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TOWARDS A EUROPEAN MARKET IN SUBCONTRACTING

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INTRODUCTION

In its Resolution of 26 September 1989, (1) the Council noted with interest what the Commission had done so far to develop subcontracting in the Community and called upon it to continue and intensify its efforts in this area. It also asked to be kept informed of the progress of this work.

This communication is intended to meet these two objectives: it assesses the work carried out hitherto and sets out the broad lines of a strengthened policy directed at meeting the specific needs of this sector and preparing for the "post-1992" period.

It should be pointed out that these various measures form part of a wider policy conducted by the Commission, pursuant to the Council Decision of 28 July 1989, (2) to promote the development of firms, in particular small and medium-sized firms.

The assessment which has been made since then and the pressing and converging demands of the market all go to confirm the need to give this policy a fresh impetus so that firms are better able to respond in advance to the challenges of 1992. Measures to promote subcontracting thus form a coherent package which defines the scope and limits of a Community policy in this area. They respect the principle of subsidiarity by adding a Community contribution to the efforts made at the various national, regional and local levels by administrative bodies and trade organizations, and reflect the Commission's coordinating and instigating role.

(1) OJ C 254, 7.10.1989

(2) OJ L 239, 16.8.1989

I. SUBCONTRACTING: A VITAL ACTIVITY FOR THE COMPETITIVENESS OF THE EUROPEAN ECONOMY

The Commission's Communication of 7 August 1989 on the development of subcontracting (3) highlighted the role of subcontracting in the European economy and the structural changes it is facing. Given the economic importance of this sector, the main aspects of its recent performance are described below.

A. IMPORTANCE AND DEVELOPMENT OF SUBCONTRACTING

1. *A passport to competitiveness*

The decision to make use of subcontracting is very closely linked to strategic thinking on the proper size of firms. The development of this size demonstrates that, throughout the world, the search for a point of equilibrium, based on the advantages and disadvantages of different sizes, is indeed a strategic one. Finding the right equilibrium between a firm's size and its capacity to respond to the growing internationalization of markets makes it necessary to concentrate again on the firm's particular strengths, and therefore to contract out a growing and increasingly sophisticated proportion of activities previously handled internally.

The performances of European advanced-technology industries and of Japanese industry in general have clearly demonstrated how crucial to competitiveness a structured network of specialized subcontractors is.

Concentrated organization of production which relies on highly integrated entities is therefore gradually giving way to a network-like structure based on specialization and interdependence between partner firms. This structure is made easier by the development of electronic mail and the introduction of computer-assisted design and production systems.

The decision to contract work out is thus becoming a structural factor in the overall strategy of main contractors. It is one which has to be viewed by both parties quite differently from in the past.

In this context, subcontracting as a privileged point of contact between large and small or medium-sized firms is also an essential element in any analysis of the uniformity of business channels, standards and quality.

(3) COM(89) 402 final

2. *An image in need of revision*

The "externalization" of a firm's operations is forcing subcontractors to become ever more specialized. Increasingly complex tasks are now being contracted out. Likewise, demand for services subcontracting is growing all the time. At the same time, we are witnessing a significant reduction in the number of first-line subcontractors, with, as a "knock-on" effect, a wave of reorganization among other subcontractors.

Seeing himself entrusted with one complete operation in the production process, the subcontractor, in particular the first-line subcontractor, is increasingly positioning himself as the indispensable partner of the main contractor, whose requirements, in terms of technological adaptation and follow-up as well as competitiveness, he must meet.

Since the relationship between the main contractor and the subcontractor is one of interdependence as opposed to dependence, all small and medium-sized firms in this sector need radically to redesign their strategies, their activities and the way in which they organize and manage their production operations.

Specialization, innovation, diversification and business promotion are new concepts for many such subcontractors, but they do hold the key to successful reorganization.

The forthcoming completion of the Community's internal market, the mushrooming of inward investment by third-country, especially Japanese, investors in Europe and the moves towards a market economy in central and eastern Europe can only accelerate and reinforce this trend.

B. SUBCONTRACTING: AN INTEGRAL PART OF ENTERPRISE POLICY

The policy pursued by the Commission, both under the action programme for small and medium-sized firms (4) and, more recently, in accordance with the above-mentioned Council Decision of 28 July 1989, has consistently stressed the specific importance of subcontracting given the predominant role played by small and medium-sized firms in that area.

Following adoption by the Council of its Resolution of 26 September 1989, the Commission has continued and intensified its efforts to develop subcontracting, especially cross-border subcontracting, in the Community.

