numbers are served per square meter of store space. This indicates an oversupply of store space in food retailing and, therefore, low productivity in Austria. Austrian food retailers generated a turnover of only ECU 4,200 per m² (1993); the corresponding figure for Great Britain was almost ECU 7,400.

Tourism contributes roughly 15% to the Austrian gross national product. While this may not seem large when compared with the GNP-share of manufacturing or trade, it is impressive when compared to the share of tourism in other countries. In Austria turnover per capita generated by international tourism amounted to ECU 1570,-. By comparison the figure for Switzerland was ECU 890, for Spain ECU 450, and for Europe ECU 330.

The average size of Austrian enterprises in this sector has increased from some 3 employees in 1983 to almost 4.5 employees in 1993. The increase in average size has been partly caused by the upgrading of services. Thus many enterprises developed from very small family enterprises to professionally managed modern enterprises. This development was accompanied by improvements in the infrastructure and by dynamic growth of tourism world-wide.

Austria in general, and Vienna, Graz, Salzburg, and Innsbruck in particular, benefited from a fast development of city tourism.

Average hotel capacity in Austria is about 35 beds. In Vienna this average increases to 112 beds (due to the 25% share of large 4-star and 5-star hotels). Three to five-star hotels have increased their share to about 70% of bednights sold. At the same time the number of beds in one and two-star hotels has decreased.

Austrian tourism had a difficult year in 1994. The slow economic recovery in Germany affected the number of international tourists in Austria, as a strong dependence on German tourism is a characteristic of the sector.

The strengths of Austrian tourism lie in the country's image as a place with a long tradition, a high cultural standing, especially in music, and an abundance of natural beauty and geographic variety. The relatively unspoiled environment, the flexibility of the entrepreneurs, and the well trained personnel are other success factors in the Austrian tourism industry. Austria enjoys an excellent image both as a winter resort and as a summer destination. This also explains why repeat-guests account for up to 74% of summer guests and 84% of winter guests.

According to national sources, about 7% of all private enterprises and about 9% of all employees in Austria's private economy belong to the *transport* sector. This relatively

large and steadily growing share corresponds to the situation in other European countries. More and more enterprises sub-contract transport to independent carriers, and increasing trade at the national and international levels has caused an increase in the demand for transport services.

Carrying and forwarding agents, transporters of merchandise, and transporters of persons will be especially affected by Austria's membership in the European Union. While the demand for some services - such as managing the paperwork and the formalities connected with imports and exports - will decrease as the internal market develops, a great number of new opportunities will open up. International competition, however, will also increase. The competitive position of Austrian enterprises is best characterised by, on average, having relatively high labour cost but also up-to-date equipment which conforms to Austria's strict environmental-protection laws. In particular, in comparison to East-European freight carriers, Austrian enterprises are handicapped by considerable costs which, in general, cannot be offset by a higher quality of service.

3.2.2 Finland

According to national sources, in 1991 there were approximately 123,500 enterprises in Finland, these employed about 1,232,500 persons.

Table 6 Main variables for the whole economy by employment size-class, 1991

	Total	0-9	10-19	20-99	100-199	200-499	> = 500
Definition	number	percentage					
Enterprise	123,475	88.5	5.8	4.5	0.6	0.4	0.2
Employment	1,232,545	19.4		17.7			37.2

Source: Enterprises in Europe, Statistics Finland.

It is important to note that the above table excludes roughly 90,000 enterprises which as of 1.6.1994 were not subject to value added tax. Therefore Statistics Finland has not officially registered these enterprises. These enterprises are mainly micro or small enterprises in the service sector.

Micro enterprises (0-9) accounted for 88.5% of the number of enterprises, 19.4% of employment and 16.5% of total turnover. The respective figures for small and medium-sized enterprises (10-499) are: 11.3% of number of enterprises and 43.4% of employment, and for large enterprises (500+): 0.2% of number of enterprises and 37.2% of employment.

During the last few years the importance of micro enterprises has increased slightly in employment and turnover. The opposite has occurred with respect to small and medium-sized enterprises, as their importance in terms of number of enterprises and turnover has declined over the last few years. The importance of large enterprises has remained about the same according to the number of enterprises, but their weight in employment and turnover has decreased.

