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## **COMMUNICATION FROM THE COMMISSION**

### **THE EUROPEAN OBSERVATORY FOR SMEs**

**Comments by the Commission on the Second Annual Report (1994)**

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#### INTRODUCTION

In the context of Community initiatives aimed at promoting better observation of the economic development of enterprises as part of the dynamics of effective implementation of the Internal Market (1), and namely in the framework of the European Observatory for SMEs set up by the Commission on December 1992, the Economisch Instituut voor het Midden-en Kleinbedrijf (EIM), 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 to the Commission a second independent Report on the situation of, and the prospects for SMEs in the European Union.

This Report is mainly in the nature of a review which presents the latest enterprise developments and prospects in the European economy in, so far as possible, a quantitative form. It discusses a series of current issues which are relevant to understanding present and future SME trends. It presents changes in the form and direction of Community and national policies which affect the business environment and SME performance. And, by doing so, it aims at stimulating, and providing a basis for, substantive debate and greater understanding of horizontal issues relating to SMEs.

The Commission is pleased to note that the first report has been well received, and widely discussed in all quarters and trusts that this new Report, and its successors, will be as important a source of ideas, information and experience as the first. The Commission therefore considers that, by providing specific coverage and detailed consideration of the impact of the Internal Market on SMEs, the Observatory can surely act, by means of its future reports, as one of the most important analytical sources on which are to be considered practical proposals for the implementation of the "Integrated Programme in favour of SMEs and the craft sector" (2). In particular, the report's quantitative approach, will undoubtedly be very useful as a basis for discussion in the framework of the enlarged partnership between the Commission and the Member States, as proposed in this Programme.

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1. Council Decision 93/379/EEC of 14 June 1993, O.J. L 161 of 2 July 1993.  
2. COM (94) 207 final of 3 June 1994.

This document represents a summary of the Commission's comments on the Report, referring mainly to new data and results provided by the Observatory, and focuses primarily on its most controversial findings or aspects that are particularly open for outside criticism. The first section of the document, which has been organised according to the Report's structure, 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). As it has been the case with regard to its comments on the first report (3), the Commission did not appraise systematically the data for each Member State or the annexes to the Report although incidental use might be made of them in order to illustrate or highlight some of the ideas and concepts used.

### GENERAL COMMENTS ON THE REPORT

The Commission very much welcomes this second Report considering the state of SMEs in the European Union, particularly as it reaffirms the need for strengthening the competitiveness of enterprises as a means to stimulating growth and creating jobs along the lines presented in the "White Paper on Growth, Competitiveness and Employment", which has clearly recognised the importance of supporting the development and adaptation of SMEs so as to make the Internal Market fully effective, and laid down some general guidelines for an Integrated Programme to assist them.

The Second Annual Report of the European Observatory for SMEs aims at providing both institutions and individuals with an interest in SMEs with a comprehensive, although still preliminary analysis of the Internal Market's impact on them. It is largely based on comparable data collected by EUROSTAT as well as on the conceptual framework set out in its "Enterprises in Europe" reports, and it involved reviewing major trends affecting SMEs, drawing an overall view of SMEs and craft enterprises in the Union and assembling information on such fields as employment and human capital, capital and finance, innovation and R&TD.

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, sometimes further subdivided into 10-19, 20-49 and 50-99 employees;
- medium enterprises: 100-499 employees, sometimes further subdivided into 100-249 and 250-499 employees (4).

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3. COM (93) 527 final of 5 November 1993.

4. The general expression "SME" is the only one used throughout this document as to designate all enterprises employing less than 500 persons. Any other reference to micro, small and medium enterprises should therefore be read as referring to specific size classes.

The Commission largely supports the methodology used by the Observatory in this regard, as it has already proved to secure the use of comparable data throughout the reports, thus providing a structured and comprehensive basis to guide their development in subsequent years. It nevertheless recalls that the limited availability of data referring to the period 1991-93 (5) invites to the use of some precaution when looking at the relevance and accuracy of qualitative assessments made in the Report, particularly whenever developments having occurred during this period are compared to those identified in previous years.

#### 1. SMEs in the European Union

It is estimated that in 1990 the non-primary private sector of the Community included about 15.8 million enterprises, of which more than 99.9% were SMEs. In particular, it is estimated that there were about 14.7 million micro firms, some 7 millions of which had no salaried employees, 970,000 small firms, 70,000 medium firms, and only about 13,000 large enterprises (6). Including large firms, the average enterprise in the European economy had about 6 persons employed (ranging from 3 in Greece to 10 persons employed in Luxembourg and in the Netherlands), while the average SME employed just over 4 persons. As a result, SMEs then provided some 68 million jobs, thus accounting for a growing share (some 72%) of total employment in the European non-primary private sector.

Moreover, small and medium-sized enterprises appear to dominate in manufacturing, construction and wholesale trade, and are the second most important source of employment in every other sector. On the other hand, micro enterprises excel in retail distribution and (even if their employment share has slightly decreased from 1988 to 1990) personal services, whilst being of particular importance also in construction and wholesale trade. As regards large enterprises, they seem to dominate in extraction, transport and communication, and, to a lesser extent, in producer services, without having any major role in other sectors, apart from manufacturing. However, the Commission considers that, as the Report does not clarify whether temporary staff is included and, in that case, how it has been measured and adjusted, the sectoral classification used by the Observatory may be misleading, especially if used for policy recommendation purposes without having been further investigated.

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5. It should also be taken in consideration that, due to the introduction of new sources of information and use of improved measurement methods, the data from "Enterprises in Europe" for 1988 and 1990 are not fully comparable.
  6. Referring to intermediate size classes, it is estimated that there were about 563,000, 337,000, 70,000, 56,000 and 14,000 firms in the, respectively, 10-19, 20-49, 50-99, 100-249 and 250-499 employees range.

With regard to firm size, it is significant to note that a clear divide seems only to take place between micro enterprises, small and medium enterprises, and large enterprises. In fact, although the average firm size roughly increases by a rather constant factor of ten between the main size classes, the data presented in the Report points to the existence of a remarkable stability in average firm size increases between every intermediate size class in the 10-499 employees range (7). As the first report has already given some preliminary indications in this direction, this can be seen as additional evidence on the existence of fundamental different problems, attitudes and behaviour within the SME sector, thus seeming to justify the adoption of differentiated policy approaches aiming at micro enterprises on the one hand, and small and medium enterprises on the other hand. Furthermore, this preliminary finding seems to give a clear indication as to the need of reconsidering the current definitions of SMEs with a view to adopt a general, though flexible, size class classification which would better reflect observed differences between different types of enterprises.

Quite unsurprisingly, SME characteristics at the Member State level were found to be roughly similar to those identified for 1988 and discussed in the first report. Therefore, the present Report generally offers the same broad explanations of national differences in the relative position and development of SMEs in the Union. Thus being, small and medium-sized enterprises seem to dominate in most Member States, with the exception of Greece, Italy and Spain where micro firms are dominant, whilst large firms seem to perform a relative major role as employment providers only in France, Germany and the United Kingdom.

If the EFTA-EEA countries are considered, the whole picture now seems to be somewhat different. In fact, their remarkably low number of enterprises makes them, with the single exception of Iceland, much more oriented towards large enterprises than the EU Member States. In particular the EFTA-EEA countries depict, as a whole, a lower number of enterprises per 1,000 inhabitants and higher average firm size than any Member State, and their enterprise structure very much resembles the German one.

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7. The progression factor to be found here approximates 2.25.

A preliminary analysis of recent developments in the number of enterprises, turnover and employment has also been carried out by the Observatory. As a result, it can be estimated that the total stock of enterprises in the non-primary private sector of the Community has increased to some 16.6 million firms (8) in 1993. In particular, the number of micro and small enterprises increased by an estimated 820,000 since 1990, the number of medium-sized enterprises remained roughly unchanged and the number of large enterprises is supposed to have decreased by about 750. Furthermore, the evidence presented in the Report seems to indicate that SMEs consistently outperform large enterprises, at least if their respective performance is measured by average annual growth rates in the number of firms, employment and turnover (9). Along with the supposed counter-cyclical behaviour of the smaller firms employment share and the general tendencies towards declining overall firm size, increasing business dynamics and flexible industrial specialisation, to which the Observatory rightly refers as possible general explanations of observed superior SME performance, the outstanding growth experienced in the services sector during the last two decades should have made a decisive contribution to this result.

Moreover, the Observatory has considered useful to analyse developments between 1988 and 1993 by distinguishing two sub-periods, as the years 1990 to 1993 have witnessed slower growth and recessionary tendencies throughout the European economy. Although far from being recession-proof, the smallest enterprises seem to be quite resilient to economic downturns, as micro firms have been the only ones able to secure some net job creation in 1990-1993, 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 efforts made at the Member State and Community levels to maintain and increase employment, and to anticipate and accelerate the development of new jobs and activities, namely by reinforcing the job creation potential of SMEs.

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8. 17 million including the former GDR.

9. The only exceptions to the concentration of employment in SMEs seem to be, at least for 1988-1990, Ireland and, though to a smaller extent, Spain.

## 2. Macroeconomic environment

In general, the Report considers that the current macroeconomic environment still carries only moderate prospects for SMEs in the immediate future. In particular, the expected slow acceleration in private consumption, on whose developments SMEs seem to depend more heavily, which is linked also to persistent high levels of unemployment, does not allow much hope for a rapid economic recovery of the SME sector. Nevertheless, as growth in external demand, and therefore extra-EU exports of goods and services, is forecasted to accelerate in 1994-1995, international trade can contribute in a positive way to stimulate and reinforce the SME position in the Union.

A reference is also made to currency rates and their impact on enterprise competitiveness. In general, currency devaluations are seen as having a short run favourable effect on SME competitiveness, as some significant improvements in the competitive position of Greece, Italy, Spain and the United Kingdom seem to have occurred in the recent past. Considering that absolute changes in the general import price level have, however, been greater than changes in the general export price level in all four Member States, those immediate benefits could well be short lived. Moreover, SMEs are found to be relatively more sensitive to transaction costs and exchange rate uncertainty than large enterprises.

The Commission considers that not only do the Report's findings point to the paramount importance of achieving EMU objectives as a basis to enhancing the macroeconomic environment of SMEs in order to help them to make the most of the Internal Market, as they also highlight the need to overcome the handicaps which have contributed the most to an erosion of European competitiveness in recent years.

Although the cost and the price of energy have not been addressed in the Report as one of the important elements that can affect SME competitiveness, the Commission wishes to note that since energy is a fundamental element for a market economy and a key factor of production, access to reliable and efficient energy sources seems also essential to promoting the competitiveness of European enterprises.

### 3. Impact of the Internal Market on SMEs

The Commission broadly shares the Observatory's views as regards the potential contribution of further liberalisation of international trade to the development of economic activity and business opportunities in the Union, as well as on the importance of accompanying policies and further development and deepening of the Internal Market for European SMEs. In particular, since the first-order effects of the Internal Market are the first and most crucial link in the causal chain referred to by the Observatory in the first report (10), and only complete success in abolishing cost-increasing and market entry barriers will ensure that anticipated knock-on and macroeconomic effects of the Internal Market will follow, the need to provide for a careful monitoring of its functioning has already been clearly recognised by the Commission (11).

To consider the expected impact of the Internal Market on manufacturing industry, construction and services, the Observatory grouped the Member States in two categories, namely those with a share of micro enterprise employment below or above the Union average in 1988, thus aiming to take into consideration, among others, differences in their economic structures and patterns of trade (12). In general, the Internal Market is seen by the Observatory, on the basis of results obtained from a questionnaire enquiry addressed to SME experts in the Member States, as having a positive effect on the business environment of SMEs, as well as on demand factors, resources and business development, especially on those Member States with a lower proportion of SMEs. On the other hand, with the single exception of increased possibilities for economies of scale induced by sheer market expansion (which are viewed as being relatively more important in Member States with a high proportion of SMEs), the completion of the Internal Market is believed to have an initial, less favourable impact on competition, costs and prices. Clearly, this amounts to recognise that the short run effects of the restructuring process under way will be far more reaching for SMEs than for large scale enterprises.

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10. See COM (93) 527 final of 5 November 1993, p. 8.
  11. "Making the most of the internal market - strategic programme", COM (93) 632 final of 22 December 1993.
  12. These are referred to as, respectively, Member States with a low (Belgium, Denmark, France, Germany, Luxembourg, Netherlands, United Kingdom) and a high (Greece, Ireland, Italy, Portugal, Spain) proportion of SMEs. Clearly, the methodology used by the Observatory in this respect can be called into question. In fact, although corresponding to the broad split-up made by the Commission in its comments on the first report when discussing country-profiles for 1988 (COM (93) 527 final of 5 November 1993, p. 24), the present distinction seems to be at odds with findings presented early in the Report and referring to SME structure in the Member States. Furthermore, the Observatory gives no reason on whether should 1988 data be preferred to 1990 data, while it is clear that use of the latest official statistics would have implied a change in the "low/high" classification of Ireland (see note 9 above). Finally, as no indication is given in the Report as to how, if at all, results for individual Member States have been adjusted, the Observatory findings need to be cautiously assessed and require careful interpretation.