These efforts are directed towards three objectives:

1. *creation of an environment conducive to subcontracting in the run-up to the completion of the internal market;*
2. *improvement in the flow of information and communication between main contractors and subcontractors;*
3. *promotion of European subcontracting among third-country investors.*

(4) COM(86) 445 final

They have been given practical shape by the following initiatives:

1. *Creation of an environment conducive to subcontracting*

A study on the cost of the multiplicity of certification procedures for subcontracting firms has recently been launched. It is intended as a back-up to the harmonization effort already undertaken by the Commission in the context of the global approach to certification and testing (5) and as a means of gauging the impact of this problem in the specific area of subcontracting.

The study will also aim to assess the extra burdens on small and medium-sized firms in this sector associated with the wide variety of procedures by attempting to quantify their financial, technical and administrative cost and their cost in terms of human resources and time.

A second study, dealing with the technical infrastructures existing in the Community in the fields of testing, certification and quality, has also been launched recently; it will throw further light on the present situation.

Pooling of the findings of these two studies will enable the Commission to implement a coherent set of measures and to help strengthen subcontracting firms - particularly SMEs engaged in subcontracting - in these specific areas.

2. *Improvement in the flow of information and communication between main contractors and subcontractors*

2.1 The Commission has continued its work on multilingual sectoral terminologies.

These are particularly useful because products covered by subcontracting, not being standard products, do not feature in the usual nomenclatures of products or activities.

And so, in order to permit the development of cross-border subcontracting, a multilingual system for codifying products or activities that are contracted out is needed, in particular to serve as a basis for setting up subcontracting data banks and exchanges and, if necessary, to make it easier to create a network of such exchanges.

Eight volumes are now available:

- metals;
- plastics and rubber;
- textiles;
- wood and derived products;
- electronics;
- industrial services;
- ceramics;
- general services to enterprises.

The volumes on metals and plastics and rubber, which were produced several years ago, are being updated.

(5) COM(89) 209 final

- 2.2 The development of cross-border cooperation encouraged by the 1992 project reinforces the need for a clear understanding of each partner's obligations and responsibilities.

Consequently, a practical guide has been prepared on the legal aspects of industrial subcontracting in the Community so as to help subcontractors in drawing up contracts. This guide begins by listing the essential elements which should appear in a subcontract, particularly as regards quality control, liability and rights to intellectual property and know-how. The second part compares the legal environment for subcontracting in the twelve Member States.

- 2.3 As requested by the Council, the Commission has also examined in detail the feasibility and expediency of promoting the creation of a European Information Centre on Subcontracting.

On the basis of a detailed operational programme, the trade organizations which offer assistance and advice on subcontracting have been consulted at length. It transpires that all these organizations feel that information on subcontracting at European level needs to be improved. However, the creation of a specific, independent and self-financing structure seems premature and would, therefore, prove extremely difficult at this stage.

A stage-by-stage approach has thus been proposed. At the outset, the Commission will take direct responsibility for the various initiating, coordinating and information-providing tasks necessary to the development of a genuine European market in subcontracting.

3. *Promotion of subcontracting among third-country investors*

At the Commission's initiative, a conference on the investment opportunities offered to European subcontractors by Japanese investors in Europe was held on 21 and 22 June 1990 in Brussels.

This conference followed a fact-finding mission at the end of 1988 to study subcontracting in Japan and was intended to bring together European subcontractors and representatives of the large Japanese firms established in Europe.

The wave of Japanese firms setting up in Europe represents a significant potential for subcontracting, since still too little of the work goes to European firms.

The aim of the conference was therefore:

- to analyse the difficulties facing cooperation between European and Japanese firms;
- to identify the factors that will make for an efficient and harmonious partnership;
- to instigate a flow of business between Japanese main contractors and European subcontractors;
- to make Japanese firms aware of the skills and know-how of European subcontractors.

More than 450 people attended the conference, during which the European-Japanese subcontracting relationship was scrutinized.

A synopsis of Japanese investment and of cooperation with Japanese main contractors was drawn up, together with the formal conclusions of the conference.

II. AN INCREASED EFFORT BY THE COMMISSION TO PREPARE FOR THE POST 1992 PERIOD

The welcome granted to the Commission's efforts to date by the professional circles concerned, the growing awareness of the vital role of subcontracting for the competitiveness of the European economy and the expectations of subcontractors regarding information and adjustment to the new conditions in the Europe of tomorrow make it necessary to continue and intensify the Commission's programme.

Moreover, since work on the feasibility of a European Information Centre on Subcontracting has resulted in the Commission taking on the various initiating, coordinating and information-providing responsibilities which were originally to have been entrusted to that body, the Council should be presented with a revised version of the programme set out in the 1989 communication.