Table 7 Number of persons employed (x 1,000) by sector and size-class in Finland, 1991

NACE sector	Employment						Total
	0-9	10-19	20-99	100-199	200-499	> + 500	
1 Energy and water	0.8	0.5	2.5	1.9	4.0	5.8	15.6
2 Chemical industry	3.1	1.6	6.9	n.a.	n.a.	n.a.	69.5
3 Metal manufacturing	15.7	8.4	26.2	13.9	21.7	59.0	144.9
4 Other manufacturing industry	23.0	n.a.	41.4	n.a.	n.a.	n.a.	235.0
5 Building and civil engineering	29.6	n.a.	28.6	n.a.	n.a.	n.a.	115.7
6 Distributive trades, horeca*	100.6	n.a.	56.6	n.a.	n.a.	n.a.	302.8
7 Transport, communication	15.5	6.0	14.7	7.8	12.0	79.1	135.0
8 Banking, financing, insurance	30.3	n.a.	30.8	n.a.	n.a.	n.a.	153.0
9 Other services	20.8	n.a.	10.3	n.a.	n.a.	n.a.	60.8
Total	239.4	n.a.	218.2	n.a.	n.a.	458.2	1,232.5

* Hotel and catering industry.

Source: Eurostat, Statistics Finland.

NACE 6 (Distributive trades and horeca) and NACE 9 (other services) are clearly micro enterprise dominated whereas NACE 3 (metal manufacturing) and NACE 7 (transport and communication) are dominated by large enterprises.

In 1991 industry represented 20,5% of all enterprises, 38% of all employment, and 40% of the total turnover.

Table 8 Weight of main sector in the whole Finnish economy, percentage, 1991

Sector	Share enterprises	Share employment	Share turnover
Industry	20	38	40
Construction	11	9	9
Distribution	43	25	43
Rest of services	26	28	9

Source: Enterprises in Europe, Statistics Finland.

The distribution sector accounted 43% of enterprises, 25% of employment and 43% of total turnover.

3.2.3 Norway

Table 9 Changes in employment structure in Norway by sector/kind of activity. Persons employed (numbers in 1,000)

Sector	1980		1993	
	Numbers	Percent	Numbers	Percent
Oil activities	6	0.3	18	0.9
Ocean transport and oil well drilling	41	2.1	36	1.8
Transport and communication	140	7.2	141	7.0
Construction	150	7.7	122	6.0
Agriculture, forestry, fishing	163	8.4	117	5.8
Private/Business services	258	13.2	337	16.6
Wholesale, retail trade, hotel & restaurants	327	16.8	330	16.3
Manufacturing industry, mining, electricity	411	21.1	313	15.4
Public administration	452	23.2	613	30.2
Total	1,948	100.0	2,027	100.0

Source: Statistical Bureau of Norway 1994.

Table 9 shows that, according to national statistics, the total number of persons employed increased by 4,1% between 1980 and 1993. By sector, the most notable changes are found within public administration, the private and business service sectors, and in manufacturing industry. The share of employed persons in public administration has risen from 23.2% in 1980 to 30,2% in 1993. The share of persons employed in the service sector has risen from 13.2% in 1980 to 16.6% in 1993.

Within the manufacturing industry the share of employed persons has reduced from 21.1% in 1980 to 15.4% in 1993. There is also a marked decrease in the number (and in percent) of persons working within the primary sector.

According to national sources it has been found that in 1994 a total of 220,000 private enterprises were counted within the extraction, manufacturing, construction, distributive trade, and other services sectors. This number includes about 50,000 enterprises with unregistered employment. Most of these are considered to be small. Only 84 of the enterprises employed 500 or more man-years, but these large enterprises count for almost 10% of all employment. This means that indeed 99.9% of all enterprises are SMEs.