The Internal Market programme has been billed as a stepping-stone towards a dynamic and thriving EU marketplace. Although the current economic downturn has certainly overshadowed the changes in market structure which were precipitated by its coming into force, the Internal Market is operating smoothly and according to intuition in a number of domains as reveals, amongst others, the substantial increase in intra-EU trade that has occurred since 1985 and is underlined in the Report. But it can not be taken as an elixir which will, by itself, solve all the problems confronting European firms. Nor will all SMEs undertake all of the relevant adjustments and, indeed, the Internal Market can leave the organisational structure of some SMEs (mainly those which serve only local markets) untouched.

All in all, the Internal Market can be seen as an "enabling programme" which opens up new possibilities for companies previously confined to one Member State market by offering them an opportunity for growth. In general, the Internal Market is therefore expected to deliver proportionately greater benefits to SMEs than to larger firms, especially in those sectors where there was a high incidence of non-tariff barriers in markets for their final product or services and in those regions where their markets have been artificially divided by trade barriers, as well as to SMEs operating as intensive users of inputs in highly fragmented markets or being relatively more affected by changes in performances of downstream industrial users.

The Commission thus considers that the Report's findings reinforce 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 SMEs in their efforts to anticipate and to adapt to industrial change and current mutations in their business environment. Therefore, the Commission intends to strengthen its efforts in the field of further enhancing the managerial and strategic capacities of SMEs, and improving their awareness and participation in Community initiatives which should contribute to upgrade their competitiveness and enable them to better operate in the Internal Market. These efforts will be carried out at the Community level through the 1993-96 Programme, the Community initiatives of the structural funds (mainly the new SME initiative) and will find a strategic dimension in the context of the Integrated Programme for SMEs (13).

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13. Council Decision 93/379/EEC of 14 June 1993, O.J. L 161 of 31 July 1993, "The future of Community initiatives under the structural funds", O.J. C 180 of 1 July 1994, and "Integrated Programme in favour of SMEs and the craft sector", COM (94) 207 final of 3 June 1994.

#### 4. Employment creation and human capital

Although referring to data for only a limited number of Member States, the Observatory underlines the decisive role of micro and small enterprises in job creation in recent years, whilst noting that the direct effect of, respectively, expansions and contractions of established enterprises on job creation and job losses seems to be about twice as big as that of enterprise births and deaths.

Though valuable in illustrating the complexity of the job generation process throughout the Union these findings are only a first step towards an analysis of differences between firms, relatively more important than the sectoral structure to understand the reasons for their success or failure, and still require further clarification. Nevertheless, as the major causes of enterprise failure are to be managerial and organisational difficulties, coupled by financial and market problems which can stem from insufficient preparation and absence of a precise business plan, they clearly strengthen the Commission belief on the importance of adequate information and counselling, as well as of training to newly created enterprises.

An analysis of self employment in the EU clearly shows that, notwithstanding its growing importance between 1986 and 1991, which could be viewed as an additional indicator of the ongoing process of tertiarisation of the European economy, differences in national legal and fiscal frameworks as well as in cultural and organisational attitudes towards work still reflect heavily on the structural characteristics and development of the self employment sector. In fact, the importance of self employment varies considerably amongst Member States, ranging from around 30% in Greece and Italy to a remarkable low of 10-12% of total employment in the private enterprise sector in Denmark, France and the Netherlands. Likewise, the likelihood of a self employed having employees, which averages 30% at the Union level, varies dramatically from 4% in Italy to 60% in Germany and is, in general, substantially lower for women than for men.

These findings can only but stress the need for further analysis of the self employed sector before operational conclusions can be drawn. In particular, a subsequent assessment of the economic importance and characteristics of family businesses (which, incidentally, could be facing, mainly for demographic reasons and as they need to overcome difficulties related to the transfer of enterprises, their biggest shake-up in two generations), namely if paying special attention to the role performed by assisting spouses, would be welcomed.

When considering training and human capital, the Observatory still finds SMEs to be relatively less inclined to engage in vocational training. As the limited evidence available on this issue seems to confirm that SMEs tend to face higher labour turnover rates and have fewer training plans than larger firms, and considering that non-market forces can place effective floors under training activity as well as taking into account that SMEs are recognised to be major providers of first jobs and part-time jobs and instrumental in absorbing the less sought after groups in the labour market, the Observatory thus suggests that there are strong arguments for public intervention in this field.

There is therefore little doubt about the crucial importance of a well educated and trained workforce for SMEs. In particular, when reviewing some international comparative studies on relatively low technology SME-dominated industries in both manufacturing and services, the Report clearly supports the view that differences in employees skills and qualifications are a key factor in explaining observed differences in labour productivity and in the worker's capacity of adaptation to technological change.

Therefore, the Commission feels that the Observatory's findings can only but lend additional weight to the emphasis it has already put on combating unemployment also by skilling young people and retraining staff freed up by rises in productivity as a result of technological progress, as well as on the necessity to anticipate skills needs correctly and in good time by identifying developing areas and new economic and social functions to be fulfilled (14), namely through appropriate use of the possibilities opened up by the new Objective 4 of the structural funds and the LEONARDO programme. The new developments opened up by progress towards the "information society" will also have a major impact as the new communication technologies will improve the opportunities for distant training by SMEs (15).

## 5. Capital and finance

Although it seems to draw too heavily on data for southern countries which may well not be typical, the Report largely confirms that SMEs can in general be characterised by their relatively high dependence on borrowed funds, mainly of a short term nature and provided mostly by banks, to finance investment (16). In spite of some significant differences across Member States, reflecting national specificities in both enterprise behaviour and financial institutions attitudes, this result clearly strengthens the Commission in its willingness to address the main financial problems experienced by SMEs in the European Union.

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14. "White Paper on Growth, Competitiveness and Employment", COM (93) 700 final of 5 December 1993.
  15. See the report of the Bangemann Group on the information society.
  16. In particular, short term liabilities seem to be, on average, four times as important as long term liabilities for manufacturing SMEs, and financial costs are, on average, two percentage points higher for SMEs than for large enterprises.

In particular, venture capital, which seems to be basically concentrated in France and the United Kingdom, is relatively more used for business expansion and buyout, as venture capitalists have progressively withdraw from business creation since the end of the 80's. This 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 fast-growing enterprises. Furthermore, limited availability of exit routes to venture capitalists does not appear to be conducive to providing equity funds for SMEs and their financial difficulties are therefore exacerbated by the weakening of existing secondary markets as well as by late payment.

In fact, despite the increasing number and variety of financial instruments available to enterprises, expansion of high tech enterprises, which are forced to turn to options such as start-up and venture capital, still faces major obstacles, particularly fiscal ones, and suffers from the absence of a dynamic European capital market for SMEs. The Commission will therefore continue to support pilot projects under existing Community programmes where these aim to introduce new, SME-tailored financial instruments (for example in the field of mutual guarantees and venture capital) or to improve the functioning of existing financial markets (for example by encouraging share holdings in SMEs).

The Report also confirms the trend observed in recent years towards a growing number of increasingly late payments. Following a large consultation process on possible solutions to this problem, the Commission recently announced that it could address a recommendation to the Member States on this issue (17). Will it be the case, this recommendation could focus on the improvement of the current legal framework, which is not considered sufficiently dissuasive for bad payers.

The problems referred to in the Report as regards SME access to bank credit, have already led the Commission to set up, in 1993, a Round Table of Leading Representatives from the Banking Sector to examine possible ways of improving the relations between financial institutions and SMEs. On 19 May 1994, the Round Table submitted to the Commission its final report containing specific recommendations to financial institutions, SMEs, Member States and the European Union. The Commission will examine the Round Table's recommendations and consider any necessary follow-up, namely in the context of the Integrated Programme for SMEs.

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17. "Integrated Programme in favour of SMEs and the craft sector", COM (94) 207 final of 3 June 1994.

## **6. Innovation and diffusion of technology**

Although noting that the examples used and the conclusions reached by the Observatory are mostly based on partial data available for a limited number of countries, the Commission broadly supports the finding that if on the one hand, SMEs play a key role in both product and process innovation, on the other hand, they tend to be more involved in incremental as opposed to radical innovations. This is mainly due to the fact that technology oriented businesses are typically micro and small enterprises which usually do not perform fundamental research and concentrate on having a quick response to market needs.

Only a minority of new technology based firms will expand into export oriented large scale businesses. Nevertheless, this minority is likely to provide the European Union with new worldwide leaderships which undoubtedly will be crucial to its overall competitiveness.

In addition, the Report considers that SMEs, although showing greater overall effectiveness than large companies in bringing innovations to the market, still face a number of problems as they go through the innovation process. These problems are usually linked with the lack of appropriate financial and human resources and entail high levels of risk. In order to overcome the different barriers against innovation, new technology based firms are likely to be more and more involved in cooperation with other companies, research centres or universities at their mutual benefits.

The recently adopted Fourth R&DT Framework Programme recognises the role and the needs of SMEs in the field of research and innovation, and provides for measures of technological stimulation aiming at encouraging and facilitating SME participation in Community research and technological programmes, as well as at improving their access to the results of research. Accordingly, measures to be undertaken under several R&TD programmes are mainly of three types: provision of Community support to decentralised networks providing information and assistance to SMEs (looking for partners, preparing collaborative proposals); possibility of submitting proposals for an exploratory phase, with Community support to the elaboration of the final proposals; and financing of "cooperative" research projects, in order to enable SMEs that have a common technical problem but lack the necessary research capacities to entrust an important part of their research needs to one or several third parties (research centres, universities, enterprises).

In addition, and in order to help SMEs prepare for participation in the new R&TD programmes, already before their adoption, the Commission is currently expanding the Euromanagement pilot action which is designed to provide adequate support to SMEs in assessing their technological and managerial capabilities, looking for partners and preparing collaborative research proposals eligible for Community support. Moreover, it has implemented specific actions, such as MINT (Managing the Integration of New Technologies), which has been launched in the context of SPRINT to promote the absorption of new technologies by SMEs by giving them access to consultants who are specialised in innovation management techniques such as technology, audits, design, value analysis and establishing transnational technological cooperation. Besides, the BICs (Business Innovation Centres) have been developed, and could be reinforced on the basis of the very same essential elements identified by the Observatory as key success factors in innovation.

As to future analytical developments, the Commission would welcome the Observatory to provide, in liaison with SPRINT's European Innovation Monitoring System, a mapping of European new technology based firms showing the geographical concentration of those firms and allowing for a measurement of their population, as well as to carry a more specific analysis of the nature of on-going transnational technological cooperations involving SMEs at the Union level.

## **7. Regional aspects**

Although it includes a few examples of measures implemented in the regions covered by Objective 1, the analysis of the structure of enterprises in the regions (particularly with reference to size) and the socio-economic characteristics of regions (unemployment rate and per capita GDP) is generally descriptive and provides no new information. For instance, it is well known that micro firms are more widespread in southern Europe and the size of businesses tends to grow as one moves northwards.

On the basis of surveys carried out in 19 regions, the Report also looks at border regions and studies the impact of the Internal Market on the development of SMEs in terms of business and personal flows and the development of institutional contacts. It shows in particular that the Community initiative INTERREG has made it possible to promote transborder cooperation, especially at institutional level and in some cases between firms. The Commission believes that Member States should focus more strongly on cooperation between SMEs in the draft programmes to be submitted by the end of October under INTERREG II.

The identification of impediments to transborder cooperation is also interesting, since it can reinforce the Union commitment towards abolishing such hurdles (lack of information on potential markets and possible partners, language problems). It is also interesting to note in this respect that the completion of the Internal Market has not yet had the anticipated positive effects on transborder cooperation.

On the whole, the Commission feels that although this chapter makes up for certain omissions in the first report, it is still too backward looking. It makes no mention of the new possibilities offered to SMEs in the new programming period of the Structural Funds (1994-1999) (Community Support Framework and Community Initiatives) and fails to analyse the decision-making process for regional policy, particularly with regard to partnership, which is important for increasing the involvement of SME intermediaries in regional development. Similarly, it would be useful to analyse the best means to exploit the potential role of SMEs, in particular of micro and small enterprises in the creation of jobs in the regions, especially in the Objective 1 regions, since these have the highest unemployment rates and receive important support from the Union, as well as in rural regions covered by Objectives 5b and 5a and by the initiative LEADER. These aspects and the possible implication of regional disparities in business performance are surely to be discussed in future reports.

## **8. Policy for SMEs**

For the first time, the Report devotes a chapter to national SME policies. The Commission would like the Observatory to continue producing a detailed report each year on the main developments in each Member State in this area. This is particularly important for assessing the follow-up to the White Paper, as well as to ensuring the success of the Integrated Programme which relies as much on concerted initiatives as on the effectiveness of Community contributions and actions in favour of SMEs.

As regards the debate over whether to support the creation of new businesses or the development of existing ones, the Commission generally shares the Observatory's opinion that it is not possible to rule out either of these objectives. Consideration of the matter is, however, essential for defining the priority measures which budgetary constraint imposes in the Member States.