In order to create the conditions for a genuine European market in subcontracting, while respecting the principle of subsidiarity as far as the Community's efforts are concerned, the Commission will in the next few months develop a series of initiatives geared to the following objectives:

- greater transparency of markets, to be achieved on the basis of a detailed and prospective survey;
- the establishment of an appropriate framework and of an appropriate set of information tools;
- promotion and stimulation measures.

A. SURVEY OF MARKETS

1. *Economic aspects*

No structured research into the European subcontracting markets has yet been carried out. It is particularly difficult, therefore, to gain a complete understanding of the European market in its entirety.

Studies on the economic importance of subcontracting in the twelve Member States of the Community have now been undertaken with a view to examining the existing situation and identifying market trends for the coming years, with particular regard to the strategic policies of main contractors and the likely business opportunities which will exist for subcontractors.

At the same time, a specific study of the eastern part of Germany will be carried out. A similar exercise will be conducted for the EFTA countries and for central and eastern Europe.

The result will be the first-ever European subcontracting map showing the sector's strong and weak points and, above all, providing subcontractors with a snapshot of, and pointers to, the development of demand among main contractors at European level.

2. *Legal aspects*

The subcontract, particularly in industry, is not as such governed by any specific rules and is therefore subject to general contract law. Depending on the case in point and on the legal arrangements in the Member States, it ranks with service, sales, supply or employment contracts.

The second part of the practical guide to legal aspects of industrial subcontracting contains a comparative study of the various legal systems for subcontracting in the Community.

The guide will be supplemented by a similar survey covering the countries of Europe that are not members of the Community.

In addition, a specific study on the liability of subcontractors following adoption of the different directives on the liability of producers and suppliers of services and on product safety will be carried out.

The reason for the study is that it is important for the extent of a subcontractor's liability to be clearly spelt out so that he can take account of it in setting prices and obtaining insurance cover. This is particularly true in the case of a producer's liability for defective products since Directive 85/374/EEC has established the principle of objective liability. Although it might be considered that, on the basis of Article 7(f), subcontractors may be released from such an obligation, the impact on subcontractors of this Directive should be examined in detail, particularly since it lays down the principle that, if several persons are liable for the same damage, they are liable jointly and severally.

Moreover, the opening-up of public procurement calls for in-depth discussions on the particular problem of how subcontracting will be affected. This is because subcontracting in the construction and public works sector satisfies needs very different from those in the field of industrial subcontracting. Specific consideration should therefore be given to its cross-border development. A study will be made of this problem.

3. *Awareness of third-country markets*

As indicated above, particular attention has been paid to the organization of subcontracting in Japan, a fact-finding mission having been organised there in 1988.

A similar initiative will be launched on the US market, the aim being to gain a better understanding of how subcontracting operates there and to establish what opportunities exist for European subcontractors. A fact-finding mission might take place in the second half of 1991.

B. FRAMEWORK AND INFORMATION

1. *A legal framework tailored to the new single market*

It will not be possible to talk of a true Community subcontracting market until the main parties involved are able to operate at transnational level under the same conditions as apply at national level. Clearly, all the White Paper measures aimed at completing the single market have a direct impact on the transnational development of subcontracting. However, certain specific initiatives are necessary.

Payment periods

While the question of payment periods is not confined to subcontracting alone, it is a particularly sensitive matter for firms in this sector, mainly small and medium-sized firms, which frequently have to pay their suppliers much more promptly than they are themselves paid by main contractors. Furthermore, in some cases, this problem of payment periods generates a substantial amount of credit between firms, with large main contractors benefiting and, occasionally, with the very existence of subcontractors being threatened.

In its Resolution of 26 September 1989, the Council stressed the need for this problem to be examined carefully.

Where they exist, specific laws governing this matter in the Member States seem to have in common the principle of freedom of contract. However, they differ as to the rules applicable in cases where there is no contract or where the contract provides neither for a payment period nor for interest to be paid in the event of late payment.

This problem also extends to the public authorities, since they sometimes seem to be the slowest in meeting their payment obligations towards small and medium-sized firms.

With a view to initiating discussion of the measures that could be contemplated at Community level, the Commission is drafting a paper on the overall problem of payment periods based on an analysis of the existing legal framework in the Member States.

■ Working conditions

As part of the implementation of the Community Charter of the Fundamental Social Rights of Workers, the Commission has recently adopted a proposal for a Council Directive concerning the posting of workers effected in the framework of a provision of services (6).

