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THE EUROPEAN OBSERVATORY FOR SMEs

Comments by the Commission on the First Annual Report (1993)

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INTRODUCTION

For a long time it was clear that the Commission needed an instrument to help it to pursue its enterprise policy and the proposal to create a European Observatory for small and medium-sized enterprises was originally made by the Commission in its communication "Enterprise policy: a new dimension for small and medium-sized enterprises"¹.

In December 1992, therefore, the Commission set up the Observatory as part of the process of adopting initiatives designed to underpin progress already made in the assessment and expansion of its enterprise policy, particularly in finding out more about the situation and prospects of small and medium-sized enterprises by improving the statistical coverage and analysing the impact the Internal Market will have on them.

The prime objective of this undertaking, which, for the first time, brought together twelve national organisations specialising in analysing small and medium-sized enterprises, was to provide the people responsible for enterprise policy with a suitable instrument, which would bear comparison with existing ones elsewhere, for analysis at European level and thus to enable them to cope better with the demands for analysis and study involved in devising enterprise policy measures.

The annual reports from the European Observatory for small and medium-sized enterprises, which will be compiled on the basis of official statistics and can thus be viewed as the analytical counterpart of efforts undertaken by EUROSTAT to improve and develop the statistical information available on enterprises, should thus enable the situation of SMEs to be monitored and their prospects in the Internal Market to be assessed and should also encourage increasingly serious thought and debate on the guidelines for enterprise policy and on the best way to help SMEs to overcome the problems attendant on their size and to exploit the opportunities which present themselves in the wake of the completion of the Internal Market.

1. COM (90) 528 final of 18 December 1990.

The annual reports could also develop into an excellent benchmark not only for the people responsible for the policy in support of SMEs both at Community and national level but also for national and Community organisations representing SMEs and the moment when they are presented could offer an excellent opportunity to quicken the debate on the stakes involved in enterprise policy.

In view of these general objectives, it became clear that the Observatory had to be built up, on the basis of what had already been achieved, through networks and experimental cooperation in order to avoid any unjustified duplication of work and to reap the benefits of the synergy made possible by the concerted use of the resources currently available. The aim here would thus be to put work already undertaken by several organisations in the Member States on a different tack and support pan-European research and coordination, which are likely to make greater demands on these organisations than their routine tasks.

Considering that the neutrality and the scientific character of data-processing procedures which preside over the development of statistical data, and are ensured both by EUROSTAT and the National Statistical Offices should be matched by a comparable independence of the Observatory, the Commission deemed it best to restrict its role to that of a catalyst. The contents of the reports and the methodology used are the responsibility of the network which prepares them, with the Commission merely setting out the guidelines and monitoring the network's activities.

The Economisch Instituut voor het Midden-en Kleinbedrijf (EIM), the coordinator of the network made up by the KMO Studiecentrum, Danish Technological Institute, Institut für Mittelstandforschung, Hellenic Organisation of Small and Medium-Sized Industries and Handicrafts, Instituto Vasco de Estudios e Investigación, Association pour la Promotion et le Développement Industriel, Economic and Social Research Institute, Università Commerciale Luigi Bocconi, Chambre des Métiers du Grand Duché de Luxembourg, Economisch Instituut voor het Midden-en Kleinbedrijf, Instituto de Apoio às Pequenas e Médias Empresas e ao Investimento and the University of Warwick School of Industrial and Business Studies, has submitted an initial independent report to the Commission on the situation and the prospects of small and medium-sized enterprises in the Community.

The Report accumulates a substantial amount of useful data and follows up on these with a number of policy recommendations. As the overriding objective of the Observatory is to provide a comprehensive analysis of horizontal issues relating to SMEs, the Commission considers that this Report can become a key reference document for those responsible for enterprise policy and small business development at a regional, national and Community level. In particular this, and subsequent reports can act as a rich source of information on the development of various groups of SMEs and the conditions in which they operate, and the information contained in the Report is of potentially enormous value for assessing the effects of the Internal Market programme upon small and medium-sized enterprises. The Commission therefore wishes to contribute to the launching of a wide-ranging discussion on these matters by presenting its own comments on the Observatory's First Annual Report.

This document represents a summary of the Commission's comments on this report. The first section of the document sets out the Commission's comments on the analytical part of the report (Chapters 2-11) whilst the second section covers its policy recommendations (Chapter 12). The Commission did not appraise systematically the data for each Member State or the annexes to the report (methodology and SME policy in the Member States) although it might refer to certain aspects of the annexes to illustrate or highlight some of the ideas and concepts used.

GENERAL COMMENTS ON THE REPORT

The Commission very much welcomes this Report considering the state of small and medium-sized enterprises in the Community, particularly as it comes at the moment when businesses attempt to take advantage of the opportunities, and grapple with the problems, presented by the new reality of the Internal Market.

Reports of many kinds have discussed the situation of, and prospects for small and medium-sized enterprises in the European Member States. However, this is the first wide-ranging report which considers small and medium-sized enterprises in the Community as a whole, albeit a heterogeneous whole, looking at how enterprise developments in the Community are taking place, as well as at sectoral and other trends within Member States.

This Report aims at providing both institutions and individuals with an interest on small and medium-sized enterprises with a comprehensive, although preliminary analysis of the Single Market's impact on SMEs. It involved reviewing major trends affecting small and medium-sized enterprises, drawing an overall view of SMEs in the Community and assembling information on such fields as entrepreneurship and business dynamics, markets and sales, employment and productivity, capital and finance.

As the integration of the European economies has proceeded apace and is accelerating under the impulsion of the completion of the Internal Market, the task faced was immense and this Report, which is to be the first of a series designed to assess the evolution of small and medium-sized enterprises, could not be expected to cover all relevant aspects of SME development. Whilst it looks at many aspects having regard to the essential role played by small and medium companies as vectors of European economic growth in the context of the actual implementation of the Single Market and the speeding-up of the process of integration, it certainly does not cover as many other issues in any detail.

Throughout the Report, the European SME sector is taken to comprise enterprises (except in agriculture, hunting, forestry and fishing) employing less than 500 persons. Additionally, the following broad size classes are distinguished within the SME sector:

- micro enterprises: 0-9 employees;
- small enterprises: 10-99 employees;
- medium enterprises: 100-499 employees ².

Furthermore, extensive use has been made of the general industrial classification of economic activities within the European Community (NACE 70), and the following sectoral breakdown of private non-primary enterprises has been employed:

- industry (NACE 1-4), usually further divided into extraction, energy and metal processing (NACE 1, 21-24), and manufacturing (NACE 25-26, 3-4);
- construction (NACE 5);
- distributive trades (NACE 61-65);
- services (NACE 66-67, 7-9).

Thus being, the statistical basis as well as the conceptual framework used by the Observatory have been those developed by EUROSTAT and set out in "Enterprises in Europe - Second Report" ³, although some additional estimates have also been made, relating to missing data on the number of firms, employment and turnover.

The Commission largely supports the methodology used by the Observatory in this regard, as it seems to be the only one capable of leading to the use of comparable data throughout the Report, thus providing a structured and comprehensive basis to guide its development in subsequent years. It nevertheless considers that the limited availability of data referring to the period 1989-92 ⁴ invites to the use of some precaution when looking at the relevance and accuracy of the qualitative assessments made in the Report and relating to that period, particularly as the anticipation effects of the implementation of the Internal Market should have been particularly felt during those years.

1. SMEs in the European Community

Chapter 2 of the Report summarizes the available statistical information on the SME sector in the Community and presents an initial analysis of its current size and relevance to the European economy. Furthermore, a preliminary assessment of size and structure of the crafts sector is also presented.

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2. The general expression "small and medium-sized enterprises" is used throughout this document as to designate all enterprises employing less than 500 persons, thus including micro-enterprises.
 3. Commission of the European Communities, 1992.
 4. "Enterprises in Europe" provides data mainly for 1988, therefore somewhat limiting "a priori" the reach of the analysis made by the Observatory. Furthermore, the figures presented in both publications do not include the former GDR.

It is estimated that in 1988 the non-primary private sector of the Community included about 14.6 million enterprises, of which more than 99.9% were small and medium sized-enterprises. In particular, it is estimated that there were about 13.6 million micro firms, some 6 millions of which had no salaried employees, 920 thousand small firms, 70 thousand medium firms, and only about 13 thousand large enterprises. Including large firms, the average enterprise in the European economy has just over 6 persons employed (ranging from 3 in Greece to 10 persons employed in the Netherlands), while the average SME employs almost 4.5 persons. As a result, small and medium sized enterprises provided some 62.4 million jobs, thus accounting for some 70% of total employment in the European non-primary private sector.

It is significant to note that the average firm size roughly increases by a rather constant factor of ten between size classes, ranging from almost 2 persons employed by micro firms to over 2000 employees in large firms. This can be seen as a first indication to the existence of fundamental different problems, attitudes and behaviour within the SME sector, thus justifying the adoption of differentiated policy approaches aiming at micro, small and medium enterprises. Furthermore, this preliminary finding seems to receive also some confirmation from an analysis of similar differences found in turnover per employee generated within each size class, even if in this case the average turnover per employee in the SME sector as a whole was only 13 per cent lower than in the large firm sector and the best overall performance was to be found in medium-sized enterprises ⁵.

Naturally, a more precise picture can be drawn at a lower level of aggregation. In this respect, the Report clearly shows that the industrial sector has by far the largest average firm size, the trade and construction sectors being the realm of SMEs.

5. As it is indicated in the Report, figures for turnover include the cost of raw materials and the purchase value of merchandises, so that turnover per employee needs to be interpreted carefully, especially when used as an indicator for apparent labour productivity.

Some clear-cut differences are also to be found when SME presence is considered from a national point of view. The Report suggests that there is a strong positive correlation between the number of enterprises in the Member States and its population size, whilst a negative one is identified between the average firm size and the number of enterprises per 1,000 inhabitants⁶. A particularly interest finding is that the relative importance of the SME sector, measured in terms of both the overall average firm size and the share of SMEs in employment and turnover, seems to be higher on those Member States where population density, wages rates and, particularly, GDP per capita are lowest⁷. Relative economic prosperity, national markets size and, to a much lesser extent, differences in sectoral breakdown, all acting as driving forces of concentration processes and enabling a better exploitation of economies of scale are offered as possible explanations.

If a distinction is made between those Member States which, together, account for at least 70% of all enterprises within every size class (France, Germany, Italy, Spain, United Kingdom) and the remaining seven, a positive correlation between the average firm size of SMEs and GDP per country still is to be found within each group. However, the whole picture seems now to be somewhat distorted. In spite of the remarkably low size of Belgium SMEs, the second group consistently outperforms the first as far as the average SME size is concerned, even if an allowance is made for the smaller relative importance of medium firms in the Mediterranean countries. This, together with the fact that SMEs tend to be bigger in the northern/central countries than in the southern/peripheral ones, could point to the presence of other factors, such as different cultural attitudes towards work organisation and different degrees of openness of national economies, influencing the relative position and development of small and medium-sized enterprises in the Community. Whether such factors could countervail or override the influence of sheer economic performance, as measured by GDP per capita, notably in the context of the development of the Internal Market can be a subject for future discussion. Nevertheless, it is clear to the Commission that the results presented in the Report needs further investigation.

A preliminary analysis of recent developments in the stock of enterprises, turnover and employment has also been carried out by the Observatory for the period 1989-1992⁸.

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6. Since further evidence is missing in the Report it is doubtful, however, that the number of enterprises per 1,000 inhabitants can be taken as an indicator of entrepreneurship.
 7. In the Report, these are considered to be peripheral/poor small/medium countries (Greece, Ireland, Portugal, Spain), as opposed to central/rich small/medium countries (Belgium, Denmark, Luxembourg, Netherlands) and large countries (France, Germany, Italy, United Kingdom).
 8. Due to the limited availability of data, in the case of micro and small firms the growth in the number of self-employed was used as a proxy for the growth in the number of enterprises.

As a result, it is estimated that in 1992 the total stock of enterprises in the non-primary private sector of the Community increased to about 15.7 million firms. In particular, the number of micro and small enterprises increased by an estimated 1.1 million, the number of medium-sized enterprises remained unchanged and the number of large enterprises is estimated to have decreased by about 500.

As regards to turnover, no significant differences in performance have been found between SMEs and large enterprises, at least in the Community as a whole, although the largest part of SMEs turnover growth comes from domestic demand, whilst external demand seems to have been relatively more important for large firms. Nevertheless, it is interesting to note that developments in external demand seem to have had an indirect effect upon SMEs largely exceeding its direct contribution, as measured by the absolute share of exports in SMEs turnover.

The Observatory also identified an increase in the relative importance and contribution of SMEs to employment over the period 1989-1992, as small and medium-sized enterprises had achieved net employment creation of about 1.6 million jobs during those years, thus increasing its share in the total stock of jobs. Beside, the data presented in the Report seems to point to an increase in the enterprise size differential, the average size of micro and small firms having decreased whilst the average size of medium and large firms increased during that period⁹.

It is nevertheless worth noting that after a period of strong employment growth in all size classes (1989-1990) only micro firms have been able to secure some net job creation in 1991-1992, these years being characterised by an important reduction in the number of both medium-sized and large enterprises as well as in their employment levels. This clearly strengthens the Commission in the need for stepping up the efforts made at Member States and Community levels to maintain and increase employment, in particular in the SME sector.