While it is true that new businesses have a high mortality rate and few of them have much potential for job creation, the establishment of new businesses is nevertheless essential for renewing the industrial fabric. It is the only way ahead for the development of certain regions where the existing business fabric is inadequate. As regards both new businesses and those already set up, the Commission is of the opinion that the general economic and legal environment plays an essential role in stimulating entrepreneurship and helping firms in the sensitive stages of their development. As regards firms with a high growth potential in particular, the Commission considers, also in the light of the experience gained in the framework of the Business and Innovation Centres, that it would be appropriate to further encourage organising special support for them..

As far as the instruments of SME policy are concerned, the Report shows that advisory and assistance services play a decisive role in several fields. However, although a vast number of services have been set up at all levels in the Member States, businesses tend to overlook or underuse them, either because they do not reach a critical mass or lack adequate visibility. For this reason, the Commission attaches particular importance to promoting mutual consultation and exchange of experiences between Member States in order to stimulate the demand for enterprise support measures which exist at national or regional level, as well as to strengthen the effectiveness, visibility and coherence of services currently available to enterprises. Therefore, national or regional advisory and assistance projects for SMEs, aimed in particular at enhancing the managerial capabilities of SMEs and defining strategies for modernisation, would receive particular attention in the framework of the Integrated Programme.

## 9. The craft trades (18)

The Report examines the current importance of the craft trades in the European economy in either quantitative and qualitative terms, whilst paying particular attention to the various national concepts and definitions of crafts, and considers the consequences of the completion of the Internal Market on the craft sector, namely by summarising its major strengths and weaknesses. Moreover, an operational concept of "Craft Dominated Sectors" (CDS) has been developed with a view to allow for cross-country comparisons of "craft-like" sectors.

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18. This constitutes the Report's "theme study".



The Commission recognises the accuracy of the analysis carried out by the Observatory on this subject, and broadly shares its views as regards the instrumental role performed by the craft trades in providing economic continuity, breeding vocational skills and new entrepreneurship, and absorbing and upgrading the less sought after groups in the labour market. However, it considers that some of the results presented in the Report, and relating to the effects of the completion of the Internal Market on the craft industries, deserve further discussion.

Although recognising that the Observatory is probably right in assuming that craft enterprises in the lower income regions are more vulnerable to increasing competition as a result of the Internal Market, namely since the proliferation of flexible highly automatised machine tools make it possible for bigger enterprises to compete successfully even in niche markets and to do it because of sluggish demand, the Commission notes that there exist also good examples (such as of Italian craft enterprises in footwear, metal sector or textile and clothing) where appropriate division of labour and use of cooperatives has significantly ameliorated the competitive position of smaller companies. Besides, increased mobility of entrepreneurs and craft employees, which is already higher than assumed in the Report (19), namely on border regions, can certainly contribute to further improvements in the overall competitiveness of craft enterprises.

In general, the craft experts interviewed by the Observatory are mainly defensive. They feel that craft related policies are increasingly issued by far away public authorities. And they believe that the Internal Market will lead to further concentration in the food crafts sector and to increased competition in the repair and maintenance sector. However, it can be observed that decisions for the construction of supermarkets are made on a regional level, and that there is a clear tendency for bigger enterprises to establish their own service departments, as increased sophistication of products often means that only specialised companies, with particular work tools and spare parts, can do the maintenance.

The Commission nevertheless considers that not only does the Report highlight the paramount importance of the craft trades in the European economy, namely as instrumental in upgrading the professional qualifications of the relatively unskilled workers, hence contributing to reabsorb unemployment, as its findings can surely contribute, by their richness and variety, to encourage increasingly serious thought and debate on craft industries and small businesses.

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19. The figure of less than 1% given for Germany relates to foreign craftsmen that want to establish in Germany and does not include those who passed the German Mastercraft examination and want to establish in this Member State.

## 10. Monitoring SMEs in the internal market: synthesis

In general, a brief analysis of developments in selected business indicators, as presented in the Report under each country-profile for the period 1986(88)-1990(91), does allow one to note that SMEs have maintained or increased their employment share in almost every Member State, with Ireland being the only exception to this general pattern (20). Nevertheless, whilst SMEs have gained in importance most noticeably in Belgium and Denmark, some concentration of employment in the upper size-classes seems also to have occurred in Spain (with large firms "crowding out" medium enterprises), and in Luxembourg and Portugal (where both micro and small firms appear to have lost some ground to medium enterprises).

On the whole, the information included in the Report shows that SMEs are relatively more important in a group of five peripheral Member States (Greece, Ireland, Italy, Portugal and Spain) and increasingly becoming so in Denmark and Luxembourg, whilst large enterprises tend to have a greater than average share of employment only in France, Germany and the United Kingdom. Besides, an analysis of turnover and employment growth rates by enterprise size class over the years 1988-1993 (which can thus be expected to depict tendencies that are reasonably independent from the business cycle), seems to indicate that the size structure of some national economies could be changing fast. In fact, even if Portuguese SMEs do appear to have done better than the Union average in both grounds (21), SME performance has been consistently lower than average in Italy (22), and the best overall performers are actually to be found amongst large Irish and Spanish enterprises.

However, the complexity and intricacy of factors determining both the situation of, and the prospects for SMEs still prevent to go much beyond these tentative remarks, especially since any national SME tendencies are expected to increasingly interact with Union-wide enterprise and macroeconomic developments within the context of the functioning of the Internal Market. And indeed the Report shows that significant convergence in the SME business environment and in SME performance was already under way during 1988-1993, in the run up to the completion of the Internal Market, even if observed differences in a number of indicators are still found to be large enough to lead to SMEs exhibiting distinctive behaviour in different Member States in the foreseeable future.

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20. See note 9 above. In fact, only in manufacturing was the Irish SME share in employment found to be significantly above the Union average in 1990.
21. Best SME performers also include Denmark and Germany.
22. The same is true for the United Kingdom.

Additionally, the Observatory's SME Internal Market Monitor (SIMM), meant to allowing for a comparative assessment of Member States according to changes in a set of selected SME business environment variables that have subsequently been classified into a number of domains supposed to represent important determinants of SME performance, seems to reveal that only in a limited number of domains have a few Member States significantly and consistently experienced above, or below average changes in all the variables concerned. Nevertheless, those domains (government policies, labour markets and capital markets, in this order) are exactly the ones the Observatory found to be more likely to affect SME performance.

Although welcoming its rather innovative approach, the Commission considers that the Observatory's monitoring procedure still requires a number of specific improvements. First of all, the fact that macroeconomic developments can always act, along with the completion of the Internal Market, as an independent force on SME performance should be explicitly taken in consideration, even if relative synchronisation of the business cycles, as well as relative convergence of the business environment is to be expected in the coming years. Secondly, since different SIMM-indicators are assumed to capture distinct Internal Market aspects and relate either to its first-order or longer term effects, an assessment of their relative importance through time would also be needed. And finally, as no reference is made in the Report, if only on a theoretical basis, as to the expected effects of actual changes in the business environment variables on SME performance, it is still not clear whether the Observatory's findings can have any operational relevance.

### **GENERAL COMMENTS ON THE POLICY RECOMMENDATIONS**

The Report proposes a number of policy recommendations which strongly focus on the current employment debate and the role SMEs and entrepreneurship can play in reducing unemployment. By doing so, the Observatory clearly is in line with the present priorities of the European Union.

The Observatory analyses in turn labour demand oriented approaches, then labour supply based approaches and finally the matching of the two. It thus deals with many subjects that were developed in detail in the Commission's White Paper on Growth, Competitiveness and Employment. The Observatory's stance is generally the same as the Commission's.

Many recommendations on promoting exchanges of information and experiences between the Member States concerning the relevant initiatives, in order to identify best practices and encourage their spread, have in fact been already considered by the Commission in the framework of the Integrated Programme for SMEs.

Other recommendations, such as the development of a European programme for promoting entrepreneurship, could also be examined in the context of the implementation of the Integrated Programme .

In addition, new programmes under discussion (SOCRATES and LEONARDO) should make it possible to respond to most of the Observatory's recommendations on education and training, as should the European Social Fund under the new Objective 4.

In particular, as was stressed in the Integrated Programme for SMEs, since most of the measures affecting the job creation potential of SMEs are still of national origin, it is at present a question of encouraging the Member States and all those concerned by the development of SMEs to bring the various initiatives within a single framework that will ensure their consistency and visibility.

## CONCLUSIONS

In general, the Second Annual Report has more focus on dynamics than the first one: whether on employment creation and training, capital and finance, or innovation and diffusion of technology, it proved to be possible to present developments in addition to structures. Moreover, it provides a dynamic picture of several variables of the SME sector as well as the business environment by Member State and presents the results of a first convergence/divergence analysis, thus monitoring anticipatory effects of the completion of the Internal Market during the period 1988-1993.

In this vein, as more longer time series become gradually available and the time elapsed since the official completion of the Internal Market allows more first and possibly second-order effects to be visible, the Commission considers that the Observatory's future work should pay increased attention to development of the SME Internal Market Monitor. To this end, it seems possible to adapt the structure of subsequent reports so that it will mirror more closely the proposed contents of the Monitor, namely by explicitly considering the various items to be presented and variables to be analysed as elements of either the performance of SMEs or their business environment.

As it stands, the Report does confirm that, in spite of some size-related handicaps and unfavourable macroeconomic trends, SMEs clearly are to be considered as one of the main single sources of employment growth potential in the nineties.

The Commission has a continuing commitment towards improving the business environment and promoting the development of enterprises in the European Union, and the European institutions have further strengthened their engagement on the field of specific measures in favour of SMEs during the past few months.

The implementation of new initiatives, within the framework of the achievement of the objectives of the White Paper, will doubtless contribute on the return to growth and to competitiveness as well as to the improvement of the employment situation. To this end, the Community will endeavour to stimulate, innovate and supplement the range of existing actions in a new form of partnership, as proposed under the Integrated Programme in favour of SMEs and the craft sector. By providing specific coverage and detailed consideration of the impact of the Internal Market on SMEs, the European Observatory for SMEs can surely act, by means of its future reports, as one of the most important analytical sources on which are to be considered practical proposals for its implementation.

In particular, this partnership requires an action narrowly concerted between the Community, the national and regional authorities and all the business intermediaries, whether they be employers' federations, professional associations or Chambers of Commerce and Industry, to give concrete expression to the common objective of mobilising SMEs as the most important layer of job creation. It is indeed essential to engage all strengths and means to obtain a "mass effect" in the implementation, at all levels, of enterprise policy, as well as to ensure that the various actions in support of SMEs fit in with current economic and political objectives, so as to raise their profile and coherence, without necessarily touching the legal bases which subtend these actions.

The Commission will thus endeavour to promote such a development by prompting and supporting the adoption of a suitable framework for a number of concerted actions, in the respect of the subsidiarity principle and without recourse to additional budgetary means, and by ensuring that the Community instruments based on various provisions of the Treaty integrate into such a mechanism.

## ***EXECUTIVE SUMMARY***

# **THE EUROPEAN OBSERVATORY FOR SMEs**

Second Annual Report, 1994

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***

April 1994

Recent years have witnessed the advent of the internal market. While the recession formed a barrier to rapid progress, significant changes can be noted in the business environment of SMEs. Intra-EU trade, after stalling between 1970 and 1985, has sharply increased once more since the agreement on the completion of the internal market. Business orientation has unmistakably shifted towards a Union-wide outlook. Recent surveys show, however, that SMEs report an increase in competition more often than an increase of exports. In the intra - EU border regions business flows, personal flows and institutional contacts have increased only to a limited extent. The major residual barriers are related to remaining differences in legislation, technical standards and cultural and language differences. SMEs are particularly hampered by difficulties in access to information. These aspects warrant careful and continuing observation. For that reason a monitor of SMEs in the internal market has been designed, focusing both on the business environment and the performance of SMEs.

On the threshold of the internal market SMEs are still faced with business and market conditions which differ between Member States. On the other hand, a tendency towards convergence can be observed in many elements of the business environment. This holds particularly for real short term interest rates, inflation, direct and indirect taxes as a percentage of GDP, availability of venture capital and labour costs per employee.

The performance of SMEs is related to these structural tendencies in the business environment as well as to the business cycle. SMEs (0-500 employees) now employ 67 million people, about 2.6 million more than in 1988. In the large enterprise sector, where there are 26 million jobs, employment has not increased since 1988. However, the real divide is between micro (0-10) and small (10-100) enterprises on one hand and medium-sized (100-499) and large (>500) ones on the other. Micro and small enterprises in the Union now offer employment to 53 million people, of whom about 17 million are businessmen and -women. Between 1988 and 1993 these enterprises created 3 million jobs, especially in the distributive trades and other services. However, medium-sized and large enterprises have lost even more jobs in the recession than they created since 1988. ENSR estimates that in 1990 there were 4.4 million enterprises within the Craft Dominated Sectors in the European Union, employing 24.5 million persons.

The dynamism of the small business sector is also illustrated by the strong growth in the number of firms. Every year an estimated 1.5 million Europeans decide to start a business of their own. In spite of high failure rates, especially during the recession, the number of enterprises has continued to grow at an impressive rate. Over five years the number of enterprises increased by 9%, to reach a total of 17 million last year

(including former East Germany). In the same period the population of the Union increased by only about 2.5%.