The purpose of this instrument, which takes account of a number of Court of Justice judgments, in particular the *Rush Portuguesa* judgment, is to lay the foundations for the coordination of Member States' laws by increasing legal certainty, establishing in advance the working conditions applicable and eradicating practices which may be both detrimental to fair competition between firms and prejudicial to the workers concerned. This proposal for a Directive relates not only to transnational subcontracting but also, as indicated in the Action Programme, to public procurement. The aim, in both cases, is to ensure that a "hard core" of clearly defined protective rules is observed by the provider of the services.

■ Public procurement

In response to the Council's wish and on the basis of the findings of the study mentioned above, the Commission will present proposals for improving the legal framework for subcontracting in the public procurement field.

The communication on promoting SME participation in public procurement in the Community (7) stressed the fact that transparency of subcontracting and steps to establish a better contractual balance were essential prerequisites for a harmonious development. It is particularly desirable here that subcontractors should be given certain guarantees, especially as regards their liability and the means of redress in the event of non-payment by the main contractor.

(6) COM(91) 230 final

(7) COM(90) 166 final

An improved legal framework would also enable subcontractors to participate with greater confidence and certainty in public contracts awarded in other member countries.

In particular, it may be considered that the main contractor notify the contracting authority of the subcontractors he intends to use and the amount of the lots he plans to contract out.

A study of international trade practices will be carried out to assess the main contractor's liability for loss incurred by the purchaser owing to non-performance by the subcontractor or to other acts or omissions on the part of the subcontractor as well as the relationship between the contracting authority and the subcontractor.

2. Up-to-date and easily accessible information

The development of a policy aimed at actively providing SMEs with reliable information is a constant concern of the Commission and one of the cornerstones of enterprise policy.

Therefore, as already mentioned, although the implementation of a specific structure does not seem appropriate at this stage, the optimum use of all available information and cooperation instruments is considered essential.

Furthermore, the lack of an official definition of subcontracting makes it difficult to pin the concept down; the supply of regular, up-to-date and easily accessible information thus poses particular problems, especially at Community level.

The studies mentioned above, the regular contacts the Commission maintains with the bodies devising new ways of assisting and advising subcontracting firms, and the growing role that the Euro-Info-Centres (EICs) will play as an interface between the Commission and business should make it possible to overcome this obstacle in part.

With a network of almost 200 EICs spread throughout the Community, the Commission now has a high-profile instrument for channelling information to firms.

The EICs have a twofold task: to channel Community information to the 13 million small and medium-sized firms in the Community and to signal to the Commission those firms' aspirations and problems and the changes they are undergoing.

They have an active role to play in enabling firms to anticipate market developments and changes.

Special attention will be paid to subcontracting in the provision of selective and sectoral information, which will be compiled and distributed in closely coordinated fashion by the Commission, subcontracting firms and their representatives, and the individual EICs.

Regular publication of information and various specific measures (information days, symposia, meetings, news flashes, etc.) will also begin shortly, with particular attention being focused on:

- the economic, legal, technical and commercial environment of subcontracting;
 - European subcontracting markets and certain third-country markets (United States, Canada, Japan, Latin America, etc.);
 - public procurement and major European contracts;
 - the results of research and development, etc.
- Mention should also be made of the promotional role which the BC-Net will play once it has been extended to third countries.

This action to provide small and medium-sized firms with a regular flow of specialized information is also necessary in order to enable them to plan their production and work out appropriate development strategies accordingly.

It is also appropriate to stress the promotional role which the BC-Net will acquire vis-à-vis third countries once it will be extended to them.

3. A pan-European subcontracting forum

Given the changes facing European subcontracting and the major transformations under way on firms' traditional markets (completion of the internal market, transition in central and eastern Europe to a market economy system, direct inward investment by Japanese firms, etc.), the main parties involved in subcontracting will need to meet periodically to discuss their respective experiences, problems and expectations.

In 1988, the Commission organized a highly successful conference on subcontracting in Europe at which stock was taken of the situation.

Four years on - and for the reasons set out above - a further meeting is necessary, and the Commission plans to extend its coverage to Europe as a whole, i.e. including the EFTA countries and the countries of central and eastern Europe.

In selecting the topics for discussion, priority will be given to the economic and commercial aspects of subcontracting, the provision of information, promotional channels, arrangements for identifying new customers, the purchasing policies of main contractors, and access by subcontractors to technological innovation.

C. PROMOTION AND ENCOURAGEMENT

1. *Linking-up of subcontracting exchanges and data banks*

Numerous intermediary subcontracting bodies (chambers of commerce, regional development agencies, industrial federations, etc.) operate subcontracting data banks and exchanges, generally on a regional basis. There are a good fifty of them in the Community as a whole.