In the 1981-92 period there was an increase in numbers of registered enterprises of almost 28%¹. The biggest increase was within the service sector. During this period the number of enterprises within business services has almost doubled (from 10,748 in 1981 to 20,943 in 1992). Also, within the hotel and restaurant sector, distributive trades and private services an above average increase in numbers of enterprises occurred. The number of manufacturing enterprises increased by only 9% over the same period. Despite these changes biggest sectors measured by the numbers of enterprises remained the retail trade, construction, transportation, and manufacturing industry in 1992, as was

¹ Source: Boye&Kinserdal, 'Små og mellomstore bedrifter i Norge - en analyse av betydning, lønnsomhetsforhold og kapitalforhold. Utfordringer. forslag til tiltak' SNF, Bergen, Norway 1992.

the case in 1981. However, by 1992 there were almost as many business service enterprises as there were manufacturing enterprises. In 1981 there were only half as many business service enterprises as manufacturing enterprises.

In 1981 95.2% of all enterprises in Norway employed less than 20 man-years. The corresponding number for 1992 was 96.5%. Only 0.7% of enterprises employed more than 100 man-years in 1981, while the corresponding figure for 1992 was 0.5%. This development shows a stronger orientation towards smaller enterprises. The share of enterprises employing less than 20 man-year has increased in all sectors, but especially within the manufacturing industry an increased share of smaller enterprises has been found (from 84.2% in 1981 to 88.3% of all enterprises within the manufacturing industry in 1992). In the same period the share of enterprises employing more than 100 man-year has been reduced from 3.6% of all manufacturing enterprises in 1981, to 2.4% of the same in 1992. Thus, the number of enterprises within the manufacturing industry has increased (9%) during the period, but the enterprises are generally smaller when measured by man-years, and there has been a reduction in employment in the sector (see table above).

3.2.4 Sweden¹

Between 1988 and 1992, the main growth across the EU occurred among small and medium-sized businesses, particularly micro-enterprises (0-9 employees), and Sweden was no exception. Between 1986 and 1992, employment fell in Sweden by an average of 0.7% annually in trade and industry. The only increases were found among enterprises with 20 or fewer employees. Micro-enterprises have exhibited growth of 2.3%, with a corresponding annual decline of 2.3% among large enterprises with more than 500 employees.

Accordingly to national sources, about 2.5 million people were employed in private enterprises in Sweden in 1992. Half of these were employed in enterprises with fewer than 200 employees, and micro-enterprises employ almost a fifth of all employees. SMEs in Sweden therefore play an important role in providing jobs. The biggest enterprises, those with 500 employees or more, account for 45% of the jobs in trade and industry.

Table 10 Employment by size class in Sweden, percentage, 1992

	0-9	10-19	20-49	50-99	100-199	200-499	> + 500
Employment	22	8	9	6	5	5	45

Source: Register of Education.

Within the *service sector*, where most SME employment is found, the largest sectors are the wholesale and retail trade, and hotels and restaurants, which together employ 30% of the service sector's work force. Other SME-dominated areas of the service sector are business services (financial services, property, leasing, computer processing, research and development) and other services such as consultancy. Other private services (including private education and medical services, other social services, household services and international organisations) also display a high proportion of SMEs. Busi-

¹ Data presented here and those presented in Table 3 may differ due to the use of different sources (Eurostat data for Sweden is based on financial statistics).

ness services and other private services account for 16 and 11% respectively of the employees in SMEs.

Manufacturing industry is not nearly as dominated by SMEs as the service sector, it accounts for 21% of those employed by SMEs.

Looking at the job distribution among the size categories in different sectors of trade and industry, SMEs dominate several categories; in other private services, wholesale and retail trade, and hotels and restaurants, SMEs employ 80, 67 and 65% respectively. In other private services, micro-enterprises (0-9 employees) dominate, accounting for 37% of jobs in the sector. However, the power industry, mining, manufacturing, and transportation are dominated by large enterprises. Most of these jobs are found in enterprises with more than 500 employees. About half of the jobs in business services are in SMEs, particularly in consultancy services, while the other half is employed in enterprises with more than 200 employees (presumably mainly in the financial sector).

Swedish SMEs are considered stable with regard to their employment. They are less likely to adapt the size of their work force to prevailing economic conditions than their larger counterparts. One explanation for differences between the employment trends in different size categories is that SMEs are less active in the manufacturing sector, which is where the real employment cut-back took place during the recession. Another reason is the growth experienced by the SME-dominated service sector. And, in addition, employment cuts have pushed many enterprises down into a lower size category.