SMEs - both existing ones and new start-ups - can play a key role in combatting unemployment. At all policy levels this should be promoted by improving the business climate, reducing labour costs and administrative burdens and by stimulating the diffusion of new technological knowledge. The European Commission is particularly recommended to promote the dynamism of the European business sector, to establish a European Platform for Vocational Training and to facilitate the international exchange of 'best practice' policies applied in Member States to stimulate job creation by SMEs.

# 1 STRUCTURE AND KEY INDICATORS AT THE UNION LEVEL

The vitality of the European economies is seriously at stake. Economic growth is down or even negative, the international competitiveness of European business seems in jeopardy and the unemployment rate is unacceptably high.

Meanwhile the Member States have embarked upon a mission of further economic integration, which is expected to increase dynamism and prosperity, but will also imply a far reaching restructuring of their economies. In this crucial stage of European development, the key role will be played by small and medium-sized enterprises (SMEs).

In 1993 there were 17 million of these SMEs in the European Union (inclusive of former East Germany), but there were only about 12,000 large enterprises (LSEs) with more than 500 employees<sup>1</sup>. This means that for every 1,000 inhabitants there are almost 50 enterprises. In the past five years the number of SMEs has increased by about 1.5 million enterprises<sup>2</sup>, or by 9%. In the same period the total population of the Union increased by only about 2.5%. This signals a revival of dynamics and entrepreneurship. Growing flows from unemployment into start-ups of new enterprises in recent years only seem to play a minor part.

Most jobs in the private sector are in SMEs. In fact three out of ten jobs are in micro enterprises and four are in small and medium-sized businesses. This means 67 million jobs were provided by SMEs in 1993, about 2.6 million more than in 1988. Job creation since 1988 has been especially vigorous in the micro enterprises sector. Small enterprises showed modest employment growth, but medium and large enterprises were not able to maintain job numbers between 1988 and 1993.

The average size of an SME has slightly declined over the past five years. During the economic boom in 1989 and 1990 SMEs became somewhat larger due to vigorous job creation, but in the early nineties continued new start-ups as well as job losses caused average enterprise size to decline. On average an SME now occupies four persons.

	micro firms (0-9)	SMEs (10-499)
<b>Structure (1990)</b>		
number of enterprises (x mln.)	14.7	15.8
number of enterprises per 1,000 inhabitants		49
idem EFTA-countries** (1988)		21
average enterprise size (employment)	2.0	4.3
number of persons employed (x mln.)	30.1	68.0
employment share 10-499*** (%) (1988)		58
idem USA (%) (1988)		43
SME share in total business R&D (%)		18
employment share of micro/SME per sector (%)		
- manufacturing	15	63
- retail trade	58	86
- all sectors	32	72
<b>Business developments 1988-1993 (average annual growth)</b>		
number of enterprises	1.8	1.8
employment	1.7	0.8
turnover at constant prices	2.7	2.2
* Excluding former East Germany.		
** Excluding Switzerland.		
*** Share in employment of enterprises >10.		

<sup>1</sup> Exclusive of large firms in former East Germany.

<sup>2</sup> Exclusive of new enterprises in former East Germany.



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Average figures for the European Union tend to conceal the differences between the Mediterranean countries and most of the other Member States. In the former countries there are about 65 enterprises per 1,000 inhabitants, whereas in the latter this ratio is just below 40. Within Europe at large differences are even more spectacular. In the EFTA-countries<sup>1</sup> there are less than 25 enterprises per 1,000 inhabitants, and firms in these countries are twice as big as in the EU on average; even bigger than in Denmark, Germany and the Netherlands. This can partly be explained by a higher level of labour costs and of per capita income in the EFTA-countries. Enterprises in the Union also seem to be smaller than in the USA, as indicated in table 1.

These international comparisons indirectly support the hypothesis advanced in the First Observatory Report, that, especially in the Mediterranean countries, the internal market will stimulate processes of concentration and restructuring, resulting in a smaller number of enterprises with a larger average firm size. However, in the years preceding the completion of the internal market there was no clear evidence of this process.

A share of 18% in total R&D expenditures of enterprises highlights the role of innovative SMEs. However, these statistics tend to underestimate the actual efforts made by SMEs. Besides the same ECU spent by a smaller enterprise may produce better results in terms of the number and quality of innovations than in a large enterprise.

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<sup>1</sup> Excluding Switzerland.

The completion of the internal market is co-determining the economic performance of European business and European SMEs, in connection with various other factors. Some other major influences are: the business cycle, currency exchange rates, GATT and other international trade agreements, and, last but not least, business orientations and strategies anticipating tomorrow's markets. As for the latter, business expectations of the internal market have dynamics of their own, as shown by the wave of mergers and acquisitions in the eighties. Consequently, the impact of the internal market is inseparably connected with these anticipatory strategies and orientations.

### 2.1 Progress of the internal market: a qualitative impression

#### *International trade*

Intra-EU trade has significantly increased since the agreement on the completion of the internal market. There is some evidence that the growth rate of intra-EU exports by SMEs is at least twice the growth of SME exports to other countries over the last three years.

The export potential of SMEs considerably exceeds current exports. Mobilization of this potential depends on the progress of the internal market, i.e. closing SMEs' information gap, reducing administrative burdens, and on the development of Economic and Monetary Union.

The period 1986 to 1989 witnessed a substantial increase of intra-EU trade in services, in particular construction and business services.

Last year's GATT agreement is expected to influence general SME export performance positively, supplementing the internal market programme. Services will benefit especially. Liberalization of trade in services is a strong impulse to redefining make-or-buy and allocation decisions in this field, and to creating new business network structures. New opportunities for (predominantly SME) service firms are the result.

#### *Mergers and acquisitions*

Mergers and acquisitions are an indication of and strategic anticipation of industrial restructuring. The number of mergers and acquisitions within the EU rapidly increased in the eighties and reached a peak in 1990. They were almost exclusively a matter for large enterprises. However, an indication of SMEs' involvement in

the restructuring process as a result of the internal market is the increase of joint ventures since the publication in 1985 of the White Paper on the completion of the internal market. Here, larger numbers of SMEs are involved, especially in manufacturing, and in the banking and insurance business. In addition, LSE mergers have clear consequences for SMEs, notably Europeanization of the subcontracting market. Furthermore, increasing returns to scale can enhance further specialization and labour productivity growth, thus creating further opportunities for SMEs.

#### *Business orientation of SMEs*

Business orientation has unmistakably shifted toward an EU-wide outlook, in spite of the gradual and often delayed real effects of the internal market<sup>1</sup>.

Recent EU-wide survey research on the effects of the internal market shows increasing competition being reported by EU businessmen on the one hand, and increasing exports on the other.

In particular SMEs report increasing competition more often than increasing exports. One possible implication is that increasing exposure to international competition will inevitably result in a shake-out among SMEs in the EU, with the more competitive ones surviving in the longer run. The main policy issue is the regional implications of the restructuring process involved. This requires careful monitoring. European SME experts interviewed for this Observatory highlight the development of production costs in manufacturing as a negative internal market effect on SMEs. The reason is that economies of scale and increasing international competition are behind lower costs. This is especially the case in the Member States with high SME employment. Future restructuring effects will probably be stronger there.

#### *Major barriers to SMEs*

Gaining access to and processing information is a major barrier for SMEs. The administrative burden of cross-border operations within the EU has indeed been reduced in the last few years, but is still considerable for SMEs. Public procurement participation is still being handicapped for that reason. SME experts throughout the EU point at the removal of administrative burdens and barriers at the border as major positive effects of the internal market.

<sup>1</sup> The European Observatory for SMEs. First Annual Report, figure 3.1 (page 81), distinguished between first order, second order and long-term effects of the internal market.

However, remaining barriers in the field of customs procedures, fiscal matters and technical standards should not be underestimated. New procedures, shortcomings in informing businessmen about them, and diverging transition periods between Member States add substantially to administrative burdens. SMEs are expected to benefit especially strongly from a reduction of these barriers.

#### *Restructuring effects*

Restructuring effects are by their nature mainly 'second order' or long-term internal market effects. In other words, only the first signs will be observed by now. Some insight into effects on SMEs can be derived from expert opinion, however. The European SME experts surveyed were asked for their opinion on some of these effects, either direct or indirect.

On balance they felt that manufacturing SMEs will gain weight in the South of the EU, and lose ground in the 'mature' economies in the North. On the other hand, the relatively SME dominated South will face radical restructuring effects as a result of scaling up tendencies and increasing international competition.

The internal market impulse for service exports is emphasized by experts in the North, while in the view of the SME experts from the South this impulse to services is likely to be confined to the domestic market.

SME experts from the South also expect better access to new markets for their SME construction industry as an internal market effect. This is based on the joint

effect of reduced non-tariff barriers in the North and lower labour costs in the South. The experts also predict some scaling-up trend within construction, but this trend seems mainly to apply within the SME range.

## 2.2 Convergence in the business environment facing SMEs

On the threshold of the internal market, SMEs were still faced with conditions which differ between the Member States. Some elements of the business environment which exhibit sharp differences are interest rates, labour costs, availability of venture capital and direct taxes as % of GDP.

However, in the years preceding the formal completion of the internal market a definite tendency towards convergence could be observed in several selected business environment indicators. Table 2 provides an overview.

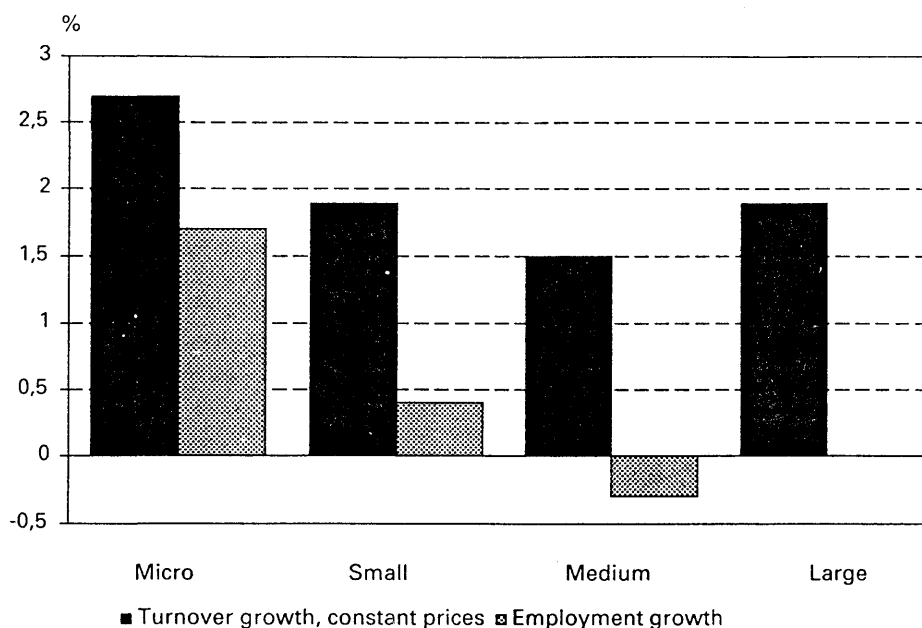
In part it appears that convergence of these indicators has been caused by the economic downturn in the early nineties. This certainly holds for interest rates and for inflation. But, by and large, more structural forces related to the internal market have also become manifest.

In future Observatory reports the monitoring of convergence in the business environment of SMEs will be continued.

Business environment variable	Convergence (+) Divergence (—)	Significance
Real short term interest rates	++++	***
Direct taxes and social contributions as % of GDP	+++	***
Direct taxes as percentage of GDP	+++	***
Indirect taxes on goods and services in % of GDP	+++	***
National majority acquisitions and mergers in manufacturing industry and construction	++	**
Public expenditures on active labour market measures as % of GDP	++	*
Venture capital stock as percentage of GDP	++	***
Share of extra EU-trade of goods & services in % of GDP	++	**
Inflation	++	***
Labour costs per employee in current prices	++	**
Business expenditures on R&D in % of GDP	+	***
Share of intra EU-trade of goods in total exports	+	**
GDP per capita at constant market prices in PPP	+	*
Gross fixed capital formation at current prices as percentage of GDP	—	**
Firms per 1,000 inhabitants	—	*

Notes: \*\*\* highly significant, \*\* significant, \* not significant.  
a. The rate of convergence was calculated on the basis of statistical data; for an explanation of the methodology the reader is referred to the main report.

Figure 1 Development of turnover and employment, by size class, average annual growth 1988-1993



### 2.3 Performance of SMEs and their business environment

Turnover of SMEs increased slightly more than that of large enterprises over the entire 1988 to 1993 period. Especially in the late eighties, SMEs experienced high

rates of output growth and seem to have improved their market share. In the early nineties the economic recession slowed down turnover growth of SMEs to a considerable extent. In 1993 output of the SME-sector actually declined in most Member States.