The creation of such data banks and exchanges is all the more important that the lack of information on market opportunities is known to greatly handicap SMEs when planning their investment and their production.

In order to capitalize on these initiatives and to ensure that the resources employed have a synergic effect, the Commission has decided to examine the possibility of linking them up.

A feasibility study will shortly be launched to take stock of these various structures, their effectiveness and fields of operation, the data-processing systems used, and the technical and financial resources needed to create such a network. On the basis of the study's findings, a pilot project will be undertaken to determine the action to be taken on a wider scale.

The special case of the eastern part of Germany will be considered, together with possible specific measures designed to correct the poor basic infrastructures and managerial structure in the area.

Finally, in the light of the results achieved at Community level the possibility of extending the network to similar data banks or exchanges in other European countries will be examined.

2. *Support for intra-European cooperation initiatives*

In recent years, the Commission has increased the number of transnational cooperation initiatives. Whether it involves the transfer of technological innovation (Sprint programme), research and development (all the Community R&D programmes), regional development (Interreg programme), cooperation between firms (BC-Net, BCC) or a combination of the last two (Europartenariat, Interprise), forging links between firms from different regions in the Community is now a central concern of the Community institutions.

Measures to enhance the "network" effect make a key contribution to the effectiveness of this policy and involve not only efforts to promote personal contacts - an especially important element in subcontracting - but also integrated operations under the various instruments.

The above-mentioned programmes can, if necessary, provide the framework for projects involving subcontracting. In order to reinforce the cohesion of subcontractors in Europe, greater account should be taken of subcontractors' demands and needs in these programmes, particularly in the CRAFT programme.

In addition, significant steps have already been taken to promote transnational subcontracting, particularly through multilingual sectoral terminologies and the practical guide to legal aspects of industrial subcontracting.

However, if the firms involved are to be helped in preparing for the period after 1992, further steps must be taken to bring about more direct and more specific contacts between main contractors and subcontractors in different regions, and even between subcontractors able to complement each other in terms of production and know-how.

In the context of the measures taken to reinforce the Europartenariat programme, and particularly where the eastern part of Germany is concerned, special emphasis will be placed on opportunities for cooperation in the subcontracting field.

At the same time, special support will be given for specific measures aimed at encouraging exchanges between Community regions and other European regions. These may include meetings, exchanges of technical experts, training and awareness programmes concerning new methods for organizing and managing production, information programmes on standardization, certification and quality, etc.

A pilot project in the consumer electronics sector which is being co-financed in particular with large firms located in Europe will involve a representative sample of subcontracting SMEs and will be aimed at improving and promoting the supply of European subcontracting in the electronics sector.

3. Preparatory measures and measures aimed at promoting awareness among managers

In the light of the findings of the study of subcontractor liability, it might be necessary to launch an awareness programme covering the three key elements: liability, quality and legal certainty. Where appropriate, the programme will be implemented in close association with the intermediary subcontracting bodies and will be drawn up on the basis of the specific characteristics of the subcontracting firms, particularly as regards availability of managers, details of links with main contractors and the sector in question.

Similarly, the conference on the opportunities offered to European subcontractors by Japanese investors in Europe revealed a desire on the part of subcontractors to acquaint themselves better both with Japanese working and production methods and with the organization of subcontracting in Japan.

In order to meet this need, the Commission will shortly set out proposals for short training courses (2-3 weeks) on such matters which would be specifically targeted on those European firms planning to work with Japanese main contractors established in Europe. These courses, which will be organized in close collaboration with the EC-Japan Centre for Industrial Cooperation, will take place in Japan.

CONCLUSIONS

More than ever before, the competitiveness of European industry depends on the development of harmonious and balanced subcontracting relationships. In order to equip firms for this challenge, the Community institutions must play their instigating, coordinating and information-providing role in such a way as to create the conditions required for a true European subcontracting market.

It is therefore essential for the Commission to step up its activities in this field and to tailor them at all times to the real needs of a sector which is particularly vulnerable to changing market circumstances.

Accordingly, one of the priority aims of the Community's enterprise policy is to ensure that subcontractors are better prepared for the period after 1992.

The measures described in this communication are consistent with the Council Resolution of 26 September 1989 and with the document adopted on 22 November 1990 and entitled "Enterprise policy: a new dimension - expanding the programme to support SMEs", (8) which argues that a quantum leap is necessary to improve SMEs' preparedness for the challenges arising from the single market.

(8) COM(90) 528 final