4 POLICY

4.1 Introduction

In the First Annual Report of the European Observatory for SMEs a special Annex was devoted to 'SME Policy in the Countries of the EC' (page 399 to 432). In that Annex the analysis focused on the level at which SME policy is supported. In most cases this was at the national level, by national government, but in some Member States decentralisation is a major issue and regional governments are important in providing support to SMEs. In order to provide consistent coverage, the four 'new' ENSR-partners have provided information about SME policy in their countries which is comparable with that presented in the aforementioned Annex of the First Annual Report.

The Second Annual Report also dealt with SME policy (Chapter 9: Policy for SMEs), but the focus of that chapter was on new measures, recently been taken at the Union level, as well as at the national level in the 12 Member States.

In the First Annual Report the following 'fields' of SME policy were distinguished:

- Start-ups
- Subcontracting
- Export
- Financing
- Employment
- Education and training

For each of these policy fields different policy instruments were selected:

- Financial instruments
- Fiscal instruments
- Information and counselling
- Training
- Other instruments

The following Table presents an overview of SME policy fields and instruments that are in operation in Austria, Finland, Norway, and Sweden. A cross (X) in a cell indicates that in the country concerned at least one policy measure (or programme) exists in the 'Policy field' in question.

Table 11 Policy schemes in selected policy fields for SME

Policy fields	Country	Instruments				
		Financing	Fiscal	Info & counselling	Training	Others
Start-ups	Austria	X		X	X	X
	Finland	X		X	X	
	Norway	X		X	X	X
	Sweden	X		X	X	X
Subcontracting	Austria			X		X
	Finland					
	Norway					X
	Sweden					
Export	Austria	X	X	X	X	X
	Finland	X		X	X	
	Norway	X		X	X	
	Sweden	X		X	X	
Financing	Austria	X	X	X	X	
	Finland	X	X			
	Norway	X		X		
	Sweden	X				
Employment	Austria	X	X	X	X	X
	Finland	X		X	X	
	Norway	X			X	X
	Sweden	X		X	X	X
Education and training	Austria	X		X	X	
	Finland	X			X	
	Norway	X			X	
	Sweden			X	X	

Source: Contributions of the ENSR.

The next section presents some information about the objectives, the contents and the organisation of the SME policy in each of the EFTA-4 countries.

4.2 Austria

The Austrian government recognises the importance of SMEs in the Austrian economy.

Public promotion activities are mainly co-ordinated and funded by the Federal Ministry for Economic Affairs, and by corresponding departments at the state level.

Financial support - in the form of loans with subsidised interest rates, credit and risk guarantees, or grants - is an important form of promotional policies. Such programmes stimulate particular activities (such as exports, research, innovation, or investment) and are designed to make up for size (SME), regional, or sector-specific weaknesses and disadvantages.

One important area of promotional policies and activities is 'soft aid': that is the offering of consulting services, information, and training to SMEs at reduced rates. Such services are often designed for specific trades or restricted to a specific problem area, such as innovation or marketing. Technology policy in Austria, for instance, promotes co-operation between private enterprises and research institutions, transfer of information to the SME and training of entrepreneurs. In Austria the number of promoted consultancies has roughly doubled between 1988 and 1993. Since 1991, the Economic Promotion Institute of the Federal Economic Chamber has administered well over 20,000 consultancies a year.

In the last few years, problem-oriented promotional policies comprising soft aid as well as financial support were targeted at improving technology diffusion, research and development, product design, quality management, and certification (ISO 9000).

Overall, Austrian SMEs find a tight network of supporting measures provided by the economic chamber and by public authorities. Trends show that soft aid and problem-oriented policies and support are increasing, while general support programmes are declining.

4.3 Finland

4.3.1 Introduction

The Ministry of Trade and Industry (MTI) is the main body responsible for Finland's industrial and technology policy and for the preconditions for the development of Finnish industry including SMEs. The MTI also contributes towards the establishment and growth of SMEs, the safeguarding of profitable business activities and the promotion of competitiveness. Other important fields of responsibility are technical inspection, international technological and economic co-operation, and energy policy. The MTI participates in international trade policy negotiations. It also prepares and implements appropriate national legislation. The MTI is also in charge of the regulation of foreign trade, the development of the capabilities to maintain Finland's competitiveness abroad, the removal of restrictions on competition, improvements to consumer policy, and export promotion.