9. However, the growth in the stock of micro and small enterprises seems to have been overestimated in the Report (see note 7 above). As the overall net natality rate of enterprises (see section 4 below) could also have been overestimated, the figures and provisional interpretations provided by the Observatory should be checked against actual developments in future Reports. Furthermore, the eventual occurrence of threshold effects, due to the down-sizing of medium and large enterprises, though mentioned in the Report, was not taken in consideration.

Finally, a preliminary assessment of size and structure of the crafts sector in the European Community is also presented in this Chapter, a lower and an upper approximation of its economic importance being provided by the Observatory. While across the Community as a whole, the number of craft enterprises varies between 29% and 32% of all firms, providing between 12% and 25% of all jobs, figures for individual Member States vary considerably more and do not correspond, in most cases, to the size of this sector according to official national definitions. However, the Report's estimate is based on the "strong" assumption that all enterprises up to a certain number of persons employed in NACE-classes 2-5, 67 and 98 can be considered as crafts. The use of a qualitative, and not only quantitative, definition of craft enterprises as based on craft-type work organisation, using the workers "entire" skill instead of relying on assembly-type work, as well as the establishment of a distinction between different types of crafts enterprises, namely on the basis of their scale of production, level of creativity and tradition heritage, could surely contribute to a better insight into this sector in subsequent reports ¹⁰.

2. The impact of the Internal Market

Chapter 3 of the Report discusses the impact of the Internal Market upon SMEs in general terms, distinguishing between first order, second order and long term effects as they result directly from Community legislative measures becoming effective, relate to changes in market size and competitive conditions, or stem from long term changes in economic structure and income effects of the completion of the Internal Market.

The Observatory thus considers the completion of the Internal Market to affect the enterprise sector in five main ways ¹¹:

- a potential net reduction in costs due to a reduction of administrative procedures for international trade, and due to a better exploitation of several kinds of economies of scale;
- improved efficiency in enterprises resulting from innovations, induced by more competitive markets;
- adjustments between industries on the basis of a fuller play of comparative advantages in an integrated market;
- more dynamism and an improved flow of innovations, new processes and new products;
- more economic growth in the long run, leading to new market opportunities.

10. The craft sector will in fact be the subject of an in-depth study in the Second Observatory Report.

11. First Annual Report, p. 87.

As those factors will not be equally relevant to all kinds of enterprises or economic activities, the Report argues that the costs of adjusting to the new international framework will, by and large, more than compensate any benefits for SMEs in the short run. In particular, this is considered to be the case in such fields as markets and sales (where some concentration is expected to occur, namely in the southern/peripheral countries), exports and internationalisation (where the removal of external barriers to trade is seen as favouring large firms first), employment (where the possible emergence of some kind of "dual" labour market is suggested, due to an expected polarisation of work qualifications), and capital and finance (where the beneficial effects of increased competition are supposed to be overcome by some concentration of financial centres in the northern/central countries).

Therefore, the Report considers that the effects of the Internal Market upon SMEs will in general be "U-shaped", leading to an improvement of their position only in the medium and long run.

This is believed to hold on a sectoral basis also. In manufacturing sectors where hardly any economies of scale can be obtained in the short run SMEs are expected to be able to maintain their market share, whilst in less mature industries, and particularly in the least industrialised Member States, SMEs will be subject to severe competitive pressure and be forced to reorganise and restructure. In the construction sector, the opening up of public procurement will induce better opportunities for SMEs and lead to increased competition especially at the main contractor level (or both the main contractor and subcontractor levels in border regions). In distributive trades, the bulk of the short term impact of the Internal Market is expected to be felt by small retailers in the Mediterranean Member States which could be especially affected by concentration processes. In the service sector, the general tendency will be for SMEs to benefit from the development of niche-markets and tailor-made personal services, even if it can be expected that enterprises incapable of adapting to the new business environment will be forced out of the market. The craft sector will probably be less severely affected by the Internal Market due to the predominance of customised provision of goods and services and less scope for economies of scale that, together, characterise this sector, but increased competition will still occur especially in the border regions.

The Commission shares the Observatory's view as regards the difficulty of proper isolation of the detailed impact of costs reductions and new business opportunities induced by the Internal Market. As the strengths and weaknesses of SMEs differ by country and by sector, current developments on the European and international economic system as well as the separate national legal systems and institutional arrangements within the Community can contribute to enterprises exhibiting distinctive behaviour, respective of Member State.

Thus, this assessment of the implications of the Internal Market, essentially meant to underline than more than ever it is fundamental to be aware of the importance of the threats it carries for SMEs, is based mostly on mainstream economic theory and still needs to be checked against further evidence. In particular, it is still impossible to isolate its potential negative effects from the international context where the implementation of the Internal Market is actually taking place. Furthermore, although the Report tries to establish them on a sectoral basis, a view of the possible spillover or linkage effects (meaning that the evolution of some sectors could impend, for better or worse, on other sectors) is still missing.

The Commission considers that the Report highlights the need for more studied analysis of the impact of the Internal Market upon SMEs. In particular, the assumption that the advantages of the Internal Market will be first reaped by export-oriented large firms, largely based on the fact that small and medium-sized enterprises engage in less cross-border trade than their larger counterparts, will have to be checked against the potentially large benefits which will accrue to SMEs as purchasers of inputs and services, and as subcontractors to larger firms. In addition, it may be necessary to raise the awareness of the fact that, since the objective of the Internal Market is to dismantle non-tariff barriers which have in the past been most keenly felt by certain types of SMEs, it may therefore hold out proportionately greater benefits for these SMEs 12.

It is also unclear to what extent the completion of the Internal Market can be seen as a determining factor in the process of "dualisation" of labour markets, with SMEs forced to make greater use of less-skilled labour than larger firms, as this tendency already exists and reflects the operation of the economy as it stands, as well as national labour market and social policies. The claim that the Internal Market may bring about convergence of labour costs which could undermine the competitiveness of small and medium-sized enterprises in the less-favoured regions needs also to be called into question. At a theoretical level, it can be pointed out that increased wages will not be tantamount to an increase in unit labour costs if they are offset by productivity catch-up through technology transfer and dissemination of the most advanced production and management techniques. On an empirical level, it can be observed that labour market integration has not proceeded at the same pace as product or capital market integration and, as a result, wages and labour costs continue to be largely determined as a function of supply and demand conditions in the individual Member States.

12. Even in the case of the transitional VAT system, where the abolition of formalities at internal frontiers have been offset to a certain extent by increased in-house administration, firms will notice savings. According to a study carried out by the UK Customs and Excise Department, the switch-over to the transitional VAT system will lead to annual savings of 135 million £ from 1994, after increased costs of 100 million £ in 1993.

Finally, the Report's statement that the costs of capital and financial intermediation are likely to increase as a result of increased concentration in the financial services sector is not corroborated by relevant evidence 13.

The Commission recognises that this preliminary analysis reinforces its conviction about the need to improve SMEs information on the functioning of the Internal Market and the new opportunities opened to them, as well as, amongst others, the need to assist small and medium-sized enterprises in their efforts to raise global quality standards and develop new and more appropriate forms of cooperation both between themselves and with large enterprises. Therefore, the Commission intends to strengthen its efforts in the field of enhancing the managerial and strategic capacities of SMEs, and improving SMEs awareness and participation in Community initiatives which should contribute to improve their competitiveness and enable them to better operate in the Internal Market. In this regard, the Commission thinks in particular that specific attention could be paid to assisting small and medium-sized enterprises in critical moments of their development.

3. Trends

Chapter 4 of the Report reviews some major trends affecting European SMEs and presents a broad assessment of their implications for small and medium-sized enterprises.

The current macro-economic environment does not carry much promises for SMEs in the immediate future, as most Member States are still severely hit by the recession. Beside, persistently dim economic prospects do not allow much hope for a rapid economic recovery, at least as regards private consumption and investment on construction, on whose developments small and medium firms seem to depend more heavily. Nevertheless, as international trade, and therefore external demand, as proved to be quite resilient to bleak economic activity in the world economy, the completion of the Internal Market can contribute in a positive way to stimulate and reinforce the SME position in the Community, especially if moderation in labour costs developments is pursued and continues to contribute to an easing of inflationary pressures. However, appropriate measures for enhancing the competitiveness of, and stimulating the demand faced by European enterprises are to be taken at all the relevant levels of decision, as the opening-up of markets should be accompanied by a reduction in technical barriers to trade and a recovery in the purchasing-power of households, particularly in those Member States where the private demand is less sensitive to changes in interest rates.

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13. Moreover, this statement seems to be at odds with detailed studies on the cost of capital in the European Community, United States and Japan carried out by Coopers & Lybrand (1993) and econometric analysis of the impact of the Internal Market on the European financial services sector (C. Ryan, CEPR, 1992). In particular, this later study finds that the impact of financial services liberalisation will generate large benefits for lenders and borrowers (i.e. clients of financial intermediaries and not the intermediaries themselves) in the core Member States of the European Community.

As regards the demographic developments foreseen for the rest of the decade, the Commission broadly shares the Observatory's view. The well documented dejuvenisation and ageing phenomena of the European population will mean for SMEs a reduction of their traditional work force basis but, at the same time, will lead to the rise of relatively well-educated and affluent groups, thus boosting the demand for differentiated consumer goods and personal services and offering new opportunities for small and medium-sized enterprises. Clearly, there is room for decisive improvements in the functioning of labour markets, especially in what regards work organisation, management of qualifications, and professional mobility and flexibility if those opportunities are to be fully seized. In particular, it seems necessary to envisage new forms of work sharing, capable of accommodating a larger participation of female and senior workers in economic activities without adding to involuntary and hidden unemployment.

Technology is addressed in the Report mainly on the basis of a review of the existing literature on this subject¹⁴, and the emergence of pervasive new technologies as well as the acceleration of technical progress are seen as a beneficial factor for SMEs in a context of general availability of new technological breakthroughs and rapid shortening of product life-cycles. Therefore, it is considered that the flexibility of high or medium-tech SMEs will enable them to perform a major role in this field, especially if they are to join forces with other small and medium or large firms as the generation of technology and its diffusion and application are complementary aspects and in practice not substitutes. Nevertheless, technology could still be used as an entry-barrier in high capital-intensive sectors, and a large part of SMEs operating in mature industries, segmented markets or just being too dependent on products entering the final stages of their life-cycles, could continue to lag behind.

A final reference is made to the internationalisation trend¹⁵, as well as to recent developments in intra-Community trade, international cooperation and licensing, and foreign direct investment. In general, internationalisation is seen as favouring SMEs in their input markets and leading to further reinforcement of international cooperation networks, even if an increase in competitive imports and in the pace of the industrial mutations implied by internationalisation can add to the threats faced by small and medium-sized enterprises in the near future.

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14. A chapter on innovation and diffusion of technology will be included in the Second Observatory Report.
 15. See section 9 below.

4. Entrepreneurship and business dynamics

Chapter 5 of the Report focuses on entrepreneurship and business dynamics. Taking into consideration the heterogeneity of data and information sources available within the Community it is underlined that no definite conclusions are drawn although some "stylized facts" can be stressed.

The average annual growth in the stock of enterprises during the period 1989-1992 is estimated at 1.9%, or some 300,000 enterprises per year in absolute terms, although a downward trend is identified in this period. In particular, the number of micro and small firms has increased in most Member States, while a tendency for decrease is noted in the stock of medium and large enterprises.

This evolution is the result of both natality and mortality rates, which have been estimated at around 10% and 8% respectively. Referring to more disaggregated data, it is possible to note that both rates have been smaller for industrial sectors throughout the Community, which could be viewed as either an indicator of the ongoing process of "tertiarisation" of the European economy or evidence of faster renewal of the economic fabric in services. As a matter of fact, natality and mortality rates tend to be distributed in the same way between sectors and Member States, and therefore SME "turbulence" seems to have been somewhat bigger in northern/central countries relative to the rest of the Community, those being probably the ones with the highest rate of entrepreneurship¹⁶.

When analysing new firm survival, the Report unsurprisingly finds the major causes of failure to be managerial and organisational problems, coupled by financial and market problems. As some of the market problems referred to (strong competition and insufficient demand) can stem from insufficient preparation and absence of a precise business plan, this clearly reinforces the Commission belief on the importance of adequate information and counselling, as well as of formation and training to newly created enterprises. Although an analysis of differences between firms, relatively more important than the sectoral structure to understand the reasons for their success or failure, has not been conducted by the Observatory it is interesting to note that the best performance, as regards new firm survival, are to be found within Member States which have already developed some formal systems of professional formation and qualification requirements related to the access to some professions or activities, as is the case of Germany and the Netherlands.

16. These results should however be taken with precaution. In fact, no data is available for some Member States, and differences in definitions reduce the scope for comparison between countries. Moreover, while it is clear that mortality rates were underestimated for Belgium, where no sanction is imposed on firms that do not cancel the registration when closing, the methods used to define natality rates, and referring to the registration of new firms regardless of whether they start an activity or not, should also have lead to overestimation of births.

As regards the economic environment factors affecting entrepreneurship, the Observatory did not find any straightforward relationship between the number of new enterprises and the business cycle. As expected, the major reasons for starting an enterprise are self realisation, the presence of a business opportunity and the existence of a perceived income gain. Significantly, the average new entrepreneur is a young, well-educated male, with a sound previous professional status and possibly some entrepreneurial family links. However, women and ethnic minorities appear to have raising rates of entrepreneurship, especially in the trade and services sectors.

