

PORTUGAL 2007

# Informal Meeting of Competitiveness

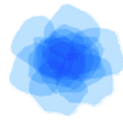
## SME and Industrial Policy

SME Policy

Presidency Discussion Paper

Lisbon, 20-21 July 2007





Informal Meeting of Ministers for Competitiveness  
(SME and Industrial Policy)  
Lisbon, 20-21 July 2007

"SME Policy"

Presidency Discussion Paper

On the 13<sup>th</sup> of March 2006, the Competitiveness Council approved the Conclusions on "**SME policy for growth and employment**", welcoming the approach to SME policy contained in the Commission's communication "**Implementing the Community Lisbon Programme – Modern SME policy for growth and employment**", launched in November 2005.

For almost two years, the Commission, in close partnership with Member States, has been implementing this Modern SME Policy that was launched in November 2005. The main objective of the policy is **to release the full potential of SME to create more growth and jobs** in the European Union. The main instrument to achieve this ambitious target is the integration of the "**Think Small First**" principle, into Community and National legislation and policies. In addition, the Commission proposes actions in **five key areas**:

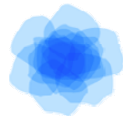
- promoting entrepreneurship and skills;
- improving SME access to markets;
- cutting red tape;
- improving SME growth potential;
- strengthening dialogue and consultation, with SME *stakeholders*.

SME are facing new challenges, as many changes took place, namely the enlargement of the EU, the liberalization of worldwide trade, energy and environmental challenges.

The Commission is currently preparing a **Mid-term review Communication** on Modern SME policy, due to be adopted in early October, taking stock of the achievements, both by the Member States and the Commission. The overall assessment is encouraging: the renewed Lisbon Strategy; and the launch of a modern SME policy that have mainstreamed SME policies in EU's broad economic reform agenda, and brought SME at the centre of political attention.

The Member States have made considerable efforts to live up with their commitment to improve SME competitiveness, e.g. by facilitating the procedures for starting up an enterprise, encouraging entrepreneurship, integrating the "Think Small First" principle in the national legislation and facilitating transfer of businesses. However, sustained efforts are still needed, in many Member States, to translate the commitments made into concrete benefits for SME. Also, new challenges resulting from EU climate change agenda (v.g. energy efficiency and emission goals) should be taken into account in further action at EU and Member State level.

The Commission has committed itself and was asked by the Council to review progress in the implementation of the 2005 Communication and to discuss future action. Furthermore, the Commission announced its



intention to address new areas like energy-efficiency or sustainable industrial policies which provide business opportunities for European enterprises, including SME.

This debate provides an opportunity for Ministers to exchange their views on the future of modern SME policy. The Presidency suggests structuring the discussion around four key topics, which have been identified as requiring specific action:

1. Innovative SME financing
2. Better Regulation for SME
3. Internationalization of SME
4. SME and energy efficiency

## 1. Innovative solutions on SME financing

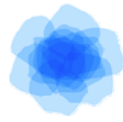
The future of European competitiveness depends on an integrated, open, and competitive financial market that allows new ideas to get quickly to the market. For growth-seeking innovative entrepreneurs, external financing becomes necessary, when their initial funds have been exhausted. Knowledgeable private investors are critical for identifying businesses with growth potential, but there is still a lack of business angels and other professional seed investors in Europe.

Although the preliminary figures Commission future major Communication on the review of the Single Market for 2006 show a considerable growth in seed investment to €1.7bn, the challenge is to create an environment where these investments can be kept at a constantly high level. Public investors, or public-private partnerships, can fill part of the funding gap for growth companies, but the lack of private investors can prevent the creation of such partnerships.

Venture capital provides firms, in their early stages, with advantages deriving from its global connections, such as access to global markets. Leading venture capital funds compete globally for funds, but invest locally in small firms, that can provide potentially high growth and high returns. This is a long-term activity, where a stable and favourable environment is essential. Policy-makers should recognise and remove obstacles, to investments and growth such as regulations and taxation rules that lead to the fragmentation of venture capital along national lines, and take action to facilitate cross-border investments. Many institutional investors are also subject to obstacles that limit their legitimate wish to diversify into venture capital.

Mezzanine finance (hybrid forms of finance with features of both debt and equity) can be a complementary source of finance to debt and equity and can be helpful in financing the start-up, and expansion of SME, innovation and business transfers. Mezzanine finance instruments are gaining in importance, but remain little used compared with loan financing. The level of development in the market for mezzanine financing varies across Europe, especially where SME are concerned. While SME, in some countries, can choose from a wide range of different products, other countries still have ground to make up in this area.

The implementation of the Basel II Capital Accord in European Banking is expected to have some implications on SME financing. These may not necessarily be negative, as long as European SME's recognise the importance of providing more accurate and transparent information on their activities as well as adopting codes of conduct to rule their relations with the financial sector. Governments may play an important role, by stimulating the emergence of risk sharing mechanisms such the credit enhancement of the securitisation of SME loans and other schemes allowing European SME's a better access to bank loan term lending.