Table 3 Correlation between business environment indicators and SME performance across the Member States, 1988-1993

	Canonical correlation* of SME performance	
	with domains	with individual indicators
Government policies	0.61	
- indirect taxes		0.52
- direct taxes		0.44
- direct taxes & social security contributions		0.32
- inflation		0.10
Labour market	0.60	
- active labour market measures		0.56
- labour costs per employee		0.04
Capital market	0.57	
- gross fixed capital formation		0.54
- venture capital stock		0.19
- real short term interest		0.18
International markets	0.48	
- intra EU-trade in total trade		0.37
- extra EU-trade in GDP		0.35
R&D	0.37	
- business expenditures on R&D		0.37
Entrepreneurship	0.33	
- enterprises per 1000 inhabitants		0.33
- national majority acquisitions		0.25
National market	0.28	
- GDP per capita		0.28

\* Canonical correlation describes the correlation of the set of SME performance indicators (turnover growth and employment growth) with the individual business environment indicators as well as with groups of indicators (the domains).

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However, it is primarily in employment growth that SMEs have most notably outperformed large enterprises. Between 1988 and 1993 SMEs in the European Union were responsible for a net employment increase of 2.6 million jobs. On the other hand, in 1992 and 1993 large enterprises lost the same number of jobs (1 million) as they created in 1988-1991.

In fact the divide is not between SMEs and large enterprises, but between micro and small firms on one side and medium and large enterprises on the other. As is shown in figure 1, the micro firms were the best performers with small firms as runners-up. Medium-sized firms actually lagged behind large enterprises.

Between 1988 and 1993 the turnover and employment growth rates of SMEs in the Member States have clearly converged. For instance, at the end of the 1980s SME real turnover growth ranged from 1.7% (UK) to 9.2% (Portugal), but by the early 1990s the range was from -0.4% (UK) to 3.6% (Ireland). It seems that in part this simply reflects slowing economic activity across the EU. However, the performance of SMEs is not only related to the business cycle, but also to structural tendencies in the business environment.

An exploratory analysis across the Member States reveals that SME performance in the period 1988-1993 was most strongly correlated with policy-oriented indicators such as taxes and active labour market measures as well as with the cost and availability of labour and capital and with international trade (see table 3).

## 3.1 Job Generation

The creation of new jobs can arise because new enterprises are established and because established enterprises expand their operations. From detailed studies in five Member States it can be concluded that the direct effect of expansions on job creation is about twice as big as that of enterprise births. Of course, the establishment of new enterprises may also have an indirect effect because it stimulates expansion in later years.

Net employment growth does not only follow new job creation, but also depends upon job losses due to closures and contraction of enterprises. In most countries (except for the UK) contractions are more important than enterprises deaths.

Job generation studies focusing on the size dimension of firms are still rare in the EU. However, recent analyses in Denmark and the UK provide results which appear to closely parallel the well-known findings of Birch regarding the USA.

Results show that net job growth was either fully (Denmark) or nearly (UK) confined to micro and small enterprises, and was actually dominated by micro firms (under 10 employees).

Results for the UK also provide an interesting contrast between a period of rapid economic growth and the onset of recession. As is shown in figure 2, SMEs seemed relatively stable in both generating and shedding

jobs over the greater part of the business cycle.

On the other hand, large enterprises (LSEs) show a dramatic increase of job losses due to contractions during the early stages of the recession.

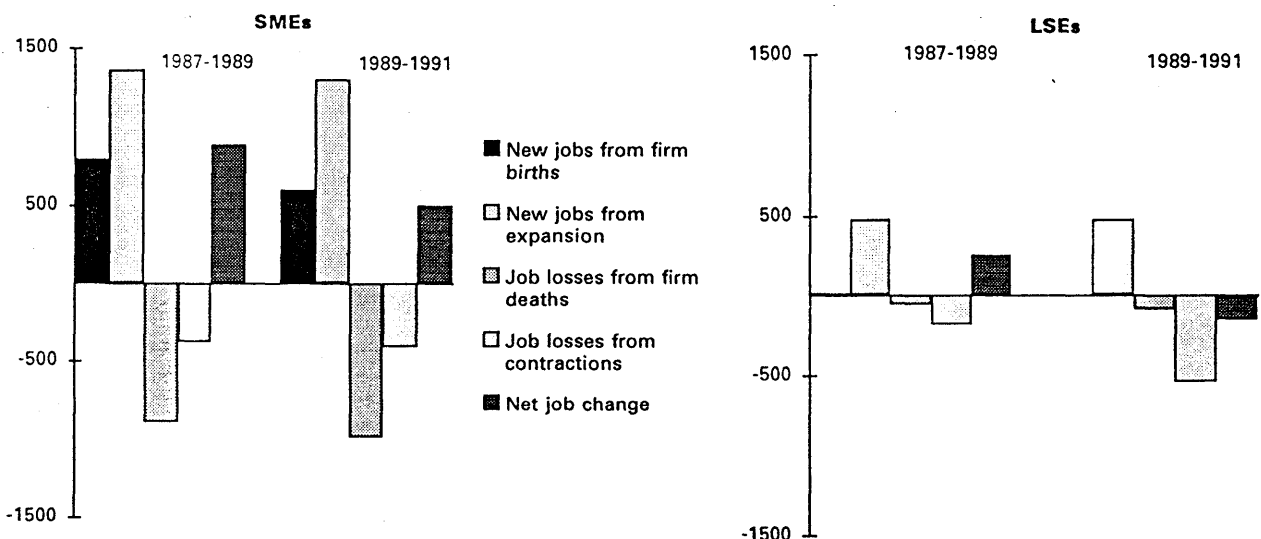
## 3.2 Training and labour productivity

### Training and SMEs

While comparisons are fraught with difficulties, it is clear that very marked differences remain between the 'initial' vocational education and training systems used by young people entering the world of work across the Member States. For the less well documented 'continuing' training of adults national systems are if anything even more diverse. Europe's SMEs must thus contend with a wide range of training arrangements. Nevertheless, basic economics predicts that all enterprises are reluctant to invest their own resources in training employees in skills of use to other employers, but SMEs face particular problems because they experience higher labour turnover rates and so have greater difficulty in retraining any skills created within the enterprise.

The available evidence shows that smaller enterprises do indeed train less, and, when they do train, make more use of external training and place relatively more emphasis on induction training for new personnel. In Denmark, for example, only 36% of micro enterprises have a specific training budget compared to 76% for those with 250 or more employees.

Figure 2 New jobs and job losses in the UK, by size class, 1987-1991



However, there are some indications that non-market forces like legal requirements and 'peer' group pressures have placed effective floors under training activity among SMEs, for instance in Germany's long established 'dual' apprentice training regime.

#### *Training's impact on labour productivity*

Since the 1980s a series of two-country studies has assessed the impact of a better qualified workforce on labour productivity levels. This was done through a series of very detailed analyses of 'matched' establishments in various sectors. An example is given in the case study below.

The consistent pattern shown by these studies supports the view that better qualified workforces are key factors underlying the observed differences in labour productivity.

### 3.3 Financial structure and financial costs of SMEs

The financial structure of SMEs is characterized by:

- a high dependence on borrowed funds
- large dependence on banks as the main source of borrowed funds
- high proportion of short term credit.

This type of financial structure implies higher financial costs for SMEs compared to large enterprises. Financial costs are, on average, two percentage points higher for SMEs than for large enterprises.

The lowest ratio of financial costs to turnover is found in Germany, followed by the Netherlands and Ireland, while the highest ratios (above 4%) are in Portugal, Italy and Greece (see figure 3). In most of the EU countries, except for Spain, the share of financial costs in manufacturing firms (both large and small) is bigger than in services.

The ratio of financial cost to gross economic profits, indicating the capacity of the firm to generate funds for further expansion as well as paying interest also differs between Member States (see figure 4). In some, the financial burden is always greater for manufacturing SMEs than for large enterprises (e.g. Italy). In others it

#### Case Study      Hotels in Britain and Germany

Considering a total of 30 British and German *medium quality hotels* selected from national Michelin guides, average labour requirements per guest night were about 50% higher in London than in Germany and twice as great in hotels in large British provincial cities as in Germany.

While in both countries most staff lacked qualifications, in Germany 35 per cent had attained craft-level qualifications in hotel and catering against only 14 per cent in Britain.

Although British hotel rooms were refurbished more often, labour saving improvements were most noticeable in Germany. Further, the work of (unqualified) chamber maids appeared more efficiently organised in Germany. Some three quarters of German housekeepers held vocational qualifications (against a single example in the British sample) and they spent much of their time on organisational tasks which in Britain tended to be dealt with by managers.

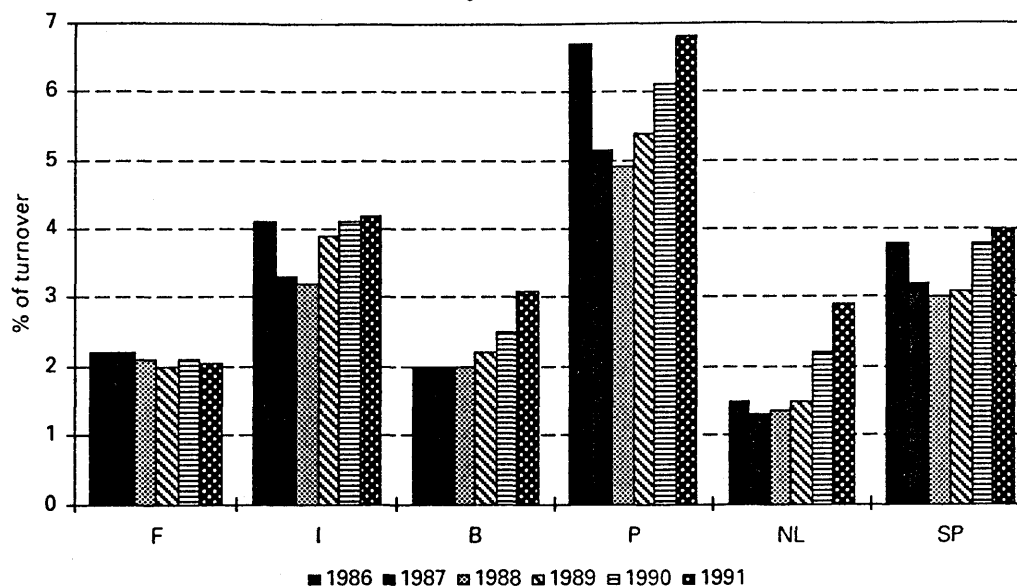
So far as 'front' reception desk staff were concerned, some 70 per cent of German staff employed during normal working hours were vocationally qualified or in the process of qualifying. The comparable British figure was only 17 per cent. Partly due to more sophisticated computer systems, German reception desks were manned more economically, but individual staff in Germany were able to carry out a variety of tasks, often left in separate hands in Britain.

Source: Steedman and Wagner (1989).

changes yearly (France, Portugal). Similar patterns occur outside the EU. In Japan SMEs are worse off, while in the USA larger enterprises face higher financial burdens.

In Germany and in the Netherlands enterprises can generally count on more favourable conditions regarding financial costs. In these two countries, in fact, the financial burden is lower than elsewhere; on the other hand in Italy and Portugal the financial burden amounts to more than 40% of gross economic profits. The lower financial burden of German and Dutch enterprises can to some extent be explained by low interest rates, and on the contrary by high interest rates in Italy and Portugal.

Figure 3 Financial costs on turnover, manufacturing SMEs, 1986-1991



### 3.4 Risk capital

Banks are the largest single source for risk capital provision accounting for 35% of the total in 1992. The second largest source is capital arising from realised capital gains (16%), a reflection of the maturity of the venture capital markets in Europe. Pension Funds (13%) and Insurance Companies (9%), come next.

The stock of Venture Capital (VC), representing medium or long-run equity investments in private business, is basically concentrated in the United Kingdom and France, but with Italy showing the biggest increase from 1991 (see figure 5).

The supply of new risk capital has shown a 5% reduc-

tion in 1992. It amounted to 3.8 billion ECU, and it is unevenly distributed across the Member States with the three biggest countries, United Kingdom, France and Germany, accounting for 77% of the total.

Looking at the destination of VC by type of investment, (see table 4) it appears that VC is concentrated in expansions and buy-outs while investment at earlier stages is barely represented. On average funds for seed and start-up projects do not exceed 8.5% of the total amount invested by venture capital firms all over the EU. The following table shows the distribution of VC investment in Europe in 1992.