Some problems with the definitions and data used in the Report make it difficult to interpret results on self employment ¹⁷, especially when contrasting them with those derived for the stock of enterprises. It can be noted, however, that self employment, while seeming to appeal relatively more to male and older persons, is particularly important in the southern/peripheral Member States, where it provides around 20% of total employment in the enterprise sector. In general, it appears that wage-earners are the single main source of inflows into self employment, although a large part of the remainder comes from out the labour force and unemployment (especially in Ireland and Spain), the main outflows being to wage employment and out of the labour force. In this case, it can probably be presumed that either most of the newly self employed are near the end of their professional careers ¹⁸ or re-entering the labour market after some period of inactivity. Nevertheless, as the relative importance of identified exit routes from self employment can be also interpreted as an indication for the presence of a considerable number of "unemployable" or discouraged workers that engage into their own activity for mainly negative reasons, further analysis of the characteristics of the self employed is needed before operational conclusions can be drawn.

5. Markets and sales

Chapter 6 of the Report offers an analysis of markets and sales of SMEs, focusing on distribution and patterns of sales as well as on customer characteristics and business relationships.

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17. In particular, different definitions, not always in correspondence with those relating to the related concept of independent workers, have been used for different Member States. Furthermore, the base year is now 1990 and data provided by the OECD have been used extensively in this section of the Report.
 18. Again, there seems to be some difficulties in interpreting the (scarce) figures provided by the Report on this subject, as this is, at first view, in contradiction with the findings regarding new entrepreneurship and mentioned above.

On the whole, SMEs account for more than two thirds of the sales of the non-primary private sector in the Community, the sales of the construction and the trade sectors being the most highly concentrated in micro and small firms. On the other hand, looking into enterprise size-classes reveals that sales of small and medium-sized enterprises are heavily concentrated into the trade sector ¹⁹, whilst sales of large enterprises come mainly from the industrial sector. Accordingly, as the share of exports in total sales tend to increase with firm size, and the industrial sector is relatively more oriented towards exportation, the Observatory found SMEs to be less prone to directly meet external demand. Nevertheless, exports do account for a bigger share of sales for all size classes in small Member States ²⁰, which can be seen as indicating that the relatively small dimension of local and domestic markets is a factor for earlier internationalisation of SMEs.

Judging from the limited information available on this subject, the Report argues that micro and small enterprises, as probably also stable or declining and older firms, more frequently serve final consumers and make little use of distribution channels. Furthermore, a large part of SMEs seems to be operating relatively more on segmented markets and to depend on a smaller number of clients, thus being more vulnerable to shifts in the demand structure although facing less competition pressures.

Subcontracting is approached in the context of development of industrial structures based both on specialisation and networking and, in general, the Report concludes that subcontracting sales tend to be more important for smaller firms, which have benefited more from its development in recent years. The Commission largely shares the Observatory's remarks ²¹ as to the importance, evolution and implications of subcontracting for small and medium-sized enterprises.

Analysis of other kinds of business relationships, although based on a too broad definition to be used operationally, leads to the conclusion that entrepreneurs perceive that beside benefiting their company performance, they will not have to forfeit their highly valued decision-making power through cooperation agreements.

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19. It is to note, however, that the concepts of "sales" and "turnover" have been used as substitutes throughout this Chapter. Furthermore, generalisations from the data presented, notably as regards the establishment of an eventual inverse relationship between SME-share in total sales and GDP are not easy to draw since detailed information for Denmark, Greece, Ireland and Spain is missing.
 20. See note 6 above.
 21. This section of the Report makes extensive use of the study "Economic importance of subcontracting in the Community: working document on the national reports", Commission of the European Communities, 1992.

The Commission notes that the present trend into some kind of alliances between firms which are not necessarily based on formal contracts, especially when matched by an increased awareness of the current structural developments in the enterprise environment, is an essential strategy to improve the competitiveness of enterprises and thus strengthen the European economic performance, and will continue its efforts to assist cooperation programmes and transnational business relationships, to stimulate the potential for cooperation, and to encourage those who are still apprehensive of cooperation.

6. Employment

Chapter 7 of the Report examines the major features of employment in the SME sector, focusing in particular on the importance of enterprises of different sizes to job provision and employment changes, as well as on the job characteristics and competitiveness of small and medium-sized enterprises.

On the whole, micro enterprises play a role almost as important as large enterprises in employment (29% against 30%), and they are even, in some Member States, the main single provider of jobs in the non-primary private sector. Furthermore, although the data available on employment creation by SMEs is scarce and job generation studies are difficult to compare and interpret, small and medium-sized enterprises are considered to have the greatest job creation potential throughout the business cycle. In particular, firms with the greatest propensity to create large number of new jobs on a continuing basis are believed to be those smaller firms who have already demonstrated an ability to expand their operations successfully, but whose markets have yet to reach maturity.

In terms of quality, small and medium-sized enterprises are major providers of first jobs and part-time jobs, thus playing a key role in the training and flexibility of labour, and SMEs are also instrumental in absorbing the less sought after groups in the labour market as they recruit more than their fair share of young people, women and unskilled workers. As these are groups with a high risk of unemployment, this fact also underlines the sector's needs to develop skills and vocational training and therefore of the significance of new initiatives taken in this context.

Wages also appear to increase with the size of enterprises, labour costs in industry being on average between 30 and 50% higher in large enterprises than in smaller ones ²². However productivity seems to be generally higher in large enterprises ²³. SMEs, and particularly micro and small enterprises, have to bear higher unit wage costs ²⁴ which have an adverse effect on their degree of competitiveness which, given their general tendency to use less intensive production techniques, might reduce their potential for creating jobs.

Long-term unemployment has increased over the past years in the majority of the Member States and the situation in the Community is now marked by high rates of unemployment which are detrimental to both the competitiveness of the national economies and the social fabric of the Community. Moreover, international competition, the globalisation of economic flows and company strategies are having a considerable impact on enterprises' choice of locations and attitudes regarding employment. Furthermore, the search for productivity gains, the concern to deploy new technology to automate production to an increasing extent, and the pressure from newly industrialised countries, whose wage costs are extremely low but who have proved capable of coping with the most modern techniques, may all induce European enterprises to shed even more jobs and to seek a competitive edge in a human resource policy based on increased selectivity.

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22. Wage inequality differs also between Member States and can be viewed as a first indication of the degree of flexibility of labour markets, since the more flexible a country's labour market is, the more changes in the relative demand and supply of different types of workers, by age and education, are supposed to show up in relative wages rather than in unemployment; nonetheless, an alternative explanation for (growing) wage inequality is deindustrialisation and the replacement of "high quality" jobs in industry by "low quality" jobs in services.
 23. The data presented in the Report does not allow to assess the relative importance of sectoral characteristics, as opposed to enterprise dimension, on productivity. In particular, recent statistics available for some Member States seem to indicate that productivity could be more linked to sectoral characteristics than to firm size.
 24. Although the evidence is mixed, some studies seem to suggest that labour costs are smaller in Member States with lower employer's perceptions of employment-protection regulations, and higher rates of participation and part-time jobs.

The Commission thinks that these two collective objectives (conserving both the social fabric and the competitive edge of enterprises) can only be reconciled by taking advantage of the SMEs strengths, particularly their presence in spearhead markets and in activities which are less susceptible to international competition (and especially their predominance in personal services and in high-performance market niches), their links with the local environment and their ability to adapt and the flexibility of their internal organisations, while helping them to negotiate the administrative and legislative hurdles, overcome their problems and devise suitable strategies.

7. Capital and finance

Chapter 8 of the Report analyses the financial aspects of the SME sector, and devotes some attention to the study of the relationship between finance and innovation, and to bank lending conditions. Moreover, a brief examination of the importance of trade credit to SMEs was also carried out.

In general, cross country comparisons showed that there is significant dispersion in the debt structure of SMEs, as well as on their profitability and gearing capacities. Furthermore, the evidence presented in the Report is mixed²⁵, and does not provide full confirmation to some working hypothesis advanced in this context, namely that SMEs tend to make lesser use of long terms loans, or to be less profitable than large firms, especially in the manufacturing sector where market power and economies of scale are expected to be more important.

Venture capital, which seems to be relatively more important in France, Germany, the Netherlands and the United Kingdom, is relatively more used for business expansion and buyout, as is provided mainly by financial institutions. With the remarkable exception of Spain, around three quarters of the stock of formal venture capital, of which less than 10% is channelled towards micro firms, is sourced domestically. Furthermore, SMEs in peripheral regions are found to be more likely to suffer from a lack of venture capital and to face greater difficulty in raising finance for innovation, as in most Member States risk-investment is concentrated around a major financial centre and the structure of financial markets, as well as the limited availability of exit routes to venture capitalists does not appear to be conducive to providing equity funds for small and medium-sized enterprises.

In general, SMEs are also seen as having inadequate access to lower cost and long term lending due to lack of collateral, they appear to be less favoured by banks and they suffer more from the recent expansion of trade credit and longer average payment periods, particularly in periods of economic downturns.

25. However, the data used in this section of the Report is hardly comparable to the one used elsewhere.

The SMEs chronic shortage of funds makes it a problem for them to obtain from banks the money that they need to operate properly. Access to sources of funds and particularly venture capital is a problem for SMEs and their funding difficulties are exacerbated by the weakening of secondary markets and by late payment. There appears to have been a marked deterioration in standards as regards paying bills at Community level, three-quarters of enterprises having to send out reminders systematically to obtain payment ²⁶.

The Commission wishes to point out that these funding problems differ widely depending on the type of enterprise (size and sector) and the requirement (creation, expansion, liquidity position or transfer) and persist despite the increasing number and variety of financial instruments available to enterprises. On an overall level, European competitiveness on capital costs seems to be an obstacle for the adjustment to internationalisation and globalisation of the business sector, and capital obstacles for SMEs could consequently be seen as one aspect of the very complex situation of competitiveness on capital markets. Expansion of high tech enterprises in particular which are forced to turn to options such as start up capital and venture capital, which are thin on the ground in the Community, faces major obstacles, particularly fiscal ones, and suffers from the absence of a dynamic European capital market for small and medium-sized enterprises. Moreover, the withdrawal of investors of venture capital from the sector of business creation since the end of the 80s probably means that a large number of viable projects do not see the light of day in the Community because insufficient financing is available, although this type of project represents in the long-term a potential source of high-growth enterprises.

8. Regional aspects

Chapter 9 of the Report deals with regional aspects, offering a first appraisal of the situation of, and prospects for small and medium-sized enterprises either in intra-Community border regions and in Objective 1 regions ²⁷.

26. "European Business Survey", Grant Thornton International, 1993.

27. As regards the later, extensive use was made of the "Fourth periodical report on the situation and socio-economic evolution of regions in the Community", Commission of the European Communities, 1991.

In general, border regions with similar patterns of development have been found to be rather unusual and borders, whether blurred or reinforced by physical, institutional or historical barriers, seem to have led to a considerable amount of disparate situations throughout the Community. As a result, whilst borders usually provoke distortions in economic flows and delimit regions with different economic levels, cross-border flows differ considerably between regions and Member States, and have developed more easily in smaller decentralised countries. Therefore, elimination of border barriers, although it might cause inter-regional inequalities to increase in the short run and have negative implications for those firms and areas of activity which for long benefited from the border as a protected haven, is expected to create additional opportunities for businesses, and thus for the local small and medium-sized enterprises which seem to be particularly suited for engaging into some form of inter-firm cooperation.

Objective 1 regions ²⁸, which on the whole are less densely populated, less industrialised and suffering from more unemployment than the rest of the Community, appear to be relatively more dominated by small and medium-sized enterprises. In particular, the average firm size is lower, and the employment share of SMEs is higher in these regions. Nevertheless, it seems that the absorption of Community Structural Funds by SMEs is still unsatisfactory, due to internal factors related to SMEs, organisational problems in several national central administrations, and limited use of the global grants instrument.

The Commission welcomes the Observatory's support for the Community's efforts to provide assistance to enterprises and to promote economic development through transborder and transnational cooperation, namely by means of the INTERREG initiative and the allocation of funds by Structural Funds (EFRD, ESF, EAGGF), and largely shares the remarks made in the Report as to the need of further improving the absorption of Community's funds by SMEs, alleviating financial burdens and helping develop financial institutions geared to the needs of SMEs, and assisting the development of managerial resources in less favoured regions.

9. Internationalisation of SMEs ²⁹

Chapter 10 of the report analyses the phenomenon of internationalisation of SMEs as a continuous, world-wide process, which is being reinforced at European level by the completion of the Internal Market.

28. Considered as prior to Council Regulation (EEC) 2081/93 of 20 July 1993, O.J. L 193 of 31 July 1993.

29. This constitutes the "Theme Study" of the First Report, which is meant to be, each year, an in-depth study on a subject of particular relevance to SMEs. In particular, it includes results of some previously unpublished documents, as well as of an original study on SME export bottlenecks which has been especially devised and carried out for the Observatory.

In global terms, the trend towards internationalisation or globalisation of enterprises hardened in the 80s as technical progress accelerated, the life cycle of products shortened and competition throughout the world increased: this is at least the message inherent in the rapid increase in fusions and acquisitions, minority holdings and joint ventures over the last 10 years.

However, internationalisation is a phenomenon which is difficult to quantify or evaluate in terms of quality, as the terminology used to describe it is often vague and reflects several different aspects. Generally speaking though, as far as enterprises are concerned, the concept of globalisation may describe:

- the capacity to take sufficient flexible action to identify and benefit from opportunities observed in any part of the world;
- the ability to purchase and distribute goods and services and transfer financial resources across borders;
- the absence of a national base;
- activity in various national markets;
- the ability to adapt products to the specific needs of each market;
- the existence of managers who are capable of thinking and acting in global terms.