4.3.2. The role of SME-organisations in the preparation of SME-policy

The Finnish SME-Policy Programme (PK-yrittyspoliittinen ohjelma 1993) was prepared and established under the Advisory Committee for Small and Medium-sized Enterprises. The Advisory Committee included representatives from the largest political parties and the most important business and labour organisations that represent SME activities in Finland. In addition experts from several ministries and public corporate finance units

participated in the establishment of the SME-Programme. It laid the basis for defining the SME policy objectives in 1994's budget.

4.3.3 Organisations responsible for the execution of the schemes

The following organisations are responsible for the execution of the different policy schemes:

Financial policy

Ministry of Trade and Industry, Ministry of Finance, Finnish Guarantee Board, KERA Ltd., Finnish National Fund for Research and Development (SITRA), Finnish Export Credit Ltd., FINNFUND, Foundation of Finnish Inventions, Technology Development Centre (TEKES).

Labour policy

Ministry of Labour, Ministry of Trade and Industry.

Export promotion policy

Ministry of Trade and Industry, Central Chamber of Commerce and the Chambers of Commerce, Finnish Foreign Trade Association, Finnish Export Credit Ltd., Finnish Guarantee Board, Finnish National Fund for Research and Development (SITRA), Finnish Institute for International Trade (FINNTRA), Foundation of Finnish Inventions, The Foundation for the Promotion of Small and Medium-sized Industry, KERA Ltd., Technology Development Centre (TEKES).

Assistance and consulting policies

Ministry of Trade and Industry, Ministry of Foreign Affairs, The Finnish Foreign Trade Association, Technology Development Centre (TEKES), The Finnish National Fund for Research and Development (SITRA), Foundation for the Promotion of Small and Medium-sized Industry, The Foundation of Finnish Inventions.

Training policy

Ministry of Trade and Industry, Ministry of Education, Ministry of Labour, Finnish Institute for International Trade (FINNTRA).

4.3.4 Distinction between SME-policy by national and regional authorities

From a Nordic perspective, Finland has a large number of regionalized organisations promoting business and industrial activities. The most important national SME-policy authorities with regionalized services are: (primary sector regionalised services are excluded)

- The Ministry of Trade and Industry has 14 regional business service offices;
- The Technology Development Centre (TEKES) has 13 regional offices;
- The Finnish Guarantee Board has 5 regional units;
- The Finnish Foreign Trade Association has 17 regional offices;

- KERA Ltd. has 15 regional offices;
- The Chambers of Commerce have 23 chambers;
- The Confederation of Finnish Entrepreneurs (SKYL) has 19 offices;
- Finally a number of organisations have jointly founded regional offices:
 - KERA Ltd. and The Finnish National Fund for Research and Development (SITRA) has 6 offices;
 - SITRA and The Foundation of Finnish Inventions have 8 offices.

4.3.5 A short description of SME-Policy in the selected policy

Start-ups

Target groups: enterprises in all sectors (non-primary sector)

Responsible ministry: Ministry of Trade and Industry, Ministry of Labour

Subcontracting

No specific policy on subcontracting existing in Finland, but there are some activities which focus on subcontracting, for example fairs for the metal industries

Responsible ministry: Ministry of Trade and Industry

Exports

Target groups: enterprises in all sectors (non-primary sector)

Responsible ministry: Ministry of Trade and Industry, Ministry of Foreign Affairs

Financing

Target groups: industrial firms (non-primary sector), some geographical and size restrictions

Responsible ministry: Ministry of Trade and Industry, Ministry of Finance

Employment

Target groups: all sectors

Responsible ministry: Ministry of Labour, Ministry of Trade and Industry

Education and Training

Target groups: all firms (non-primary sector)

Responsible ministry: Ministry of Labour, Ministry of Education and National Board of Education, Ministry of Trade and Industry

4.3.6 The objectives of SME-policy in Finland

The development objectives and operational guidelines for SMEs were defined in the SME Policy Programme that was completed in 1993. According to this programme, economic and industrial policy measures should contribute to strengthening SME activities.