Figure 4 Financial costs on gross economic profits, SMEs and large enterprises (LSEs), 1991

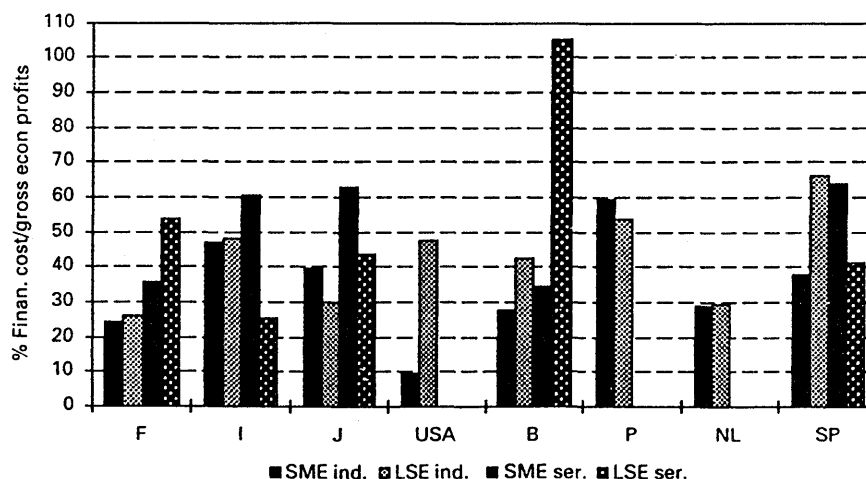
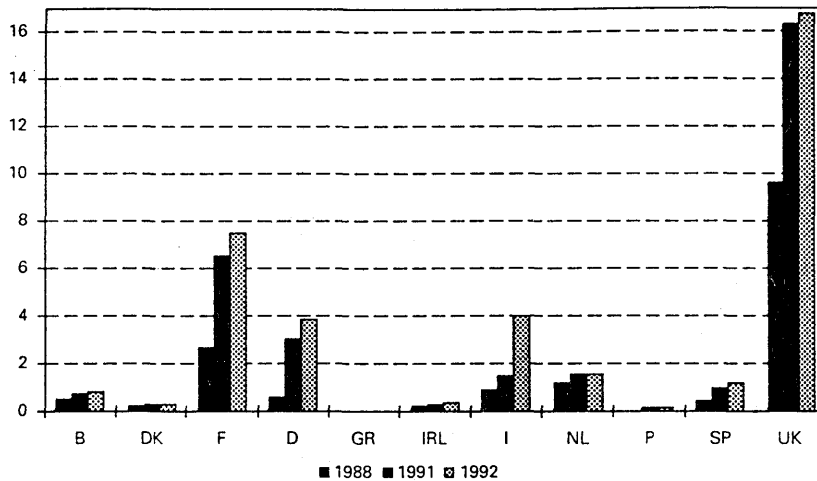




Figure 5 Venture capital stock, 1988-1992 (in billion ECU)



There are some differences between countries with regard to the distribution of VC investment: the highest shares for seed capital in 1992 were reached in Denmark, Spain and Ireland. For start-up activities the highest shares were reached in Spain, Portugal and Italy.

Companies which want to expand their activity abroad should bear in mind these differences. In the last year, payment periods have worsened almost right across Europe (65% of the enterprises registered a worsening of terms), but mainly in Greece, Italy and Spain. This implies higher costs for the firms and additional costs in carrying out action to collect overdue debts.

Type of investment	1992 in %
Seed	0.6
Start-up	5.3
Expansion	45.8
Replacement	8.6
Buy-out	39.8
Total	100

\* Non-EU countries represent 3.4% of total investment in 1992.  
Source: EVCA.

### 3.5 Late payments

Trade credit is the main source of short term financing for SMEs. Since SMEs also grant trade credit to their clients terms of payment, when long, represent a serious problem for the cash resources of the firms, because SMEs are squeezed between suppliers and customers. Average trade terms differ across Member States, being very short in Denmark (38 days) and Germany (34 days) and long in Italy (89 days), Portugal (76 days), and Spain (74 days). Average payment periods and the change in the promptness of payment in the past year are shown in table 5.

### 3.6 Innovation and R&D

In the advanced industrialised countries technology and knowledge in a broad sense are the major engines of growth. The involvement of a country in R&D activities depends on many factors including the type of the economic structure and the presence of large firms. In 1991 the EU's four biggest economies, Germany, France, the United Kingdom and Italy, accounted for 88% of total gross expenditure on R&D of the EU as whole. Looking at the ratios between expenditure on R&D and GDP, and hence excluding the size effect, Italy falls below the smaller advanced countries like Belgium, the Netherlands and Denmark. Figure 6 shows the R&D effort ratios for the EU countries in 1986 and 1991. The R&D effort increased in only 6 countries over that period.

#### *SMEs, R&D and innovation*

According to the official statistical data on R&D, SMEs are far less active in innovation than large firms. This is shown in figure 7. The only exception seems to be Ireland. On the other hand, SME innovativeness cannot be fully measured by the official statistical data, because they refer mainly to the R&D performed inside R&D departments.

Country	Average days 1993	Better in %	Worse in %
Belgium	45	4	61
Denmark	38	6	35
France	66	4	61
Germany	34	1	66
Greece	69	3	76
Ireland	60	7	57
Italy	89	5	76
Luxembourg	57	4	67
The Netherlands	48	4	48
Portugal	76	6	60
Spain	74	3	74
United Kingdom	51	8	47
EU average	65	4	65

Source: Grant Thornton European Business Survey 1994

Most of the innovative efforts of SMEs do not come from this source, and many innovations do not rely on patents. R&D work performed in SMEs and R&D performed in large enterprises is not the same. SMEs are mostly involved in development rather than pure research. SMEs for which research is a core business are relatively few (New Technology Based Firms or High-Tech SMEs).

To capture the role of SMEs in innovation it is also necessary to look at new products, new production processes, and new applications. From the outcome of qualitative studies it appears that over 60% of the major inventions developed in the last century came from

independent inventors and small companies. Compared to their share of output, this percentage shows that small enterprises are three times more 'effective' at innovating than large enterprises.

#### *Pattern of innovation across the Member States*

Some differing patterns are apparent in technological development between the EU Members.

- In France and Luxembourg, SMEs are more involved in product than in process innovation and the smaller the enterprise the less it is involved in process innovation. Large enterprises are, on the contrary, engaged in both types of innovation.

Figure 6 Business expenditure on R&D as a percentage of GDP

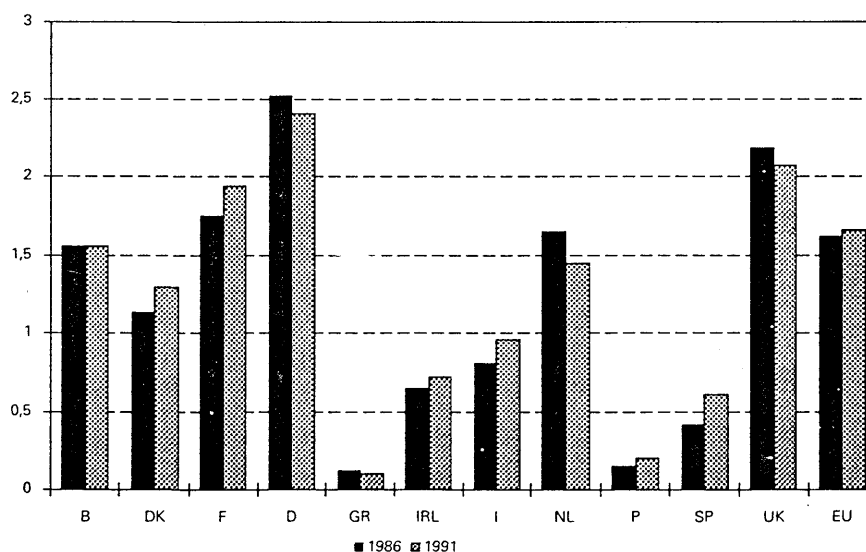
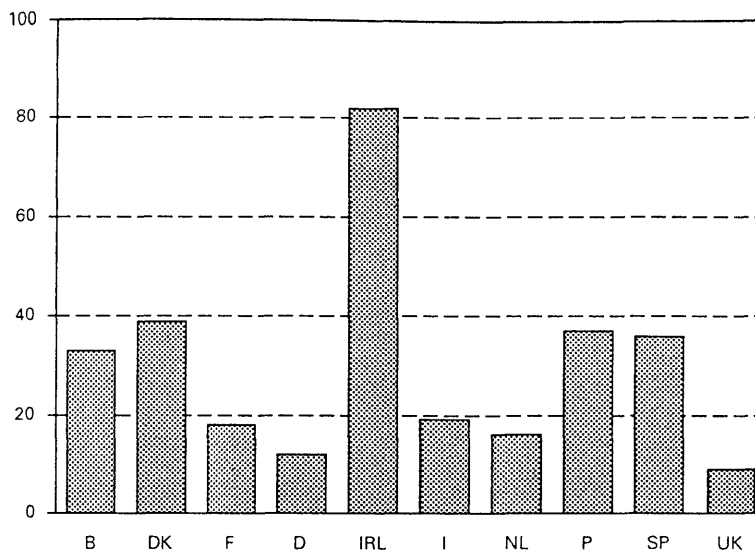


Figure 7 Ratio between SMEs' R&amp;D share and share of SMEs in employment



- In Italy both SMEs and large enterprises are more process than product innovative and large enterprises are more product innovative than small enterprises. This result can be explained by the fact that Italian industries, especially SMEs, rely much more on the acquisition of embodied technologies than on 'pure' innovativeness.
- In the Netherlands it seems that SMEs (except micro enterprises) are much more involved in process than in product innovation.
- In Ireland, almost all product innovations in a national sample were due to enterprises with less than 500 employees.
- In the United Kingdom, while only 26% of product innovations over a long period were due to SMEs, their share is increasing.

### 3.7 Innovation, obstacles and key factors

Innovation activity implies a degree of risk. Risk represents the first 'psychological' barrier. Other barriers to introducing innovations are: cost; financing problems; lack of skilled personnel; and insufficient market knowledge. These kinds of barriers play an important part in the smallest enterprises.

However, even when the innovation has been introduced, implementation may present difficulties. The main implementation difficulties are the same in all the EU countries. Again these are: high cost; lack of financial resources; and shortage of qualified personnel.

#### *Key success factors in innovation*

Innovative SMEs appear to have clear characteristics. To be successful attention must be paid to three essential elements. These are:

- Project assessment and strategy of the enterprises  
The enterprise should adapt the projects involving innovation to its strategy, size and capability. Enterprises must explore the consequences of the project on: organization; marketing; internal/external skills; and the technological resources required by the project.  
A clear strategy, especially a commercial strategy, and consolidation of the innovative position are highly necessary.
- Business plan  
The innovator must plan the cost of the project as precisely as possible and be aware of the time available.  
The importance of time in developing new products must be stressed. This increases as product life cycles become shorter.
- Cooperation  
Cooperation and especially transnational cooperation appears to constitute a key point for the smallest enterprises, the smallest Member States and New Technology Based Firms.

### 3.8 Regional differences

Both within and across Member States the various regions of the European Union show large differences in structure and development. Within the SME area, regional aspects are important for at least two reasons:

- the different impact of the completion of the internal market on economic development in the various regions;
- major involvement at local level of small enterprises compared to large enterprises,

hence the greater dependence of small enterprises on local development.

#### *Type of economy*

Most of the regions of the EU are typified by a high share of SME dominated sectors. All Italian regions and most Portuguese regions, however, show a high share of micro dominant sectors. The same holds for some of the French regions, especially in the southern part of the country. In all regions in Denmark SME dominant sectors have by far the greatest share. In some regions, especially in France, large scale dominated sectors have a share only slightly lower than SME dominated sectors.

#### *Number of firms per 1,000 inhabitants*

The number of firms per 1,000 inhabitants decreases as one moves from south to north through the EU. This figure also shows more variability between regions in the southern countries (especially Greece and Portugal) than in the northern countries (especially Denmark, the Netherlands and Belgium).

#### *Unemployment and GDP per capita*

The highest level of GDP per capita is registered in Germany (Hamburg) and the lowest one in Greece (Voreio Aigaio). However, even within individual countries there are remarkable differences. The greatest difference in GDP per capita is registered in Germany between Hamburg and Lueneburg, followed in France by the differential between Ile de France and Corse.

In regions with a higher GDP per capita, micro dominant sectors have a lower share in regional employment.

Unemployment varies strongly in some countries due to differences in the economic structure between regions. The highest unemployment figures are found in Spain, the lowest in Luxembourg. In many regions with a high share of micro dominant sectors in employment there is also a high unemployment rate.

#### *Objective 1 regions*

Most of the Objective 1 regions (with per capita GDP not exceeding 75% of the EU average) are situated in Greece, Spain, and Portugal. The lowest GDP per capita is found in Greek and Portuguese Objective 1 regions. The GDP per capita in most of the Spanish and Italian Objective 1 regions is higher than the highest GDP per capita in the Greek and Portuguese Objective 1 regions.

### **3.9 Border regions**

Border regions are the intra-EU border regions. They are considered as the seam of European physical unity. However, since 1990 business flows, personal flows and institutional contacts between border regions have increased only to a limited extent, according to a telephone survey of experts in 38 border regions all over the EU (see table 6).

*Business flows* are taking place but on a limited scale. The main barriers are: differences in legislation; in social security systems; in administrative procedures; in quality requirements; fiscal systems; and cultural and language differences.

*Personal flows* have slightly increased, but cross border commuting and shopping has already taken place over a long period. Commuting has not increased due to the economic recession and high unemployment all over Europe. Moreover, the extensive administrative effort related to carrying out work abroad places SMEs in a difficult position when delivering consumer services in corresponding border regions. However, such activities do take place, for example, consumers in France (Département Nord) hire construction enterprises from the corresponding border region in Belgium (Arrondissement Mons).