The Report helps to show that internationalisation of enterprises, particularly industrial European ones, seems to be a phased process, comprising indirect international influence (mainly via subcontracting for exporters), indirect or irregular participation in exporting, direct or regular participation in exporting, cooperation with enterprises abroad (mainly in R&D and marketing), licensing and, finally, direct investment abroad.

In general, exporting is the first stage in internationalisation of companies, though in most cases this is preceded by an increase in international competition in national markets.

The fact that international trade and direct investment abroad have, over the past years, grown faster than production, suggests that enterprises have become more and more internationalised. The same applies to small and medium-sized enterprises for whom exports account for an average of 10% of turnover, particularly if one bears in mind that this could be seen as an indicator of their future globalisation in the widest sense of the term.

Nevertheless, one could also make the point that this globalisation of economic activity, although it has caused several "national champions" to disappear, has not really led to the emergence of enterprises without a national base. On the contrary, the need to simplify and reconcile aspects of business which are often seen as contradictory, such as price and quality, and to redirect production activities, has led to a search for closer and closer cooperation between enterprises, or to a change in the globalisation strategies of these enterprises aimed more at developing "relationship enterprises" than "global companies".

Moreover, given the fact that the share of intra-Community sales in the turnover of European enterprises is still much greater than the weight of the European economy in the world, one could also claim that the Community enterprises are not yet sufficiently internationalised.

In fact, for European enterprises and in particular for small and medium-sized enterprises, internationalisation means firstly Europeanisation (the rate of growth for internal Community trade being higher than that for external Community trade), even though the effects of international competition are felt in full in its traditional markets (the rate of growth of imports from outside the Community seems to be even higher).

In general terms, apart from the factors contributing to an acceleration of the internationalisation of European small and medium-sized enterprises (implementation of the Internal Market, modernisation and technical progress, dissemination of techniques, increase in non-material investment, and liberalisation of investment abroad), there are also factors which sustain the Europeanisation of SMEs (increase of the activities of large enterprises abroad, procedures for aiding international cooperation, and access to information on foreign markets) and ones which hinder it (depression of economic activity, lack of resources and problems with financing, average size which is often less than the critical size, obstacles to the transfer of enterprises, lack of training and strategic vision and organisational weaknesses).

The Report reveals that the problems encountered by enterprises in this respect largely stem from the characteristics of the exporting enterprises themselves. Indeed, most of the difficulties facing SMEs are directly related to their internal weaknesses, whilst large enterprises seem to be affected more by financial problems mainly associated with pricing or product specification.

The Commission thus feels that SMEs could reap the benefits of the Internal Market to the same extent as large enterprises as soon as they have been helped to overcome their internal obstacles to internationalisation, which are often caused by their size, and to make good their information shortfall. To give just a few examples, the conclusions to the Report confirm that the development of Community networks and instruments for providing enterprises with information and seeking out partners, the harmonisation of standards and technical norms brought about by the completion of the Internal Market and the elimination of obstacles to the spread of technical progress (mainly a matter of intellectual property rights), can contribute to strengthening the process of Europeanisation of enterprises, especially in sectors and fields where their problems are felt most keenly (mature industries or insufficient mastery of technology).

10. Synthesis

Chapter 11 of the Report summarises its major findings and results, and the impact of either macro-economic trends and the completion of the Internal Market on SME-fields ³⁰ is reviewed in a coherent, elegant way. Thus, it provides a qualitative assessment of strengths and weaknesses, as well as of current threats and opportunities faced by European small and medium-sized enterprises. Furthermore, by drawing country-profiles based on SME presence and macro-economic indicators for each Member State, it sets the basis for regular monitoring of the impact of the Internal Market on SMEs.

Unsurprisingly, the Report suggests that the European enterprise policy should attempt to reinforce the strengths and countervail the weaknesses of the SME sector. Nonetheless, it seems that, in most cases, those strengths and weaknesses, as well as opportunities and threats faced by SMEs, are just two faces of the same coin. Some selected examples are the high volatility (positive effect of high natality rates and negative effect of high death rates), and the low productivity of small and medium-sized businesses (positive effect on high employment creation potential and negative effect on high labour costs). It will thus be necessary to know more about differences identified within the SME sector itself, as well as about the micro processes underlying SMEs activities.

Although the "environment issue" has not been addressed in the Report as an element of challenge and opportunities for SMEs, the Commission wishes nevertheless to note that future developments in this field can be of paramount importance to small and medium-sized enterprises. In fact, not only are many SMEs, by their size and nature, in a much better position than their bigger counterparts to adapt themselves rapidly to the changing demands of society on environmental quality related products or services, or to pursue new activities relating to the development, production and consultancy on clean technologies, but also they will have to progressively adopt a more pro-active attitude towards the environment issue as a potential competitive edge, namely since the banking and insurance sector is expected to gradually tighten their standards in relation to the environmental performance of firms including SMEs.

30. Meaning entrepreneurship and business dynamics, markets and sales, internationalisation, employment, capital and finance, and regional aspects. As they all have been considered in previous sections, the Commission will refrain from further commenting on them here.

Finally, it is significant to note that a preliminary analysis of base-line indicators for 1988, as presented under each country-profile, does already reveal some striking differences between Member States. Taking SME-presence and degree of entrepreneurship ³¹ as indicators of current predominance of small and medium-sized enterprises, and considering business dynamics and export orientation to be indicators of future prospects for SMEs, a definite picture seems to emerge. Small and medium-sized enterprises consistently predominate and seem to have bleaker prospects in a group of peripheral Member States (Greece, Ireland, Italy, Portugal and Spain), while the opposite is true for a group of small/central Member States (Denmark, Luxembourg and the Netherlands) ³². Whether or not, and how this will be affected by convergence or rather divergence originated from the completion of the Internal Market will certainly be one of the major issues for the Observatory to discuss in subsequent reports.

GENERAL COMMENTS ON THE POLICY RECOMMENDATIONS

Chapter 12 of the Report proposes a number of policy recommendations which relate to the following areas:

- representation of SME organisations;
- entrepreneurship and business dynamics;
- markets and sales;
- exporting and internationalisation;
- employment and human resources;
- financing of SMEs;
- regional aspects.

The Commission largely supports the general assumptions on which these policy recommendations are based, in particular as regards the principle of subsidiarity, which implies that in areas that do not fall within its exclusive competence the Community shall take action only if the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the Community. In this context the Commission may in particular take any useful initiative to promote coordination between Member States in view of encouraging an environment favourable to the creation and development of enterprises, particularly SMEs.

31. See note 5 above.

32. However, while Belgium, German and French SMEs can be considered as "average firms", British SMEs showed weak performances on both grounds.

1. Representation of SME organisations

The Commission shares the Observatory's recommendation as regards proper consultations of the organisations or representatives of the small business and craft sector. The Commission refers to the existing consultation framework, which has been established by DG XXIII, and which is largely supported by the trade organisations³³. In adopting the new multiannual SME programme³⁴ the Council also acknowledged that the effectiveness of the action programme could be increased by regular contacts between the Commission and employers' organisations and that in this context SMEs should be encouraged to improve their representation at European level.

2. Entrepreneurship and business dynamics

The Commission largely supports the Observatory's view that in creating a favourable climate for encouraging new start-ups and for minimizing failure rates, most initiatives could be undertaken at national, regional or even local level.

The role of the Community is rather to initiate actions in cooperation with the Member States and/or intermediaries of enterprises which act as a catalyst for growth. Such actions are currently taken in various fields which are of particular relevance to SMEs such as ensuring a better information of businesses, promoting cooperation between enterprises, creating a better financial environment for business and assisting enterprises, including the very small, to adapt to structural changes and changes brought about by the Internal Market. Initiatives have been launched in other important areas such as R&TD, vocational training and education programmes, which are highlighted in the Report.

In addition the Community is taking actions to ensure the right legal and administrative environment for business to develop. These include measures, such as the business impact assessment system which aims at alleviating the burdens on business resulting from Community legislation. The Commission also initiates legislative proposals at Community level, such as new legal forms for businesses, which should enable them to better operate in the Internal Market.

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33. See the independent evaluation report of the Community's enterprise policy, attached to doc. SEC (92) 1992 final.
34. Council Decision of 14 June 1993 on a multiannual programme of Community measures to intensify the priority areas and to ensure the continuity and consolidation of policy for enterprise, in particular SMEs, in the Community, O.J. L 161 of 2 July 1993.

A number of concrete policy recommendations in the Report, such as the launching of a European Entrepreneurship Promotion Programme, with special reference to the unemployed and minorities which seem to be under-represented among entrepreneurs, deserves attention by the Community. The role of the Commission in this field should mainly consist in stimulating exchange of information between Member States on best practices to promote new start-ups and to encourage the development of existing businesses.

In line with the Report's recommendations and the principle of subsidiarity the Commission intends to strengthen its efforts in the field of enhancing the managerial and strategic capacities of SMEs, and to provide specific support for enterprises with a high potentiality for growth, and hence for the creation of new jobs.

3. Market and sales

The Commission notes that the new Community programme for SMEs is fully in line with the Observatory's recommendations as regards the improvement of the existing information and business-partner-search networks, and the development of instruments permitting direct contact between entrepreneurs. In addition the Commission welcomes the Observatory's support for the Community's efforts to improve knowledge of subcontracting markets, promotion of harmonised certification and standardization procedures, as well as the encouragement of cooperation between large and small enterprises.

4. Exporting and internationalisation

The Commission broadly shares the Observatory's views as regards the role which the Community can play in assisting SMEs to export and to internationalise their operations. The main focus of Community action should indeed be placed on narrowing the information deficit of SMEs, promoting cooperation between small businesses and increasing their competitiveness.

5. Employment and human resources

The Commission recognises the need for stepping up the efforts made at Member State and Community level to maintain and increase employment, in particular in the SME sector which, as stated in the Report, is a major source for creating new jobs.

In order to achieve these objectives the Commission will submit a White Paper on competitiveness, growth and employment. Measures which could be envisaged in this context include concerted actions with Member States in order to lift existing legislative barriers to the creation of new enterprises and the development of existing businesses. Specific attention should be paid to enhancing the financial environment of SMEs, the counselling and training of managers, and the development of enterprises with a high potential for growth.

Amongst the various Community measures in favour of employment, reference should also be made to the important field of training, which is highlighted in the Report. In the context of the European Social Fund, the Community introduced a new Objective 4 which is to facilitate workers' adaptation to industrial change and to changes in production systems for persons where new qualifications are required. This should contribute to promoting employment facilities and workers' geographical and occupational mobility in order to prevent unemployment and to promote a highly qualified labour force.

6. Financing of SMEs

The new Community programme for SMEs reaffirms the need for ensuring the continuity and consolidation of existing actions in view of promoting a better financial environment for enterprises, especially SMEs.

In line with the Observatory's observations the Commission intends to strengthen its efforts in the area of prompt payment, the self-financing by SMEs (including tax aspects), the mobilising of financial institutions in order to facilitate the access of SMEs to finance and the promotion of suitable financial instruments for SMEs in all Member States (including financial engineering techniques and the promotion of secondary stock markets).

New initiatives in this field have also been taken at the recent European Council meetings in Edinburgh and Copenhagen, which proposed to provide Community guarantees (European Investment Fund), to increase the volume of EIB loans available for SMEs by ECU 1bn, and the grant of Community interest subsidies. In particular, the new European Investment Fund, with a capitalisation of ECU 2bn, will initially issue financial guarantees and may at a later stage provide equity.

7. Regional aspects

The Observatory's report concentrates on border regions and regions eligible under Objective 1. Of course, these regions do not account for all of the regions benefiting from the various instruments available under the Community's Structural Funds. Also it should be recalled that the Council of Ministers decided in July 1993 the list of Objective 1 areas for 1994-1999. The new list is more extensive than the previous one.

The remarks made in the Report reflect the Commission's own concerns, namely to optimise the use of the Structural Funds by SMEs, to resolve the structural problems of border regions, to improve information and exchanges of information between the border regions and to support the reinforcement or creation of transnational networks of SME intermediaries.

A fair number of Community instruments which were created via its enterprise policy (the EIC, BC-NET and BRE networks), its regional policy (Community support frameworks, Community initiatives, Article 10 of the ERDF) and its Community vocational training programmes and initiatives (FORCE, COMETT) or technological research and development programmes respond to these needs.

The suggestion to create ad-hoc transnational bodies (Eurodistricts) and to gradually entrust them with mandatory powers exceeds the competences of the Community. However, the Commission could play a role in encouraging private and public initiatives aiming at facilitating cross-border operations, notably in the field of subcontracting.

The Commission is aware of the part SMEs could play in cementing the economic and social fabric of the Community and would like to raise the profile of its activities on behalf of SMEs in its regional policy in order to ease access by SMEs to the funds intended for them and to improve efficiency, mainly by supporting the SMEs' intermediaries. What needs to be done now, in line with the partnership principle, is to convince the Member States and the regional or local authorities responsible for implementation to focus their attention on SMEs when drawing up their regional development plans for submission to the Commission under the Structural Funds.

As to Community initiatives, a far-reaching process of consultation on the Commission's Green Paper has just been concluded. The Commission will take a decision once it has examined all the views put forward.

CONCLUSIONS

The Commission acknowledges the value of the first annual report of the European Observatory for SMEs, particularly in view of the very tight preparation schedule and the problems posed by any exhaustive appraisal of the situation and prospects of small and medium-sized enterprises in the Community. The Report contains much analysis which is relevant to the Commission's future activities and fully achieves its objectives, one of which was a preliminary evaluation of the position of small and medium-sized enterprises at the time of completion of the Internal Market was completed. As it stands this first Report will certainly become a most useful point of reference, not only for understanding the real problems facing SMEs as present but also as material for a full-scale debate on this matter.