The following goals have been set for promoting SMEs:

- strengthening competitiveness of small and medium-sized enterprises;
- improving preconditions for the growth and the establishment of industrial SMEs;
- improving the operating environment of SMEs by developing various sectors of public administration.

To achieve these goals, a number of measures were proposed in the SME Policy Programme. These related to: financial policy, indirect labour costs, labour market issues, training and development services, administrative burdens concerning SMEs, and public procurements. Most of the goals were achieved during 1994, although some follow-up measures must be implemented.

Financial initiatives include measures to ease the unexpected increase in debt servicing costs, precipitated by the depreciation of the Finnish currency, for firms with foreign currency loans. Support in the form of interest rate subsidies are also given to SMEs with long-term loans for investments.

On the issue of labour costs, and taking into account the relatively high labour intensity of SMEs, increases in national insurance costs have affected many SMEs.

Policy is now focused on reducing employer's contributions. Further legislative action has been taken to remove the restrictions surrounding statutory working hours and salary/wage requirements, with the intention of improving the flexibility of SMEs.

Education and training have also been targeted as an area of vital importance in establishing a more positive attitude to entrepreneurship. Closer links between business and academia are being promoted, and more business courses are also being provided at a secondary school level.

Administrative burdens are being reduced by streamlining the statutory requirements from information on SMEs. Furthermore, regionalised service points are being set up to bring together all the various counselling services under one roof.

To ensure that SMEs are not squeezed out of domestic and EU-level public purchasing contracts by a lack of appropriate information, channels are being created to make Finnish SMEs more aware of this kind of contract. The EU's TED database with details of public procurement contracts will be a useful source of this information for SMEs.

Other points of focus for Finnish policy are export promotion through the provision of information, assistance, and incentives for co-operation between groups of firms. More emphasis has been put on promotion of internationalisation by strengthening the operations and competitiveness of SMEs.

Finally, the Regional Business Service Offices of the MTI (Ministry of Trade and Industry) have introduced a training programme for start-ups with six different stages. Each stage is a separate entity. The latest programme is the ProStart that was launched in 1994. The ProStart programme is the second stage for start-ups and emphasises the development of the business idea.

4.4 Norway

4.4.1 Introduction

Recognising the increasing importance of SMEs in Norway through their growth in numbers and their importance to employment and value added, the government is conducting an active industrial policy. The aim is to ensure that the potential growth in small enterprises can be strengthened and realised. This includes the establishment of new companies and industrial developments in rural areas. The two main policy approaches have been improving general conditions for SMEs, and special measures for small enterprises.

4.4.2 Organisation of SME-policy

The Ministry of Industry and Energy is the ministry mainly responsible for developing SME-policy. The ministry has a special SME-division. However, the Ministry of Local Government and Labour is involved in SME-policy, especially when it concerns start-up grants, employment, and training. The Ministry of Agriculture is also involved with start-up grants for persons who intend to establish supplementary activities linked to existing enterprises. The Ministry of Finance is also involved in the process of reducing the administrative burdens on SMEs.

The main organisations representing the enterprises; the Confederation of Norwegian Business and Industry (the employers' organisation) and the Norwegian Federation of Trade Unions (the employees' organisation) are represented in several committees and working groups at both the national and the regional/local levels. These organisations also evaluate (or at least give comments on) new policy suggestions, and therefore have some impact on the development of SME-policy, even if they do not make the final decisions. These organisations are not specific SME-organisations, they represent the whole business sector in Norway.

The major bodies responsible for the execution of the policy are: the Norwegian Industrial and Regional Fund (SND) for direct financial support; and the Norwegian Research Council which finances other types of project (research and development). The Norwegian Industrial and Regional Development Fund (SND), a merger of the Norwegian Bank for Industry, the Industrial Fund, the Small Business Fund, and the Regional Development Fund, was established in January 1993. The SND does not generally favour any specific industry, but one of its target groups is small enterprises. The support is divided into loan schemes, guarantee schemes, and grant schemes. A new equity scheme has also been set up for investing in shares, primarily in SMEs. The SND has established regional offices to better serve the enterprises in the regions.