*Institutional cooperation* between regional governments, agencies etc. has already taken place for a long period and seems to be increasing gradually. A specific programme has been launched by the EU in order to promote economic development through cross border cooperation, namely INTERREG. This programme has had an important positive impact on cross border business and institutional flows.

The extent of cooperation differs between regions. An example of cooperation between institutions is the case of Denmark and Germany, where the regional governments of 'Amt Sonderfullands' and 'Kreis Schleswig-Flensburg and Kreisfreie Stadt Flensburg' work together in planning schemes on environmental protection, building shopping centres, infrastructure development etc.

The main barriers are: language and cultural differences; a lack of tradition in cooperation; and lack of clear economic complementarity between the regions concerned.

Table 6 Development registered in the intensity of business, personal and institutional flows after 1990

	Change
<b>Business flow:</b>	
- subsidiaries	+
- mergers	+
- cooperation	+
- subcontracting/outsourcing	+
- financial services	+
<b>Personal flows:</b>	
- commuting	0
- shopping	+
- consumer services	+
<b>Institutional flows:</b>	
- cooperation between regional governments, Chambers of Commerce, employers organizations	++
- INTERREG responsables	++
0 : no change + : slightly increased ++ : increased	

### 3.10 Policy for SMEs

The 'Growth Initiative' (1992) and the 'White Paper' (1993), the two latest initiatives of the European Union aimed at promoting growth and employment, both identify SMEs as a target group for policy action. They give recommendations for economic policy in both the EU and individual Member States.

Major recommendations focus on:

- employment growth
- economic growth
- improving the competitiveness of enterprises.

Practically all Member States have taken these recommendations into account, some of them already had policies in these directions.

New developments in the Member States which mostly comply with the recommendations made in the White Paper and the Growth Initiative, tend to follow the approach of implementing additional support programmes while simultaneously improving the economic environment. The approach of abolishing or alleviating 'home made' constraints on competition such as high tax rates or restrictive capital and labour market regulations has been a marked tendency in the 1990s.

Some major trends in the new measures are:

- *For Denmark:* supporting the development of enterprises with high growth potential and a new guarantee programme aimed at easing the difficulties of these enterprises concerning finance
- *For France:* fiscal reforms, reinforcement of the equity base and access to long-term credits, reform of the competition laws, deregulation of markets, promotion of inter-firm cooperation, institution of a guarantee fund
- *For Germany:* reduction of profits taxes aimed at easing the financial burdens on enterprises

- *For Greece:* improving the quality of management in SMEs by offering more information, training and advice
- *For the Netherlands:* improvements in labour market flexibility to secure the present stock of jobs and facilitate further employment, and investment in apprenticeship
- *For Portugal:* facilitating access to finance and diversification of financial sources, improvement of efficiency and fostering corporate redimensioning, fostering innovation and start-ups (Intermezzo programme), prolongation of the PEDIP I programme (PEDIP II), supporting restructuralization and internationalization processes in enterprises (FRIE Fund)
- *For Spain:* special line of loans, creation of a new mutual guarantee society, taking minority stakes in newly created enterprises (Joint-venture capital fund), and labour market reform
- *For the United Kingdom:* improving the quality of management in SMEs by offering more closely integrated information, training and advice through single local outlets (Business Links)

In some Member States policies have also been introduced at regional level, especially in the field of technology. They are directed at those regions which suffer industrial decline and underdevelopment. For example, the 'Mezzogiorno' in Italy, and the 'Neue Bundesländer'

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in Germany. Compared to national SME policies, regional support offered to SMEs more often consists of direct subsidies. Measures include: government assistance for investment; general subsidies; and public provision of infrastructure as well as various negative inducements.

The craft trades are providing economic continuity, breeding vocational skills and new entrepreneurship. Crafts are thought to account for a substantial share of all the enterprises and employment in the EU. While the economic importance of the craft sector seems to go beyond its share in GDP, this importance is hard to assess formally. Definitions of, and accordingly the productive capacity, structure, and environment of, craft industries differ greatly between the Member States. Nor are craft trades a separate statistical category.

The Member States of the EU can be divided into three groups according to the legal status of the craft sector:

1. Craft is defined by law in France, Germany, Italy, and Luxembourg. In Belgium, the definition is set by actual practice.
2. The non-official concepts of craft in Denmark and the Netherlands include 'modern crafts' as is the case in the Member States in the first category.
3. In most of the remaining Member States the concept of craft is associated with very small-scale handicraft. This is the case in Portugal, Spain, and the United Kingdom. In Greece craft also includes the very small enterprises in trade and services. In Ireland, crafts are not legally defined, but there is a working definition of handicrafts.

Enterprises in the Member States are considered (by definition or common sense) as craft enterprises according to one or more of the following criteria: their branch (line of business), their size (in terms of employment per enterprise), the type of the products they make (e.g. artistic products), the way their products are made (e.g. handmade) and their occupation.

The importance of the craft sector – measured by national definitions – differs greatly between Member States. The share of craft employment in total employment ranges from 42% in Greece to less than 1% in the UK. The share of craft enterprises ranges from virtually zero in the UK to more than two-thirds in Greece. In table 7 the quantitative importance of the craft trades according to

Table 7 Importance of the craft trades in Member States' on official or non-legal definitions<sup>a</sup> (%), different years

	Enterprises	Employment
Belgium	1	..
Denmark <sup>b</sup>	27	16
France <sup>c</sup>	35	10
Germany	23	15
Greece <sup>d</sup>	68	42
Ireland <sup>e</sup>	..	1
Italy <sup>f</sup>	35	15
Luxembourg	20	25
Netherlands	25	11
Portugal	..	..
Spain	..	..
United Kingdom	1	1

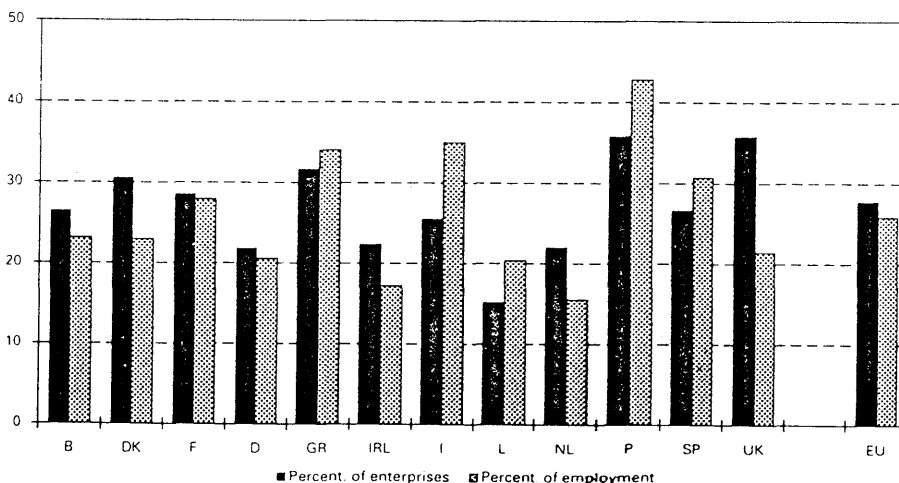
- a. Source of the figures presented: ENSR, unless otherwise stated.
- b. Key figures for 11 selected types of craft activities.
- c. Source: Les chiffres clés de l'artisanat, Janvier 1993.
- d. NSSG census data 1988, based on a broad definition of craft by EOMMEX.
- e. An estimate of the employment share of 'skilled workers' in manufacturing industry, repair and maintenance is: 12.5%.
- f. Source: CERVED, Tagliacarne 1992.

national definitions (if any) is presented. Due to differences in national definitions these data are not comparable.

To allow for a better cross country comparison of craft trades the concept of Craft Dominated Sectors (CDS) has been developed. CDS have been selected based on the dominance of craft professions in sectors. The importance of CDS differs between Member States, as is shown in figure 8. In three southern countries (Portugal, Italy and Greece) CDS have by far the largest employment share.

The average size of CDS enterprises is below non-CDS enterprises, although the differences are smaller than

Figure 8 Enterprises and employment in Craft Dominated Sectors (in %)



might be intuitively expected.

Women account for one quarter of CDS employment against 46% in the non-CDS.

Part-time employment is relatively rare in CDS compared to the total economy.

CDS are able to absorb the unemployed (much) better than non-CDS, which may be explained by relatively low entry-barriers in terms of educational level on the one hand and the possibility of acquiring occupational skills through dual training systems. Labour flows from CDS to non-CDS are greater than vice versa.

The level of education of employees in CDS is lower than in non-CDS. On the other hand, specific occupational skills are generally much more important in CDS than in non-CDS.

Participation in apprenticeships and dual training systems is significantly higher in CDS than in non-CDS. However, participation in continuing vocational training is much lower in CDS than in non-CDS.

market, however. Here, industrialization of craft activities will intensify the competition faced by many craft enterprises.

Cross border activities have only played a minor role in the craft sector. However, due to the completion of the internal market, experts expect an increase in cross border cooperation and an increase in imports (see table 8).

There is a distinct European trend in craft and SME policies toward regionalization: provincial and other regional authorities increasingly assume responsibility for craft policy and policy implementation.

	in %
An increase in cross-border co-operations	24
An increase in imports	22
An increase in cross-border education and training of employees	13
An increase in exports	12
An increase in recruitment of foreign labour	10
An increase in other forms of internationalisation	8
Additional units/outlets in other Member States	4
Don't know/no answer	3
Missing	5
Total	100

In the framework of this in-depth study on the craft trades, a unique survey of representatives of craft associations within all the Member States was carried out during 1993. This is the first EU-wide investigation of the craft trades ever undertaken. From this survey it is clear that the European craft sector is so far only marginally affected by the internal market, since most of the enterprises involved depend on customer contact and as a result serve purely local markets.

The internal market is more frequently associated with increasing risks than with increasing opportunities by craftspersons in the EU. This corresponds to the general finding that increasing competition affects more enterprises than increasing sales. The internal market is expected to cause a mild 'shake out' among SMEs. This is confirmed by craft experts' expectations with respect to the balance of start-ups and close-downs, which were clearly negative.

Craft enterprises in Member States such as Portugal and Greece may be particularly affected by the internal



### Belgium

With major economic indicators and economic structures (in both SME and sectoral terms) which are very close to the EU average, Belgium may be considered the most 'European' EU economy. A general strong convergent trend is apparent towards EU average values. This 'averageness' may reflect the open character of the Belgium economy and its restructuring towards the demands of the larger internal market.

### Denmark

Denmark has the typical profile of a small prosperous EU economy, with high GDP per capita and labour costs per employee. SMEs play an important role in the economy and most economic sectors are SME dominant, although the number of enterprises per 1,000 inhabitants is small.

The combined effect of increased employment in micro and small enterprises with decreased employment in medium-sized enterprises means that total SME employment has increased since 1988.

Self employment seems not to be well developed. Given its peripheral location and cultural background, it is not surprising that Denmark's international trade is strongly orientated towards the other Scandinavian countries.

### France

France has a relatively weak SME presence, with enterprise numbers per 1,000 inhabitants decreasing relative to the EU average. However, southern France has a large number of micro dominant sectors and a high number of enterprises per 1000 of the population. With a developed large-scale industrial sector including chemical, electronic and defence segments, France records R&D investments as a percentage of GDP above the EU average.

### Germany

As in the other large national economies (with the exception of Italy), the share of SMEs in employment is relatively low and average enterprise size is high. The sectoral structure of German SMEs shows relative underrepresentation in manufacturing industry and trade, and a relatively strong position in producer services. The employment level in SMEs has increased significantly since 1988, especially in micro enterprises. However, the self employment rate is well below the EU average, perhaps due to numerous requirements surrounding the formation of businesses.

Germany's GDP per capita and labour costs per employee are both well above the EU-12 average.

### Greece

Greece is a typical SME dominated 'southern' economy with an especially large proportion of micro enterprises, strikingly low average enterprise size and a high rate of enterprises per 1000 inhabitants, and high SME shares even in manufacturing, producer services and transport and communication. The self employment rate is the highest in the EU, probably partly explained by low start-up costs and fewer requirements for establishing a business. GDP per capita and labour costs per employee are among the lowest in the EU.

### Ireland

The size structure of Irish economy is changing very fast. Recently LSE employment has grown faster than SME employment. While the employment share of SMEs as a whole has decreased since 1988, the shares of medium-sized and large enterprises have increased substantially. The share of SMEs as a whole in employment is relatively high, but the number of enterprises per 1,000 inhabitants is quite low. The sectoral structure of SMEs broadly matches the EU average, except for an overrepresentation of SMEs in manufacturing industry. Irish per capita GDP is below the EU average but on a converging trend. Labour costs per employee are well below average as well, and grew slightly less than the EU average over recent years.