According to the estimates made by the Observatory on the basis of available EUROSTAT data some 15.7 million enterprises exist in the Community 99.9% of which are SMEs employing some 64 million persons, i.e. providing 70% of jobs in the non-primary private sector. In this context, the vital importance of micro-enterprises, half of which provide work for a single person only, is worth mentioning as they account for 93% of European enterprises and are the only ones to have created jobs over the last few years. In the same vein, to quote just one example, we could underline the role of the ethnic minorities, women and young people in the process of business creation, especially in trade and services.

However the Report also reveals that SMEs, frequently operating in segmented markets, are still too dependent on a relatively small number of customers and do not cope well with the arrival of new competitors in their traditional markets or globalisation of large enterprises. It also reveals that SMEs have to bear higher unit wage costs which, in view of their tendency to use less labour-intensive techniques, reduces their potential for creating jobs. Finally, it shows that access to sources of finance and particularly venture capital is still a problem for SMEs and that their funding problems are exacerbated by the weakening of secondary markets and delays in payment.

It is still too early to assess the relevance and even the soundness of all the analyses, conclusions and recommendations in the report. In particular, it is difficult to assume that SMEs share the same problems regardless of their activity, sector or size and that only specific policies or recommendations may help them. The Commission therefore considers that the Observatory's future work, whilst retaining the basic structure of the reports, should pay more attention to the distinctive characteristics of SMEs.

First, a finer breakdown by size of enterprise would be desirable and a clear distinction should be made between independent SMEs and those which are controlled. Second, the Observatory should be able to provide an annual overview of the structure and development of European SMEs, possibly including a comparison with their counterparts in other countries or geographical areas, in the form of a set of relevant key indicators. Finally, since the major objective of the reports is to provide a regular appraisal of the impact of the Internal Market upon small and medium-sized enterprises, the Commission, following the demand of several Member States, invites the Observatory to examine the possibility of making use of more up-to-date data, where available, with a view to following conjunctural developments within the SME sector on a more regular basis.

As it stands, the Report does seem to support the guidelines in the new Community action programme to intensify the priority areas and to ensure the continuity and consolidation of enterprise policy, especially for small and medium-sized enterprises in the Community ³⁵.

35. See Article 2 of Council Decision 93/379/EEC of 14 June 1993, O.J. L 161 of 31 July 1993.

In reality, market expansion requires enterprises to make an effort to adjust their activities and resources, irrespective of the sector or site of the enterprise. If this crucial and sensitive phase of applying the provisions of the Internal Market is not handled with great care, the enterprises and especially SMEs could prove the weak link in consolidating the new rules of the European economy, and could threaten control of the process as a whole. The Commission thus plans to encourage and support the adoption of policies to provide assistance in the process of adjustment which will increase the number of beneficiaries of Community activities accompanying the launch of the Internal Market, such as those aimed at preparing managers of SMEs for strategic management in an expanded market.

The Community must also be more prepared to listen and react to the conditions in which enterprises must adjust to the new administrative and legal environment while ensuring a transparency of its activities in line with the consolidation and codification of the relevant legislation. In particular, the Commission intends to strengthen coordination of its activities with those undertaken by other institutions in the Member States and by the business community and enterprises or their intermediaries responsible for providing guidance on integration in this new environment.

Although the main instruments to be developed and implemented are in the hands of the Member States, the Community has a key role to play as a catalyst, through its Community pilot projects and policies which, where successful, can be transformed into priority policies.

It is more vital than ever for the Community institutions and the Member States to commit themselves to a structured, cooperative and systematic process of analysis and political discussion of activities on behalf of SMEs, particularly with a view to helping them to become one of the bases for growth, job creation and economic and social cohesion in the Community.

The prime objective of the Commission will be to ensure that there is a high degree of added value in the Community's enterprise policy and to contribute to economic resurgence and growth in employment by developing activities of direct interest to enterprises and stepping up interaction between existing instruments.

EXECUTIVE SUMMARY

THE EUROPEAN OBSERVATORY FOR SMEs

First annual report

**Report submitted to Directorate-General XXIII
(Enterprise Policy, Distributive Trades, Tourism and Cooperatives)
of the European Commission by:**

ENSR - European Network for SME Research

and co-ordinated by:

EIM - Small Business Research and Consultancy

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ABSTRACT

Almost all (99.9%) of the 15.7 million businesses in the private non-primary sector of the European Community are small and medium-sized enterprises (SMEs). These enterprises provide 70% of the jobs in this sector (50% of all jobs in the Community) and make a significant contribution to the prosperity of the Community. Throughout Europe, the SME sector experienced a revival of dynamics and new entrepreneurship. The completion of the internal market will in time considerably change the environment for SMEs. In the short run European entrepreneurs in SMEs are faced with concentration processes, the adjustment to new EC legislation and with information gaps in a widening internal market, but they must also cope with recessionary tendencies in their markets. However, in the long run the expected acceleration of economic growth as a result of European integration and the ongoing internationalization of SMEs will present many opportunities for those entrepreneurs seeking to launch new products and enter new markets. Moreover new possibilities for SME growth will be offered by the demographic developments and rapid technological change. However, SMEs will have to make specific efforts to realize their potential within the increasingly more competitive climate of the internal market.

1. SMEs IN THE EUROPEAN ECONOMY

Enterprises

The typical EC business is a micro enterprise (0-9 employees) of which there are more than 14.5 million. The EC also has about 1 million small (10-99 employees) and about 70,000 medium-sized (100-499 employees) enterprises. Thus the vast majority of enterprises (99.9%) in the European economy are SMEs. It is estimated that in 1992 there were 15.7 million SMEs in the private non-primary sector of the Community, exclusive of former Eastern Germany. There were only about 12,000 large enterprises with more than 500 employees.

For the year 1988 more detailed figures of the European enterprises sector are available. A summary of the key indicators is presented in Table 1. On average there were about 45 enterprises per 1,000 people in the EC.

However, this ratio differs greatly between countries and ranges from about 30 in the Netherlands, Germany and Denmark to more than 60 in Portugal and Greece. This ratio may be viewed as an index of entrepreneurship, but it also reflects differences in average firm size as measured by the number of persons employed per enterprise.

Table 1: Key Indicators at the Community level

	SMEs (0-499)	micro firms (0-9)
Structure (1988)		
number of enterprises (x mln)	14.6	13.6
number of enterprises per 1,000 inhabitants	45	42
number of persons employed (x mln)	62.4	26.2
employment share in private, non-primary sector (%)	70	30
employment per enterprise	4.3	1.9
turnover per enterprise (x 1,000 ECU)	413	125
turnover per employee (x 1,000 ECU)	97	69
share of extraction ^a in employment (%)	3	1
share of manufacturing in employment (%)	27	14
share of construction in employment (%)	12	13
share of trade in employment (%)	24	30
share of other services in employment (%)	35	42
share of exports in turnover (%)	10	5
share of consumption goods in turnover (%)	36	38
share of investment goods in turnover (%)	9	8
share of intermediate goods in turnover (%)	45	49
Performance^b 1989 -1992 (average annual growth)		
turnover of consumption goods (%)	1.7	2.0
turnover of investment goods (%)	2.0	1.8
turnover of intermediate goods (%)	2.2	2.2
exports (%)	4.7	5.0
total turnover (%)	2.3	2.3
employment (%)	0.7	0.9
the number of enterprises (%)	1.9	1.9
General indicators		
venture capital as percentage of GDP 1989 (%)	0.8	
annual real growth private consumption 1989 -1992 (%)	2.4	
annual real growth GDP 1989 -1992 (%)	2.2	
annual growth real labour costs per employee 1989 -1992 (%)	1.7	
average birth rate of new enterprises, 1989 (%)	10	
share of 15 - 24 in population, 1990 (%)	15	
share of 25 - 64 in population, 1990 (%)	52	
share of self-employed in total employment, 1990 (%)	13	
share of craft-industry in non-primary employment, 1988 (%)	12-25 ^c	

a. Including energy and metal processing.

b. Preliminary estimate with SME Accounting Scheme; growth of turnover is measured at constant prices.

c. Lower and upper approximation.

Including large firms, the average enterprise in the European economy has just over 6 persons employed, while the average SME employs almost 4.5 persons. Average firm size however differs greatly between the Member States. Furthermore, although average firm size in extraction and manufacturing is much higher than in construction, trade and other services, the differences in average firm size between countries have little to do with the sectoral composition of the national economies. By and large it turns out that the more prosperous the country in terms of per capita GDP, the greater average size of SMEs in most sectors will be. This is probably due to scale economies in more advanced markets and to concentration processes related to higher labour costs in these countries. Furthermore, large countries having a large domestic market, seem able to exploit economies of scale more fully. Densely populated countries have a greater number of customers within the local market of enterprises, implying these enterprises can be larger.

In the period 1988-1992 the number of enterprises in the European Community has increased substantially. Empirical evidence suggests that this increase was especially marked in 1989, but has slowed since. The increase is fully due to the strong growth of small and micro enterprises. The number of medium-sized enterprises has been rather stable over the past four years, whereas the number of large enterprises is now somewhat smaller than it was in 1988.

Employment

Total employment in SMEs in 1988 was 62 million, some 70% of employment in the non-primary market sectors of the European Community. Large firms provide about 26 million jobs. Within the SME sector there are about 16 million self-employed and 46 million employees.

More than 90% of the self-employed belong to the micro enterprises (0-9 employees), and total employment in these smallest firms was 26 million in 1988. Most jobs in the micro firms are in the personal services, retailing and wholesaling. The share of construction is small in an absolute sense, but is larger than in any other size class. Over the past four years micro firms have witnessed the largest employment growth and are now estimated to be providing about 27 million jobs.

Small firms (10-99 employees) account for 25% of non-primary employment and provide about 22 million jobs. The employment in these firms is spread more evenly over the major sectors of the economy than in micro enterprises. In fact manufacturing has a substantial share at about 30%. Small firms have shown remarkable jobgrowth in 1989 and 1990, but more recently seem to have only been able to sustain employment.

Medium sized firms (100-499 employees) provide about 14 million jobs, 40% of which are in manufacturing. After strong job generation in the late 1980s, it is estimated that these firms are now losing jobs. The same can be said for the large firms sector, in which manufacturing, transport and business services are relatively dominant.

Craft industries

In the report a first assessment is presented of the size and structure of the craft sector in the EC. The term craft trades is legally defined in Belgium, Germany, Luxembourg, France and Italy, and an official non-legal definition is used in Greece, Ireland and the Netherlands.

In countries where the term craft trades is legally defined, the definition is applied in various ways. For instance, Luxembourg and Germany classify 151 and 127 professions respectively as being craft trades. The remaining countries define the sectors comprising crafts and sometimes stipulate the maximum number of employees in craft firms. In Ireland and Greece the craft trades are closely connected with 'arts and crafts'.

Craft enterprises are primarily to be found in manufacturing industry, building and installation, repair and personal services. In retail trade only a small proportion of the enterprises can be considered as craft firms.

Upper and lower 'approximations' of the number of jobs in the craft sector indicate that between 12% and 25% of all jobs in the non-primary sector are provided by craft enterprises.

2. THE IMPACT OF THE INTERNAL MARKET

At the end of last year more than 90% of all proposals contributing to the completion of the internal market had been approved. In its consequences, however, the completion of the single market is a far more gradual process. Already in the late 1980s a great many firms, especially medium-sized and larger ones, were positioning themselves in anticipation of the new conditions. Furthermore it will take many years after 1993 for the first and second order effects on both the supply and the demand side to run their full course.

Meanwhile, after a period of strong economic activity and of 'Euro-optimism', now economic slow down, increasing 'Euro-scepticism' and debate about subsidiarity and sovereignty dominate the scene. In itself, this fits within the longer term integration process of alternating periods of progress and setbacks from 1957 onward, but the immediate effect will be a delay in the full interplay of the consequences of the internal market.

In the short term the major impact of the internal market for SMEs is on their costs, which will decrease due to the reduction in delay and 'red tape' when exporting goods and services and due to the harmonization of technical standards. On the other hand some formalities have merely shifted from customs offices into the firms themselves, and sometimes new formalities arise. Although these may well be adjustment effects, there is a strong risk implied that potential cost decreases for SMEs will not be fully reaped in practice. At the same time it is not clear what effect the opening up of public procurement will have on SMEs.

In the medium term the major issues are larger markets, more competition, more trade between Member States and a fuller exploitation of economies of scale. Foremost this means SMEs in many sectors will have to face up to increasing competition from new entrants, often larger firms, on their traditional markets. Especially in those manufacturing sectors where economies of scale have not yet been fully exploited, SMEs may have to suffer losses in market share.

Also new challenges for SMEs will be created by strategic decisions of large firms regarding their location and make-or-buy choices. Sometimes these will offer new opportunities to subcontracting SMEs, but the internal market will also imply higher demands on these firms.

Within this setting SMEs have to take their own strategic decisions on how to counter competition, how to grasp new market opportunities and whether to venture (international) cooperation.

In the medium term the completion of the internal market will probably have a negative impact on the number of small and medium-sized firms in many industries, such as in manufacturing and the distributive trades. In so far as the European integration will result in a convergence of labour costs, this negative effect on the number of SMEs will be most notable in the lower income countries such as Greece, Portugal, Spain and Ireland.