The Norwegian Research Council, established in January 1993, as a merger of 5 research councils, initiates and administrates different types of research programs. The Industry and Energy division is responsible for SME-projects.

Regional authorities implement/administer several of the SME-measures formulated by the Ministry of Local Government and Labour, and the Ministry of Agriculture. One example is the start-up grants offered by the Ministry of Local Government and Labour. This grant is administrated by the county municipalities.

In addition, regional and local authorities contribute, to varying extents, to the development of SMEs by offering land and facilities, and grants for enterprise development.

4.4.3 Short description of SME-policy in selected fields

SME-policy may be divided into three major sections: framework conditions, financing opportunities, and the transfer of competence.

1 Framework conditions

In recent years costs have been reduced, which together with the low rate of inflation, have created better competitive conditions for SMEs. The cost of the employers' social security contribution have been reduced by 2.4 percentage points to an average rate of 12.8 percent. Furthermore, at present no employers' contributions are paid by the enterprises in the far north of Norway (North of the county Troms and in Finnmark). There are also other special measures for northern Norway which are to encourage restructuring and the development of enterprises.

In 1991 a new tax reform was adopted which affects all types of enterprises. A broader tax base and lower tax rate imply that enterprises with good pre-tax profits, and those which previously did not exploit favourable rules, may get substantial tax relief. In addition, the process of reducing the administrative burden on SMEs has resulted in reduced information requirements for industry statistics from small companies with less than 10 employees.

2 Financing opportunities

The Norwegian Industrial and Regional Development Fund offers a wide range of measures for enterprises.

3 Transfer of competence

A broad range of advisory services, both for public and private, are available to SMEs. The public advisory system is open to small enterprises, entrepreneurs, and investors. In addition, different types of education programs and systems are available in the areas of encouraging businesses start-up, entrepreneurial training courses, and educating SME managers. Programs for establishing networks of SMEs, which allow them to pool and better utilise their total resources, are also available.

The following is some information on SME policy and instruments in a few selected fields.

Start-ups

A broad range of instruments are available for the process of establishing new companies. Financing assistance includes: loans, grants, guarantees, and investments. However, the competition is tough, and the evaluation is based on the quality of the business idea/plan. It is also possible to get financial support for carrying out special analysis (for example, market research) or special projects (for example development projects). Information and counselling can be obtained from several institutions. In each county a regional consulting service office has been established, supported by the Ministry of Industry and Energy, to assist both new and existing companies. In addition come research

institutes and the local/regional economic development offices. The Ministry of Industry and Energy has also established (in April 1992) a freephone service for entrepreneurs. Information is given about establishment formalities, and funding and training opportunities. The latest development is the establishment of one-stop-shops for entrepreneurs, where they can get counselling and guidance concerning all aspects of business development. Within the training area, different types of entrepreneurial training courses are available, these are provided by both public and private institutions.

For unemployed (potential) entrepreneurs, the availability of unemployment benefit has been extended to help more unemployed people start their own business. Earlier (before 1993) the formerly unemployed entrepreneurs lost their unemployment benefit from their first day in business. Now entrepreneurs can receive unemployment benefits for a few months after forming an enterprise. This recognises that initial income to the new enterprises may be very low.

Subcontracting

The only measure available to subcontracting SMEs is a register of potential customers and suppliers of products and services. The aim of the register is to help enterprises find principals for which they can act as a subcontractor.

Export

The Norwegian Trade Council, funded by the Ministry of Foreign affairs, is an export promotion agency which provides expertise in exporting and internationalisation. By 1993, the Council had 37 offices abroad, located in 30 countries world-wide. The Council's main activities are providing consultancy to Norwegian enterprises through international market analysis, establishing international co-operation opportunities, and promoting Norwegian products and services abroad. Other types of services offered include the 'Export-manager for hire' scheme, and export training courses.

NORTRA; The Norwegian Tourist Board, is another example of a promotion agency, which focuses mainly on the travel industry. NORTRA was established in 1984 by the Norwegian Government and the travel industry. NORTRA promotes the Norwegian travel industry, and provides consultancy services within a broad range of travel-related issues. GIEK (The Guarantee Institute for Export Credits) is a government agency which underwrites export credits. GIEK's role is to extend guarantees to Norwegian companies exporting on credit to foreign buyers. These guarantees reduce risk and offer security against non-payment.