To enhance access to finance for very small new or existing enterprises, the Commission, in the framework of the Competitiveness and Innovation Programme, is continuing its work on ways to promote the provision of micro-credit in Europe. Micro-credit, i.e. loans of less than €25 000, offers an important means to encourage entrepreneurship through self-employment and micro-enterprises. Member States should therefore ensure that national legislation facilitates the provision of micro-finance.

Considering the importance of the above mentioned constraints, the Presidency will promote with the Commission, next October, the Forum "Financing Innovation – From Ideas to Market", in order to benchmark relevant policies and practices across the world, to highlight solutions and actions required to support SME innovation and growth, through a better access to finance. The Presidency will present the outcome of this initiative to the Council.

## 2. Better regulation and SME

Small enterprises bear a disproportional regulatory and administrative burden in comparison to larger businesses. On average, it can be said that where a big company spends one euro per employee, because of a regulatory duty, a small business might have to spend up to ten euros.

A recent study by DG Enterprise determined that the ratio between total tax related to compliance costs and all paid taxes arises to 30,9% for SME, being the same ratio for big enterprises only 1,9%.

The objective of the "Think Small First" principle is to ensure a level playing field for all enterprises, which entails taking into account the specificities of SME, when drafting or revising laws and minimizing the administrative burden for SME. This means that, whenever necessary and after a case-by-case analysis taking into account the objective of each piece of legislation, specific provisions such as simplified reporting requirements, longer transition periods, reduced fees, exemptions and support measures (helpdesks, awareness raising etc.), need to be introduced or further developed.

The "*Think Small First*" principle must be at the heart of the "Action Programme for Reducing of Administrative burdens in the European Union" and reflected in the Commission's future Communication on the review of the Single Market

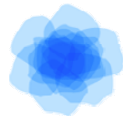
Additional efforts at national level are needed in order to "cut red tape" essential element for the competitiveness of SME.

In order to increase SME competitiveness and to reduce administrative burdens, the Commission announced that is currently examining the possibility to grant exemptions targeted to certain types of enterprises, like micro-enterprises, provided that this does not distort the function of Internal Market. Certain exemptions do already exist, in areas like statistics or employment policy.

## 3. Internationalization of SME

SME find it more difficult than large enterprises to have cross-border activities within the Internal Market. Only 28% of small companies and 36% of medium-sized ones trade cross-borders. Significantly, 24% of small and 25% of medium enterprises claim to be prepared to go to another country.

From January 2008 onwards, in the framework of the Competitiveness and Innovation Programme, a new business support network will advise SME on the opportunities provided by the Single Market and help them to find business partners in other countries, including non-EU countries.



In this scope it is necessary to help SME to face more and more demanding markets (internal market and third country markets). Accordingly, EU and Member-States policies should support SME internationalization to third markets.

Within EU trade policy and considering the principles proposed by the Commission' Communication "Global Europe Competing in the World" as adopted by the Council, this means targeting tariff and non-tariff barriers especially burdensome to SME, i.e. applying the "Think Small First" principle also at this level. Elimination of barriers, although necessary, is not sufficient. Capacitation for internationalization (v.g market knowledge, trade practices and management skills) must be supported, at EU and national level, if many innovative and competitive SME are to become global.

#### 4. SME and energy efficiency

SME are often considered as out of environmental concerns, and they think that legislation or regulatory schemes are not applied to them. These presumptions are not real as, sometimes, SME may produce important pressures on environment. This is not because SME are big polluters (although some of them may have important impacts on environment), rather because the environmental effects that they collectively may origin. Some studies point to SME, taken together, may be responsible for a significant share of the total industrial pollution. This means that environmental issues also concern to SME.

However, SME are not often aware of their impacts, and are not well informed about their obligations related to environmental legislation.

Environmental Management Systems (EMS) have been pointed out as the most effective voluntary tools used by enterprises to improve their environmental performance.

Otherwise, SME still face barriers in matter of environmental compliance:

- Lack of awareness and knowledge about environment problems, impacts and risks,
- Lack of information about potential benefits of EMS and life cycle thinking,
- Insufficient access to information, tools and training, limited financial and human resources
- Environmental behaviour is usually imposed by regulation or public pressure
- Insufficient market incentives and recognition for environmentally friendly behaviour

To help eliminating these barriers, SME policy must integrate also the environmental dimension, proposing Member States take actions pursuing objectives which increase compliance with environmental legislation by SME:

- To increase the eco-efficiency (resources and energy) of SME by using proper EMS and other tools
- To increase eco-innovation of SME, in the whole cycle of enterprise
- To enhance the environmental framework for SME
- To enforce the efficiency of the environmental policy for SME, by reducing administrative costs in order to increase compliance.