### Italy

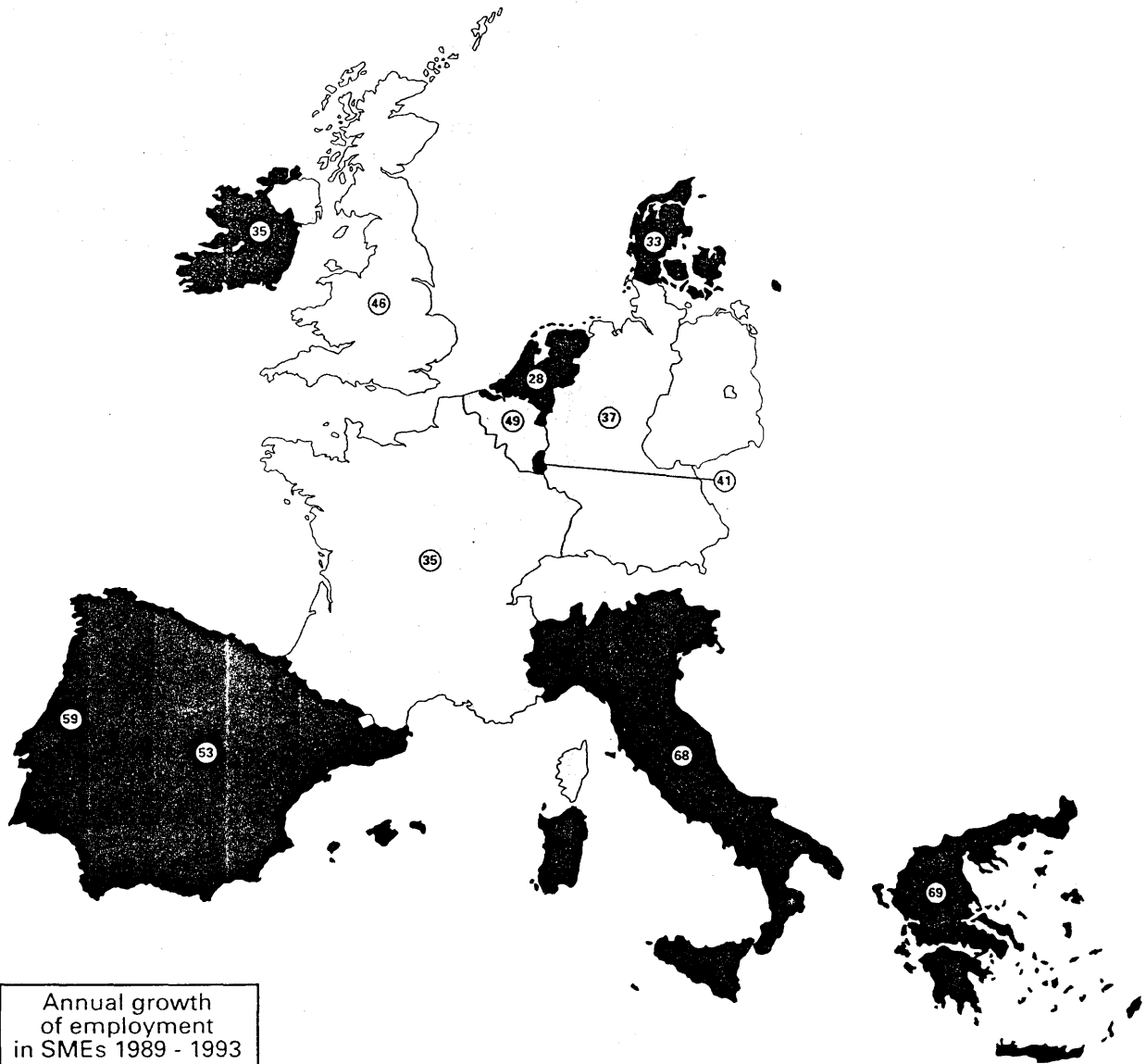
In Italy SMEs enjoy one of the highest shares in economic activity found anywhere within the EU. SMEs are particularly overrepresented in almost every sector, but manufacturing is the most SME dominated sector compared with the EU average. Micro dominant sectors have a particularly strong weight within the Italian economy as a whole and they dominate the southern regions, while SME dominant sectors dominate the central and northern regions. Self employment is well developed and continues to increase. Italy is exceptional within the EU since it is a large economy characterised by a strong SME sector but with high labour costs per employee and prosperity (as measured by GDP per capita).

### Luxembourg

In Luxembourg the share of SMEs in employment is just above the EU average, but the contribution of micro enterprises to employment is very low and in fact SMEs in Luxembourg are among the largest in the EU in terms of average employment.

The number of enterprises per 1,000 inhabitants is low as well. Employment in SMEs has increased considerably since 1988, but especially in the medium-sized enterprise class. GDP per capita is well above the EU

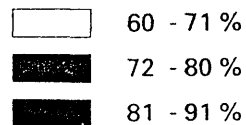
## Mapping the key indicators of the EU



Annual growth of employment in SMEs 1989 - 1993

Country	Empl. Growth [%]
Belgium	1.1
Denmark	1.5
France	0.8
West Germany	2.6
Greece	1.4
Ireland	0.3
Italy	0.1
Luxembourg	2.4
The Netherlands	1.7
Portugal	2.0
Spain	0.1
United Kingdom	-0.5
EU	0.8

Shares of SMEs in employment 1990 (EU = 72)



○ Number of firms per 1,000 inhab.  
(EU = 49)

average and so are labour costs per employee. International trade is well developed with Luxembourg being a small open economy.

### The Netherlands

The share of SMEs in employment resembles the EU average, and the sectoral structure of SMEs is also very similar, with the exception of the relatively large scale retail trade sector. The number of enterprises per 1,000 inhabitants is very low. Employment in SMEs has grown rapidly since 1988, but this has been unevenly spread among the enterprises size classes, with the micro enterprise size class growing the most. In the Netherlands GDP per capita is well above the EU average and so are labour costs per employee. The country is one of the most open in the EU, and its international trade shows clearly the 'open' character of the economy, with a disproportionate share of exports, both intra-EU and extra-EU.

### Portugal

Portugal's profile is similar in some respects to that of Greece. It has a strong SMEs presence and a very pronounced share of small enterprises in employment. The number of enterprises per 1,000 inhabitants is of course very high. Self-employment is quite developed, with women accounting for a large share of the self employed.

The sectoral structure of SMEs shows that manufacturing industry and retail trade are relatively the most SME dominated sectors. Compared with the other Member States employment in SMEs has increased a lot since 1988, especially in very small enterprises.

GDP per capita and labour costs are amongst the lowest of the EU Member States.

### Spain

Spain resembles Portugal, Greece and Italy for many economic indicators. Small and medium-sized enterprises play an important role in the economy, especially enterprises in the micro size class. The modest growth in SME employment is the result of a large increase in micro enterprises and a large decrease in employment in small and medium-sized enterprises. A large share of SMEs is to be found in manufacturing and transport and communications. GDP per capita is low compared to the EU average. Inflation is well above the EU average.

### United Kingdom

The United Kingdom's industrial structure is dominated by the LSE sector, reflected in a high average enterprise size and a relatively low share of SMEs in total employment.

The onset of a strong recession in 1990 cut employment levels and real GDP in the early 1990s although recovery began in 1992. Average labour costs per employee are below the EU average but have tended to increase relative to the average for other Member States.

The profile of international trade is similar to France and Germany, which means that intra-EU trade constitutes a relatively modest part of total exports.

In the First Annual Report of the European Observatory for SMEs much attention was paid to policy issues related to promoting and stimulating SMEs and the craft sector in the EU. In this Second Annual Report of the Observatory the recommendations will be oriented more specifically towards employment creation in small and medium-sized enterprises (including the craft sector and micro enterprises) as a prominent part of Europe's economic fabric. Primarily the recommendations are aimed at the policy makers at the EU-level and to a lesser extent towards national policy makers.

Reducing unemployment is a top policy priority for the EU, as highlighted in the recent White Paper on Growth, Competitiveness and Employment. Effectively tackling the problem requires a range of approaches involving stimulating economic growth while simultaneously fostering production systems that are internationally competitive on the (increasingly global) market, promoting the (re)absorption of the unemployed and new entrant or reentrant labour supply and significantly improving the mechanisms which 'match' labour supply to demand.

### Basic policy considerations

Policies geared to reduce unemployment are primarily the responsibility of the national governments, but, nevertheless, there is limited room for the European Commission to develop specific initiatives to stimulate economic growth and to create new jobs in the wider European context. In principle EU strategies aimed at reducing unemployment should be centred around certain key elements:

- creating a favourable European business environment that stimulates competition and economic dynamism;
- improving the 'transparency' of policies, government regulations, initiatives and legislation aimed at reducing unemployment within individual Member States, especially exchanging information on 'best practice' in employment generation in SMEs;
- carefully monitoring, evaluating and adapting existing EU-level initiatives concerned with employment stimulation and unemployment reduction (e.g. within the ESF framework) in the light of the specific role of SMEs.

Within this broad strategic approach particular attention must be given to job creation in SMEs and the craft sector. This is necessary because of:

- the (hidden) economic potential of SMEs which could strengthen the general competitiveness of Europe's economy;
- the proven record of SMEs in creating additional jobs and the likelihood they will continue to do so in the future given suitable economic conditions;
- the structure of SME employment (especially in the craft sector) which offers greater potential for the successful reintegration of formerly unemployed

workers back into productive activity; but

- the structure and practices of the SME sector raise challenges (e.g. in improving training, recruitment and personnel practices, and job 'quality' generally) as well as opportunities for job creation.

As the main report notes, labour market policy recommendations whether at the national or supranational level can be grouped under three broad headings:

- a. labour demand oriented approaches;
- b. labour supply based approaches; and
- c. 'matching' approaches.

### Labour demand policies

Demand policies can conveniently be considered under four broad headings.

#### 1. The business environment

The economic growth and hence job creation potential of SMEs, whether new start-ups or well established businesses, must be strengthened by:

- creating a more favourable general European business environment, with proper financial and macro-economic policies, and considering more expansionary policies;
- controlling and reducing administrative burdens taking into consideration the effects of both national and supranational policies, including the development of monitoring methods;
- improving SMEs' financial position in terms of both the potential for self financing and access to capital markets. Effective distribution of the 1 billion ECU worth of loans from EIB made available at the European Council in Copenhagen is essential.
- stimulating the R&D activity of SMEs and disseminating technical 'know-how' are urgent priorities. SMEs and innovative craft enterprises need to be better integrated into the EU's technology programmes.

#### 2. Wage policies

Reducing labour costs per unit of output may be pursued by restructuring wage setting arrangements to more closely reflect factors like labour productivity and/or by adapting fiscal and social security systems to bear less heavily on wage costs. Greater transparency in tax and social security systems would be a helpful starting point.

#### 3. Work sharing

Possibilities for sharing work without increasing production costs should be explored. International experience should be exchanged and pooled, always taking into consideration the social, fiscal and cultural systems that influence the design of work organisation. An international campaign aimed at stimulating work sharing arrangements which meet the specific needs of the SME sector is recommended.

### Labour supply policies

Supply based approaches can be grouped under three headings.

#### 1. Wages and social benefits

A far clearer insight into the relationships between social security systems, income policies and labour market policies, and, in particular, the position of SME needs is necessary to increase flexibility on the labour market and to stimulate the better absorption of the (hidden) supply. A Europe-wide research project is required.

#### 2. Upgrading labour quality and skills

Initial, vocational and continuing training should be better geared to the needs of SMEs. European programmes could be the basis for this, but better adaptation to the specific needs of SMEs and craft enterprises is a prerequisite. Training programmes should not only focus on training employees but must also include entrepreneurs whose decision making and management skills are the key to future economic development.

The experience of several Member States with 'dual' apprentice training systems should be shared more broadly to help promote a better mixture of theory and practice in 'initial' training for young people. Similarly international exchanges of trainees and trainers from the various national VET systems should be supported. A European Platform for Vocational Training geared primarily to the needs and practices of SMEs should be established to provide a new impulse for the VET systems of the EU and the international exchange of experiences and developments.

Much more attention is needed for entrepreneurship in education programmes, career advice and development. A Training Institute which operates internationally should be developed to provide a more cross-cultural and efficient approach to entrepreneurship training. As well as training its task should include exchanges of managers/entrepreneurs and the development of courses focused on SMEs and the craft sector. Networking with national training systems or through EICs should be considered.

The availability of Structural Funds for private training organisations instead of only public institutions is strongly recommended, as many training activities, both for employees and entrepreneurs, are organized on a private basis in the Member States.

#### 3. Increasing labour mobility

Rigidities in the labour market may hamper an efficient allocation of human resources. Government regulations concerning dismissals, pension fund systems, general or specific wage agreements, and the rights and obligations of the unemployed should be considered. Thorough analysis of the different systems found in the Member States should provide useful insights into the most fruitful avenues to be explored.

### "Matching" approaches

It is recommended that the EC trace and monitor 'best practice' in the field of matching instruments and communicate these to the relevant actors.

In particular attention should be paid to the recruitment practices of SMEs and the effective reach of the different instruments. New, modern, personal and regional oriented matching approaches should be stimulated to identify both existing and 'hidden' vacancies in SMEs and craft enterprises.

Good experiences of labour pools, as applied in several Member States, should be exchanged on an international level. The EC could stimulate this communication by workshops or international exchanges between authorities in this field.

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