The services of these three agencies are available to both SMEs and larger companies.

The consulting/counselling services which provide general information, also provide some internationalisation/export advice. Specifically in this field, four Euro-Info-centres have been established in different parts of Norway.

Financing

The financing opportunities have been described above (the types and sources). In connection with its financial support SND also offers some guidance and counselling for the development of enterprises.

Employment

Enterprises have the opportunity to have unemployed people working within them for a limited period of time, an arrangement which is administrated and financed by the labour market authorities. Another possibility is for an unemployed person to temporarily replace an employee who is attending a training course.

4.5 Sweden

4.5.1 Introduction

Sweden's small and medium-sized enterprises are in a position to contribute substantially to future economic growth. The State's role is primarily to remove obstacles and bottlenecks that inhibit business development. For instance, shortcomings can be corrected in the areas of information, qualified advisory services, competency development and venture capital. Another important task of the State is to minimise the number of unnecessary and expensive regulations, and furthermore, to simplify and clarify the structure of the State's small business support. This restructuring is to be implemented in stages.

Within the framework of Industrial, Labour and Regional policies, substantial funds are being directed at business start-ups and the development of small and medium sized enterprises. In this tax year, an allocation of 700 MECU has been made for these policies.

The Ministries for Industry, Labour, and Regional Development, all determine SME-policy (see above) and another overall objective is to increase efficiency of SME-policy by improving co-ordination between Industrial, Labour and Regional policies.

NUTEK has the central responsibility for operative measures concerning SME policy. However, a functional small business policy must be based on a proximity between the representatives of the state and the enterprises they assist. Therefore a regional structure is preferable, and this is provided through the regional called ALMI Företagspartner (ALMI Business Partner) companies which provide supplementary financing and advice. ALMI has now established subsidiaries in all counties, replacing the development funds (utvecklingsfonderna). The activities of the regional ALMI's are co-ordinated by a parent company. The parent company distributes funds for operating costs and financing among the counties according to their needs.

For export-support, the Swedish Export Council has been assigned a significant role with SMEs now prioritised as a target group. Large enterprises can use the Export Council's services but on a fee basis.

Organisations of SMEs affect small business policy through a variety of measures; for instance, through their function as reference groups, through their lobbying activities, and through the Small Business Council tied to the Minister of Industry.

4.5.2 Short description of SME policy in selected fields

Start ups

Apart from the general objectives and measures mentioned above (for example removing obstacles, simplifying the support structure, and providing advice, information and

financing at a regional level), specific actions are also taken to support start-ups. One example is 'The Start-Up Line', a telephone line which provides start-up related advice to potential entrepreneurs. This line received 12,000 calls from interested parties over the past year.

In recent years, the number of start-up grants to the unemployed has increased significantly. During the most recent tax year, approved start-up grants totalled about 100 MECU. Furthermore, the regional ALMI's are now involved in the evaluation of business ideas and the supply of advice, training and financing to enterprises.

Subcontracting

There is no specific policy.

Export

See the comments above on the Swedish Export Council.

Furthermore, the Wuro Info Centre at NUTEK, along with its regional network, actively seeks to improve the internationalisation of SMEs. The regional ALMI's are also active in this area by providing information, training and consultancy services.

Financing

Actions aimed at supplying enterprises with venture capital have been prioritised in recent years with special emphasis on the provision of both seed-capital and capital for mature business development.

Furthermore, special efforts are being made to increase the number of women entrepreneurs. Almost 22 MECU has been reserved for loans exclusively to women entrepreneurs.

Employment

For obvious reasons, the majority of employment measures are directly aimed at reducing unemployment. Measures include financing, information and counselling, training, and specific measures aimed at selected target groups, including SMEs, in matching the supply and demand for labour.

Education and Training

There is no general SME policy in the field of education, although various measures promote competency development in SMEs. Training for new entrepreneurs is an important area for the regional ALMI's, and more generally, within the framework of labour market policy.



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