But it is only in the longer run that the full consequences of the completion of the internal market will manifest themselves. On that time scale a restructuring of complete industries on the basis of comparative advantages within the internal market can take place. Labour intensive manufacturing industries in the lower income Member States will either face increasing competition from developing countries or other non-EC countries or will have to converge their industrial production structure towards that found in the more developed countries of the Community. In transport and in the wholesale and retail trades restructuring may imply a rise of large scale distribution networks.

Also a further division of labour will be stimulated by the large European market. This will create opportunities for further specialization. Restructuring and specialization alike will create a business climate conducive to new initiatives. An increasing share of goods and services will be in the early stages of the product life cycle. Business dynamics will then be boosted, showing both higher natality and mortality of new enterprises.

In macro-economic terms increasing competition, a fuller exploitation of economies of scale, a further division of labour and an increase in business dynamics all hold a promise of higher prosperity. This in itself will enhance domestic demand within the Community which will especially stimulate the sales of the small and medium-sized enterprises.

Of course other influences also shape events. First there are the possible wider aspects of further integration such as the Monetary Union, the decline of sovereignty of the Member States and the extension of the Community with new members. Secondly there are the external developments in the macro-economic environment and in the fields of demographics and technology which may in many ways interplay with the effects of integration.

3. OTHER TRENDS AFFECTING SMEs

The macro-economic environment

The evolution of the SME sector is closely linked with macro-economic developments. Changes in private consumption and in labour costs are very important issues for SMEs due to their strong dependence on consumer sales and their relatively labour intensive production methods. The growth of the economic activity in the whole EC has faced a slow down since 1990. From a 3.3% annual growth in 1986-1989, GDP growth decreased sharply to 2.8% in 1990, 1.4% in 1991 and 1.1% in 1992. Further deceleration is expected this year.

Looking at two major markets on which SMEs operate, i.e. private consumption and investment in construction, the general outlook is not encouraging. Both have been suffering persistent slowdown and their recovery is expected to be only moderate in the immediate future. In 1992, for instance, the growth of consumption fell to 1.3% and for 1993 this figure is projected to be only 0.7%.

Demographic developments

The size, composition and growth of the European population are important factors for SMEs. They affect directly and indirectly the demand and the supply side of SME-activity. On the demand side demographics affect the market in retailing, personal services, residential construction, consumer goods; while on the supply side they clearly influence the labour force available for SMEs.

In the coming decade the population of the EC will grow at an annual rate of 0.2%, against 0.3% in 1980-1990, and the population will be ageing. The population aged 15 to 24 years will decrease by three percentage points sharply reducing the supply of young labour. This will have a greater impact on SMEs, the staff of which has been always relatively young compared with larger firms.

Within the population aged 25-64 years the middle age groups (30-55 years) will increase their share. The rise of these relatively well-educated and affluent groups will boost demand for differentiated consumer goods and services. This presents opportunities for SMEs to generate new goods and services for new and growing niche markets.

Technology

Technology is the most important engine for expanding economic potential and for that reason all countries are, more or less, engaged in a technological race. The most important trends in technology are the emergence of pervasive technologies, the acceleration of technological progress, the shortening of product life cycles and the growing importance of cooperation in research and development. New opportunities and threats arise for SMEs. SMEs with an active approach towards technology, highly efficient in R&D and at the forefront of new developments, will continue to play an important role in innovation. For these firms flexible production, decentralized management practices and the differentiation of former mass markets provide new opportunities.

However, a large part of SMEs, mostly operating in mature sectors, will continue to lag behind. They can easily be locked out from new markets and new technologies because of the increasing sophistication and complexity of products and processes, and the increase of R&D costs.

Such less active SMEs only play the role of users of innovations already developed by others, and they will need to give more attention to developments in technology in order to survive in the inevitable increase of competition in the market.

Internationalization

Internationalization is a continuous process happening all over the world. At the European level this is intensified by the creation of the single European market. Increasing international trade is the most important element of internationalization, but foreign direct investment (FDI), international cooperation between firms and international licensing are clear elements in the internationalization process. Even firms operating only in domestic markets, are affected by the 'globalization' process through the appearance of international players in their input and output markets. Besides, a lot of SMEs are suppliers to large firms especially in manufacturing and they supply parts for final products to be marketed abroad. This implies that SMEs will increasingly have to meet European standards.

The participation of SMEs in the internationalization process is increasing. European integration means a rise of SME-exports, as they benefit from the removal of several bottlenecks. Intra-EC trade in six small scale sections studied in detail in this report is growing faster than exports to countries outside the EC. This means that for SMEs internationalization means primarily 'Europeanization'.

For most SMEs the first step in internationalization is exporting, but many of them are also active in FDI. International cooperation is also increasing more and more in various fields i.e. research, joint-buying, production, marketing, and this is a clear trend which has grown significantly during the 1980s.

4. ENTREPRENEURSHIP AND BUSINESS DYNAMICS

SMEs account for 99.9% of the enterprises in the EC, and micro firms (< 10 employees) for about 93%. With almost 22% of the total stock of enterprises Italy has the highest number of firms, followed by the UK (18%). In relative terms micro firms are strongly represented in e.g. Greece, Portugal and Italy. These firms are relatively scarce in Germany, which has a high share of small, medium and large firms. These enterprises are also well represented in Denmark, The Netherlands, France and the UK.

The average annual growth rate of the stock of enterprises during the years 1988-1992 is estimated at 1.9%, which means an average growth of almost 300.000 enterprises per annum. The growth rate however shows a downward trend during this period.

The evolution of the stock of enterprises is to a large extent the result of the birth of new enterprises and the death of existing ones. The gross natality rate of new firms in the EC is estimated at about 10% in 1989, which means a total number of more than 1.4 million start ups.

Comparing natality and mortality rates shows that in general the natality rates are higher than the mortality rates. Only in the UK and Ireland the mortality rates are about equal to natality rates.

In the first two or three years of a new enterprise the probability of death is highest, some 10% per year. As major causes of start-up failures are mentioned lack of managerial competence, lack of training and technical competence, lack of marketing knowledge and financial problems.

The major reasons for starting an enterprise are self-realization, the presence of a business opportunity and the difference between current wage and expected income. The vast majority of entrepreneurs are males. However, the number of female entrepreneurs is increasing, especially in the trade and services sector. The average entrepreneur is 35-36 years old and between 60 and 80% of the entrepreneurs are between 19 and 39.

Education of entrepreneurs is relatively high and the percentage of entrepreneurs with no degree or only a primary degree is rapidly decreasing. Especially specialized workers, technical people and sometimes managers more frequently move into entrepreneurship. Ethnic minorities appear to have a relatively high rate of entrepreneurship and new firm start-ups.

5. MARKETS AND SALES

SMEs account for two third of the sales of the non-primary sectors. In most small countries the share of SMEs is about 80%, although in the large countries, except Italy, sales are more highly concentrated in large enterprises. In manufacturing SMEs have about 50% of total sales, in the other services 67% and in construction and the trade sectors SMEs have almost 90% of the market.

SMEs depend on their domestic markets more than large firms, which are more involved in exporting. Sales of consumption goods and services are an important market for SMEs, and particularly for micro firms. The most important market for small and medium-sized firms are the sales of intermediate goods and services.

For the countries for which evidence is available, it appears that customers of very small firms are more frequently final consumers. It also appears that micro and small firms tend to be operating in segmented product markets to a greater extent than larger firms. Also the degree of competition faced by smaller firms seems generally less than encountered by larger enterprises.

Subcontracting relationships are particularly relevant for SMEs in manufacturing and building. SMEs can take advantage of subcontracting by acquiring access to the technological and commercial know-how of large firms. However, the development of subcontracting opportunities does not necessarily guarantee that SMEs in a particular country will benefit, because main contractors are increasingly footloose and also have the option of sourcing subcontracted supplies from other countries. Many SMEs are involved in some form of business relationship or cooperation with other companies, and in general such relationships are found to be beneficial for their competitiveness. These relationships generally do not place much restriction on the autonomy of the companies in decision-making.

6. INTERNATIONALIZATION OF SMEs

International trade has grown faster than the production of the EC, but other aspects of internationalization such as direct foreign investments, cooperation and international licensing also show rapid increases. The participation of SMEs in these processes is increasing. It appears that SMEs are catching up with large-scale enterprises in most fields, although there are still significant backlogs.

Six stages of the process of Europeanization of SMEs can be distinguished:

1. indirect international influences (e.g. subcontracting to exporter)
2. indirect export involvement (wholesale, export trading companies)
3. direct export involvement (including agents, distributors, sales subsidiaries)
4. cooperation with foreign firms (R&D, marketing, etc.)
5. international licensing
6. direct foreign investment (joint ventures, mergers, acquisitions)

Although some evidence is reported that firms may - benefitting from the collective learning curve - 'jump stages', generally speaking exports are the start of the internationalization process. Often these are preceded by international competition on domestic markets. Given internationalization 'in stages', one can look upon exports as an indicator for future internationalization in a broader sense. An increase of SME export activity now is most likely followed by increasing SME participation in Direct Foreign Investments (DFI), cooperation agreements etc.

So far as export bottlenecks are concerned, small firms face relatively more internal barriers (lack of knowledge, absence of an export manager etc.) while large firms face more distribution problems. In that respect large firms are more likely to benefit immediately from the internal market. SMEs first have to overcome their internal barriers. However, the measures taken to increase harmonisation of markets will directly reduce the information gap of small firms. These bottlenecks are good starting points for export support policies. Because the export bottlenecks of small entrepreneurs do not vary much between member states, a general approach at the Community level seems feasible.

7. EMPLOYMENT

As stated in section 1 total employment in SMEs in 1988 was 62 million jobs, and has grown further in the late eighties. This means that SMEs now provide more than 70% of employment in non-primary enterprises. SMEs are dominant in distribution, construction, most service sectors and in a number of manufacturing industries. Taken together SMEs are dominant in sectors which jointly provide almost 80% of non-primary employment.

Micro firms account for 30% of EC employment in the private, non-primary economy. They are most important in terms of job provision in Greece (almost 60%) and Italy (almost 50%). Elsewhere their importance is more limited, and at the other extreme such enterprises account for less than 17% of German employment.

Throughout the EC employment growth in the 1988-1992 period was to a large extent a result of job growth in the micro and small firms sector. Furthermore job generation studies show impressive growth rates of job creation by newly established businesses.

Micro enterprises are more likely to employ female and part-time staff than large firms, and rely more on young workers. Average earnings are substantially lower than in large firms, but is not known to what extent lower earnings are due to differences in industry, occupation and qualifications.

Regarding the manufacturing sector, average labour costs per employee in large enterprises are between 30% and 50% higher than in small firms. However, there are no implications for lower unit labour costs in small firms because low costs per employee are offset by labour productivity (as measured by value added) being at least proportionally lower; in the industrial sector labour productivity in large firms is up to two thirds higher than in small enterprises. Furthermore, such productivity differences may have been widening in the latter half of the 1980s.

On the other hand, there are indications that in distributive trade and in several service sectors 'apparent' labour productivity (as measured by turnover per employee) is highest in medium-sized firms. However, also on this measure, the lowest level of productivity is most often found in micro enterprises.

8. CAPITAL AND FINANCE

SMEs and craft enterprises tend to use a higher proportion of short-term finance. SMEs seem to have inadequate access to lower-cost, long-term lending due to lack of collateral. Besides, SMEs are disadvantaged relative to large firms by higher interest rates, particularly on small short-term bank loans.

The evidence indicates that small firms premiums on bank finance in many countries are about 1 to 2 percentage points over the rates that large firms are paying on short term finance.

Besides this restricted ability to raise bank finance at economic rates of interest, there is also evidence of equity gaps for SMEs in the majority of Member States. There are significant difficulties in obtaining venture capital at the lower end of the scale (seed-corn, start-ups).

In aggregate, Venture Capital (VC) funds in the EC have increased by some 140% between 1987 and 1991. Expressing venture capital as a proportion of GDP, the UK (2.25%), Ireland (1%) and The Netherlands are the leading countries. The countries for which VC is least important are, in rising order, Greece Italy, Denmark and Germany (between almost nil and 0.25% of GDP). It is important to note that VC investment is concentrated in medium sized firms rather than small enterprises.

Secondary stock markets appear relevant for only the very largest of SMEs, and furthermore there is a decline of those markets since 1987. Informal venture capital networks are, by comparison with the USA, relatively underdeveloped in the EC countries.

Trade credit represents a significant proportion of outstanding commercial debt in the majority of EC countries. There is evidence that small firms extend more trade credit than their larger counterparts. Furthermore, SMEs would appear to receive less credit from their suppliers than they extend to their customers. In terms of volume trade credit has also expanded throughout the 1980s. Particularly in periods of recession, late payments on trade credit may be detrimental to performance and survival prospects of SMEs.

9. REGIONAL ASPECTS

Out of a total of about 345 million inhabitants in the European Community, roughly 10% live in intra-EC border regions, covering 15% of the Community surface.

The border has in some regions created the 'border effect': underdeveloped basins at both sides of the border. Bordering regions with similar patterns of development, however, appear to be rather unusual.

Businesses like transportation, custom agents and retail trading were flourishing at crossing points of the border. SMEs and craft enterprises are overrepresented in these business activities. The Single Market however leads to job losses in the custom agents business and after tax harmonization certain cross-shopping will be less attractive.

For some activities the border acted as protection, like house building, civil construction, artisans and services. Elimination of border barriers will release this protection and will affect those small scale sectors. Firms that operate on the thus enlarged markets will not only gain more opportunities, but they will meet more competitors on the newly enlarged markets and on their traditional markets as well. Commuting will occur also in the near future, as long as differences in wages, social security and skill exist. In the long run these flows might however slowly decrease. The concept of the single market promotes internationalization. Some forms of inter-SME cooperation are particularly suited for neighbouring regions, eg. subcontracting.

In the Community the so-called Objective 1 regions are distinguished. They are defined as less developed regions where gross domestic product per capita is 25% below EC's average. This definition includes three countries completely (Greece, Ireland and Portugal), a substantial part of Spain and Italy and some other regions. Characteristics of Objective 1 regions are: less populated than the rest, the level of industrialization is 6% points below EC's average and the unemployment rate is 7% points higher. The gap (in GDP per capita) between Objective 1 regions as a whole and EC average has grown in the period 1983-1990. The average firm size in Objective 1 regions is considerably lower than in the remaining EC regions. The employment share of SMEs in Objective 1 regions is considerably higher than in the remaining areas.

The Community supports Objective 1 regions with communication infrastructure, development of energy and water supply, vocational training and other services to SMEs and research and development.

The absorption of Community Structural Funds by SMEs is rather poor, due to internal factors related to SMEs and to organizational bottlenecks in the public administrations.

10. STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS

On the European level the major findings as presented before, can be approached from the angle of strong and weak aspects of the SME sector including crafts in Europe.

Some noteworthy strong points are:

1. greater business dynamics obvious from the high natality rate and the increase of the educational level of entrepreneurs;
2. the increasing participation of SMEs in international trade, direct foreign investment;
3. the promising job creating potential, induced by new firms created, market opportunities but also by the low labour productivity growth in the SME sector.

Important weak points that can be registered are:

1. the high mortality rate; linked to the high natality rate leading to a high volatility of business in the EC;
2. weak market orientation due to lack of strategical marketing approaches and operating on small segmented markets;
3. low productivity of labour leading to high unit wage costs in spite of the relatively low wage costs per employee;
4. the financial situation of SMEs remain a weak point due to a low equity/ debt ratio and difficult and costly access to financial markets.

These weak points give rise to a relatively difficult starting position for SMEs in the new European Community.

The analysis of the different trends in the macro economic environment, demographics, technology, internationalization and the completion of the internal market shows that there are some important opportunities for SMEs in the near future as well as the medium-term. But threats have to be faced as well; especially in the short run the recessionary period will definitely be affecting all business life and not in the least that of smaller enterprises. A summary of opportunities and threats for SMEs is presented in Table 2.

Some striking opportunities that can be mentioned are:

1. New entrepreneurship springing from the increasing number of unemployed in the short run and the demographic developments as well as the internal market in the medium term.
2. The growth of the small-sized service sector, due to increasing prosperity and the subcontracting of services.
3. Small enterprises meeting new challenges due to the smaller scale application of new production processes and the managerial diseconomies to scale (back to the core) and the decrease of the minimum efficient scale of production.
4. Export opportunities are positively influenced by the reduction of non-tariff barriers in the EC. Increased specialization due to the internal market will also create opportunities for SMEs.

Contrary to this positive perspective, some major threats for SMEs can be categorized as follows:

1. Especially in the short run the market growth, both domestically and globally, will be limited.
2. A strong exposure to international competition from larger and small foreign enterprises, leading to risks of higher import penetration. The internal market will in some sectors result in concentration of production in larger firms, particularly in the least developed member states.
3. Footloose large firms will impose stronger criteria on smaller supplying firms concerning standards, quality, etc. Consequently the subcontracting market will become more international as well more competitive.
4. Job creating potential may be eroded due to labour saving technologies and higher labour costs in small enterprises.

Table 2: Opportunities and threats for European SMEs, by field

	Opportunities	Threats
Entrepreneurship and business dynamics		
- rise of middle age potential entrepreneurs	+	
- high unemployment stimulates start-ups	+	
- increase of failure rates in recession		-
- new business opportunities in internal market	++	
- more competition from abroad		--
- free movement of persons (entrepreneurs)	+	
- economies of scale		-
- specialization trend	+	
Markets and sales		
- slow growth domestic market		--
- long run growth of services	++	
- rise of middle age consumers	++	
- decrease young consumers		-
- increase of subcontracting	++	
- higher (technological) standards in subcontracting		--
- flexibilisation production systems	+++	
- export as a first step to Europeanization	+	
- outsourcing foot loose large firms		--
- abolishment physical barriers	+	
- abolishment technical barriers	++	
- higher import penetration		--
- concentration in large internal market		---
- opening-up public procurement	+	
- higher prosperity (internal market)	+	
Employment		
- rising labour costs		--
- labour saving technology		--
- increase migrant workers	+	
- dejuvenization labour supply		-
- rising female labour participation	+	
- managerial diseconomies to scale	++	
- competition with high productivity large firms		---
- free movement of persons	+	
- harmonisation social policy	+	
Capital and finance		
- weakening secondary stock markets		--
- increase of late payments		--
- falling interest rates	+	
- financing acceleration innovation		-
- internationalization capital markets	+	
- supply of venture capital	+	
- competition lending market	+	

5. Although the capital market liberalization offers advantages for SMEs, negative aspects could be the weakening of the secondary stock market, which is of special importance for the medium-sized firms. Furthermore, late payments may lead to liquidity problems and consequently to higher capital costs.

Opportunities and threats are to be faced by the SME sector and consequently by the policy makers. Taking into consideration the weak points of SMEs and the short run threats, it can be expected that the job creation potentials of SMEs will be difficult to exploit in the coming years. The SMEs will be inclined to sustain employment instead of creating it. However, in the longer run when the recessionary influences have been overcome, excellent prospects for economic growth and employment creation can be expected in the SME sector.

The opportunities created by the completion of the internal market, an increase in prosperity as well as the adoption of 'SME-made' technology will influence the development of entrepreneurship and small and medium-sized enterprises beneficially.

11. RECOMMENDATIONS

Introduction

The policy recommendations will be focusing on the major interactions between the various fields discussed and the internationalization and integration of the European economy as well as some general trends affecting the development of SMEs, like macro-economic, demographic and technological changes.

As in the first issue of the European Observatory of the SME sector the number of subjects to be handled had to be limited, so are the number of policy recommendations discussed.

It should be said that recommendations are not always of equal relevance for the different sectors and size classes within the SME sector. In principle most of the recommendations are related to the majority of the enterprises, being rather micro and small than medium-sized. More reflection on sectoral divisions and size distribution is necessary in future.

Although primarily the European Commission policy for SMEs and the craft sector is the object of the policy recommendations, the more general debates can be highly useful for policy makers on local, regional and national levels as well.

Basic assumptions for the following debate on the policy recommendations are:

- that on the Community level the SME policy should be concentrating on creating a favourable environment for enterprise development in particular for the SME and craft sector;
- the subsidiarity principle is setting limits to the extent to which the Commission can develop policies;

- the policy should be less interventionistic in terms of fiscal and financial incentives and more orientated towards creating appropriate and stimulating conditions to exploit the full potentials and the opportunities of the SME and craft sector as well as to strengthen the weak characteristics of the sector and to diminish or curb threatening developments;
- that financial instruments should be used only to compensate SMEs for serious drawbacks or to offset the discriminatory position of SMEs in the fiscal and/or banking systems (like guarantees);
- that the compliance costs of the policies developed are in balance with the effects strived for.

In the different paragraphs attention is paid to aspects of European integration to which policies in the field of SME should be oriented. Prior to these specific discussions it should be said that in the transitional period in which the non-tariff barriers are lifted specific attention should be given to the administrative burdens placed on the SME sector. Transparency of new legislation is very important to the small entrepreneur. But new systems of legislation and regulations can easily lead to extra costs being incurred by SMEs to fulfil the necessary requirements. Such new burdens should be avoided or minimized.

It is important for a full approach of strengthening the small business sector in the European Community that policy makers both on national and supra-national levels should not concentrate on aspects only directly of relevance for the sector. A harmonious policy for the SME sector should be well integrated with all aspects of business policy. A more integrated policy should be strived after instead of a limited one specifically geared to the SME sector, e.g. fine tuning of SME policy with industrial policy and general economic policy in particular is of high importance.

To strengthen SME policy making on the European level initiatives should be taken to discuss the policy issues intensively with organizations or representatives of the small business and craft sector. This is important in both the preparatory and implementation phases. It should even be a target of the Commission to strengthen the Europeanization of these organizations both horizontal and vertical in order to establish a Europe-wide opinion on this sector.

Sound policy making should be based on exact information concerning the subject of policy. Most of the information is not always available for all Member States and not always harmonized between countries. It should be stimulated to strengthen the initiatives already underway to arrive at an improved and appropriate data base on official statistics by Eurostat.

In the frame of the European Observatory the information collected will be stored and in the coming years it will be supplemented, harmonized and improved. This information will be available for EC policy makers in order to develop an appropriate policy for the small business and craft sector. This is not only of relevance for formulating policy but it can also be highly instrumental for assessments, monitoring and evaluation of SME policies as well.

Entrepreneurship and business dynamics

Apart from stimulating and promoting new entrepreneurship the survival of existing firms needs special attention. Experience shows that there is a wide difference in survival rates of start ups. More attention should be paid to developing instruments to lift the barriers and bottlenecks faced by new start ups in their first years of existence.

This can be done by improving managerial attitudes and skills and providing wide-ranging information. Specific attention should go to credit availability and financing facilities during the first years of life. Moreover, the market mechanism should be supported through the constitution of public services in providing information on legal, technologies, credit, production, competition and other affairs.

The present unemployment situation not only requires an offensive approach to create favourable conditions for new start ups but also offers opportunities to stimulate new entrepreneurship by offering the unemployed new perspectives on becoming entrepreneurs.

Creating a favourable climate for new start ups and for minimizing failure rates is in general not only related to positive economic and juridical conditions, like expansive markets, low entry barriers, ample and adequate capital markets, an accessible system of business advisory services and a juridical and regulatory framework that is transparent and not too complex.

More socio-psychological conditions should be taken into consideration in promoting entrepreneurship, like increasing the credibility of entrepreneurship in society and offering people possible choices in their professional careers. In this respect the EC should stimulate the individual member countries in exchanging experience in creating favourable economic and socio-psychological conditions for new entrepreneurs. Giving attention to entrepreneurship and stimulating awareness can be promoted by mass campaigning, providing proper information to pupils and students, as well as creating entrepreneurship training schools at secondary and higher levels.

A European Entrepreneurship Promotion Programme should be started at a European level which can be linked to existing national programmes and can strengthen these programmes.

In these promotional activities special attention should be paid to population categories that are highly responsive to new entrepreneurship. In this respect not only the unemployed should be mentioned, but also the ethnic minorities which seem to be rather under-represented in entrepreneurship. In some countries experiences have shown that the willingness of ethnic groups to start their own business is rather high.

Under-representation among female entrepreneurs is also found in most of the EC-countries, which demands special and 'tailor made' attention in promotional activities.

The aging population also requires special attention that policy makers give to the so-called 'superceders' - entrepreneurs that are in the second half of their career - and 'reverters' - people in the phase of late and post career - who may also choose to take the entrepreneurial path.

To stimulate more innovative entrepreneurship in order to keep abreast of new technological developments, special attention should be concentrated on students in higher education and research workers in universities. The awareness for entrepreneurial opportunities there seems to be rather low and training programmes at this level are rather limited in many European countries.

Channelling into and recruiting for entrepreneurship can be realised by special programmes. The EC can fulfil the role of exchanging information on experiences in this respect and of initiating cooperation between universities and polytechnical schools in setting up small business management programmes and eventually in strengthening the exchange of 'potential entrepreneur' students between countries.

Another opportunity for stimulating highly qualified and new entrepreneurs is to stimulate action by multinational firms to develop career planning for highly qualified (research) staff for whom the entrepreneurship track ('spin-off') is under consideration. Due to the recession this is currently of particular importance as many large firms have to dismiss large numbers of employees. Stimulating new entrepreneurship within this group should be more easily done by employers, employees and their organizations as well as by policy makers. Supporting instruments by the EC should be developed.

Further integration of the European economy demands and also brings to the fore the need for greater mobility of entrepreneurs.

Existing barriers in business licensing and regulations, should be lifted, particularly in border regions where differences are most marked. Stimulation of European trade associations to develop quality standards for their national associations should also be considered. This would be aimed at achieving a more transparent European-wide quality concept for entrepreneurs or small businesses.

The actions undertaken by the EC to arrive at new juridical forms for businesses (such as the European Economic Interest Grouping, the European Association, the European Cooperative Society and the European Mutual Society) should be supported in order to augment international business cooperation and to lift the existing barriers. Monitoring and evaluating these new European businesses should be carried out in order to adjust such worthwhile initiatives to the new business conditions in Europe.

In selecting instruments to stimulate new entrepreneurs attention should be paid to crowding-out effects. From a macro-viewpoint these are not always harmful. However on micro level the policy may engender social problems with financial and budgetary consequences.

Most of these initiatives could be undertaken at national or even at local or regional level, while on the European scale the exchange of information on different experiences in promotion and stimulation of new start ups as well as in minimizing failure rates is in order. Supporting national initiatives and broadening them to other countries should be considered as well. Moreover Community policy should be aiming at general regulatory problems and the communities institutional framework in which national schemes are envisaged to operate.

Markets and sales

Bearing in mind the recessionary state of the European economy, a careful expansionist policy might be advocated to exploit the employment creating potentials of the SME sector. Such a policy should also, however, be focused on restricting labour costs and on a sound pricing policy to strengthen the competitive position of the business sector - including SMEs -in the global markets.

Structural and business cycle policy should foster small businesses in order to maintain competitiveness and the smooth functioning of markets for final goods and services. In the present recessionary period, and with particular emphasis in several Member States, there is a tendency for small business to be pushed aside by larger enterprises. This will endanger competition in the long run.

Certain demographic developments will lead to a greater segmentation of consumer markets, in particular of markets for consumer goods and services.

Fewer young and more middle-aged and elderly consumers implies changes in the structure of market demand. There is a need for small businesses to be well informed in this area. Although on the national level specific tasks can be identified, the EC should also attempt to enhance information flow on market developments for SMEs paying particular regard to their increasing international dimension. This can be achieved by stimulating trade associations or branch organizations to cooperate more effectively on a European scale. This in turn will establish a sound financial basis for information access and adequate branch information.

Special attention must be devoted to the subcontracting market both on the national and the international level, as markets become increasingly international. At present a few countries run subcontracting programmes as part of industrial policy. These programmes mainly consist of information and counselling activities. EC policy in the field of subcontracting is centred on two themes. The first is the creation of a favourable legal climate and the second the improvement of communication between contractors and subcontractors.

On a European level strengthening of the subcontracting relations between large and small firms will be necessary when technology-intensive products are under consideration. Business services could also be better integrated into subcontracting or cooperative networks.

Certification of SMEs should be promoted to strengthen their market position internally and externally. The basic principle for the EC in this respect should be to make the subcontracting markets more transparent and to stimulate horizontal and vertical partnerships. Instruments to accomplish this could be the assembly of data banks and/or catalogues, the organising of trade fairs etc. A better regulation of SME participation in EC-technology programmes could be very helpful in interrelating new high-level networks in advanced technology sectors.

The reduction of non-tariff barriers in the EC evokes stronger competition. SMEs have to face more and stronger competition on their home markets as well as having to compete more effectively on foreign markets. In this large and more competitive European market economies of scale and scope can be better utilized. Small enterprises should be enabled to remain competitive and to grow to exploit economies of scale by adopting a policy based on an adequate information system and helping to strengthen cooperation between firms.

Important in this respect is the strengthening and upgrading of the existing information and cooperation instruments such as EIC, BCNet, Europartenariat. Non-manufacturing firms need to have more explicit recognition in forming EC-policy in this respect.

Exporting and internationalization

European integration and harmonization of non-tariff barriers in the EC seems to have had a substantial positive impact on the larger exporters than on the smaller ones. For smaller firms face, in addition to the same external bottlenecks as large enterprises, many internal bottlenecks.

Full attention both from national and supranational authorities should in this respect focus on compensating small firms for their internal problems limiting both their external trade and their other international activities to other EC-countries and to third countries.

These internal problems are mainly related to steps to be taken before the act of exporting. The main bottlenecks for SMEs here are: lack of information on market opportunities and distribution channels, the identification of agents or distributors and lack of financial means to enter new markets. Other problems are connected with trade barriers like custom control procedures, insurance, currencies and quality requirements.

The EC should use the EIC to inform the smaller entrepreneur better on market opportunities and developments, but also on current national regulations and conditions.

This information could be made available more systematically as a result of analyzing market developments. Regular surveys in this area should be stimulated.

An EC-wide information system on qualified importers, exporters and wholesalers should be reconsidered to assist SMEs in finding the appropriate distribution channels to foreign countries, especially within the EC. Exports to third countries can be supported by providing selective information on relevant adjacent regions like the EFTA, Maghreb and Middle and Eastern European markets.

It ought to be emphasized that cooperation between SMEs in exporting activities should be strengthened by providing appropriate information on relevant 'candidate export partners'.

As export financing remains a major problem for SMEs it is not clear to which extent export credit guarantee schemes are existing and distorting exportation between SMEs in the Member States. More insight may be needed to find out ways and means to eliminate these distortions.

There is some evidence that in recessionary periods SMEs tend to improve their export performance, the stimulus being insufficient demand on local or domestic markets. The recessive periods can be considered as learning periods for SMEs on how to export. Especially in this period good information is to be provided to SMEs to go abroad. But for the future it is also of great importance to sustain and to improve the export competence acquired in this period. This requires special programmes, training and information focusing on these exporters. Special attention can be devoted to networking and/or cooperation for exporting SMEs.

To counteract the strong import penetration of the EC from outside, a strong emphasis should be put on improving the quality and technological performance of the SME sector, as has been advocated before.

Moreover, on a national level specific attention should be paid to the development of wages and social insurance costs in the labour-intensive SME sector, to enable it to remain competitive on external or global markets.

The SME sector should be seen as part of the European production chain, with firms delivering components, spare parts and services to each other and to large enterprises. Reinforcement of the total production chain is needed to guarantee the position of the European industry in the global markets.

To stimulate the technological renewal of the SME products and processes, SME should be encouraged to take part in licensing agreements with larger high technology companies. Special attention can be channelled by the EC through the different information or cooperation programmes of the EC in this field, like EIC, Europartenariat etc.

Employment and human resources

The high and rising unemployment rate together with the existence of hidden unemployment in the EC demand a much stronger concerted action by the EC. Strengthening and integration of policy instruments and programmes originating in the different Directorates General should be major policy strategies in the coming years. A realistic strategy should be developed in close cooperation with the social partners at the European level.

The small business and craft sector, which hosts about half of the total labour force, needs special attention in such a policy. The more so because the potential for job generation by SMEs is significant. SMEs offer ample opportunities for particular groups on the labour market, like young workers, women, part-time labour, older employees and self-employed. Policies should be orientated to increase the demand for employees by developing and stimulating the labour-intensive SME sector in general as well as by improving job-matching on the labour market.

Stimulation of the SME sector should be based on viable economic reasoning and recognising the fact that SMEs are not the only subject of a social policy to diminish unemployment. Both large and small enterprises should be targeted for schemes to diminish unemployment.

On the supply side of the labour market policies should be geared towards upgrading and training personnel conform the demands requested by SMEs. This usually implies in particular vocational training for the potential labour force, but also the emphasizing of permanent training for multi-skilled staff. This will keep the labour force more abreast of new technological developments and make it more responsive to change both internal and external to the firm.

The demographic, technological and internationalization developments will demand more and more supplementary training and retraining programmes for keeping the older members of the labour force particularly up to date in their profession or adaptable to new demands in the production process.

Small firms lack facilities to implement this internally. The setting up of 'external' systems in cooperation between enterprises and governments should be pushed for. This will increase the quality of the labour force in the SME sector. In this respect the EC can play a role by stimulating international exchange of information, ideas and schemes. Due to the expected increase in international mobility (in particular in border regions of the EC) the EC can play a more active role in stimulating exchange of information on the qualities of the different professions by e.g. harmonizing certificates, or by providing information on the quality of the different national certificates.

Although most of the labour market problems should be tackled on a national or even a regional scale, the European Commission should, apart from the aforementioned actions, emphasize training, in particular taking into consideration the changes in the internal labour relations resulting from changes in the structure of the labour force, technological developments and the phenomenon of internationalization.

Entrepreneurs should be adequately informed or trained in management principles to adapt their organization to these processes. In this respect the programmes of CEDEFOP are relevant.

Exchange of experiences in effective unemployment and training programmes in the member states could stimulate the application of the best instruments to solve the unemployment.

Policy interventions need to reflect the lower productivity achieved in the small and micro firms in comparison to middle sized and larger firms. Measures designed either on the national or at the supranational level to raise the 'social wage' may have a disproportionate effect on the SME sector and particularly on employment in that sector, unless steps are taken to raise labour productivity levels.

Financing of SMEs

Investments by SMEs should be stimulated to contribute to the growth process and job creation in the European Community. However, the financing of investments by SMEs and start ups is hampered by the limited equity capital of the small firms, the limited access to capital markets and in particular access to long term funds and venture capital. This arises from liquidity problems due to late payments which hit SMEs harder than larger enterprises.

The fact that SMEs have more reliance on short term funds is consistent with a lack of demand for longer term funds but also with a lack of collateral to provide for long-term loans. Loan Guarantee Schemes and Mutual Guarantee Systems have been introduced in a number of EC-countries to cope with the latter. This policy might be extended to other member states. The EC should also strengthen its policy to establish these guarantee schemes. Guarantee schemes are in particular of importance for start ups having limited access to venture capital funds.

The establishment and promotion of risk capital funds should be strengthened by the EC, especially in view of the skewed availability of these funds in the different member states.

There are significant difficulties for the smallest firms raising venture capital. As the micro or small firms will have less access to the more formal funds, the EC should investigate ways to mobilize informal risk capital.

Tax incentives to informal venture capitalists appear to have a beneficial effect on investment levels.

Policy intervention should also be geared to increase the self financing by SMEs, which can be stimulated by tax facilities. In this respect the different legal forms of enterprises, especially occurring in the SME sector, should be taken into consideration. The EC can take the lead in informing member states of the different systems applied and to stimulate the self-financing by SMEs accordingly.

SMEs extend more credit to their customers than do large firms. Measures both on a national level but also by the EC on a supranational level should be taken to ensure prompt payments of debts. The policy of the EC should be strengthened and supported in attacking late payments by both the private and (particularly) the public sector. In this respect special attention is also required to stimulate the efficiency of the banking system, reducing the transfer times of cross-border financial transactions.

As small firms are strongly rooted in their regional or local environment, investment promotion and accordingly financial incentives or means should be put available at regional or local levels. Establishment of regional venture capital funds may be a solution to the problem of local equity gaps. Strengthening of links between the widely dispersed banking systems and advisory or information centres for SMEs, including those initiated by the EC, is needed.

With regard to bank lending small firms are disadvantaged relatively to large firms by higher interest rates on short term bank loans. These loans are more important for SMEs than for large enterprises.

It should be investigated whether this phenomenon is due to a lack of collateral, other asset evaluation techniques by the banks, or to less bargaining power of SMEs.

In order to stimulate SME-investments in R&D or innovation the EC could consider linking participation of SMEs in the different technology programmes of the EC to financial schemes under development by the EC or already available in Member States.

Border regions

In the border regions quite different degrees of integration can be found, due to differences in historical background, culture, physical barriers and economic structure. Further European integration is required for a proper 'zipper-type' of integration of the adjacent regions at the border of countries. In particular further convergent development is needed in legislation that prevents markets from being unified, e.g. social benefit and fiscal systems influencing the relative prices on input and output markets are still bottlenecks for mobility of labour, capital and goods.

Strengthen the regional policy makers in deciding on policies for specific regional conditions, to optimize the allocation of EC funds and to solve the structural differences within the border region more effectively.

Developments in the cross border regions should be monitored and assessed thoroughly in order to get better insights into the progress of integration, the effectiveness of the different activities and the real needs of business.

International cooperation requires information. There is still a shortage of mutual knowledge at the three levels of households, business activity and public administration. Therefore, information exchange in border regions, in particular of relevance for SMEs and craft enterprises, is a priority. Transnational databases and public information agencies must be supported or should be developed.

For example cross-border operations in the construction sector are usually hampered by different quality requirements, standards and norms. Better information for the SMEs and craft firms in this sector is needed to have an appropriate marketing strategy established.

Planning by municipalities and other administrative bodies must increasingly integrate cross-border aspects. Ad-hoc transnational bodies (Eurodistricts) should be set up and gradually receive mandatory powers. Systematic creation of transborder Enterprise zones could be considered to melt and integrate differences within the border regions.

Special attention should be paid to develop technological and innovation programmes in the cross-border regions; one of the weakest points at present. Strengthening the exchange of experiences in this respect between the different Euregions is desirable.

Transnational educational programmes should be further encouraged, both at the basic level (national languages and culture) and management level, preparing the professionals to work in and with firms and administrations of both sides of the border.

In the labour market area, the specialized bureaus should focus more strongly on matching demand and supply across the frontiers, taking into consideration the different educational, vocational and professional backgrounds. Detailed information on labour qualifications in the whole region should be developed.

Objective 1 regions

For SMEs in less developed regions easier access will be provided to a broad and harmonized single market for the sale of their products and the purchase of raw materials, and, for cooperation with partners of other member states in the fields of subcontracting, technology transfer and marketing.

In order to take advantage of the opportunities, the means should be provided for these firms to increase their competitiveness, to enlarge their local field of activity, to fit in the requirements of the European customers and follow the rapid evolution of the technology.

Increasing the utilization of EC Structural Funds by SMEs is likely to be more effective if the assistance focuses, in the first instance, on intermediaries rather than directly on SMEs themselves.

Developing managerial resources of these intermediaries is a high priority in less developed regions. It is therefore necessary to help and develop business assistance services and networks to provide for consultancy and information services to SMEs. In this context special attention should be paid to the improvement of the functioning of existing intermediaries rather than creating new ones, and to the establishment of network links between them on a regional, national or Community level.

In this field Community support could be given for the exchange of experience and the diffusion of best practice on methods and mechanisms for delivering assistance as well as for the establishment of transnational networks of intermediaries. Priority should be given for this type of action.

Financial bottlenecks also limit SMEs capability for innovative action. Many SMEs find Community support of no avail when their financial structure is too weak to afford additional funds and the local financial institutions are too risk-averse to provide for cheap financing. Thus Community programmes should also shift their emphasis to alleviating financial burdens or to helping develop financial institutions geared to the needs of SMEs (like Mutual Guarantee Systems) in these regions in particular.

The problems and needs of SMEs would be better understood and catered for if on the regional scale the SME and craft organizations would be stronger and better integrated in the decision making process, in the implementation of the Operational Programmes and in their monitoring.

In general a uniform approach to Objective 1 regions should be avoided. Community assistance should be more 'tailor-made' to the specific needs and weaknesses of the regions.

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