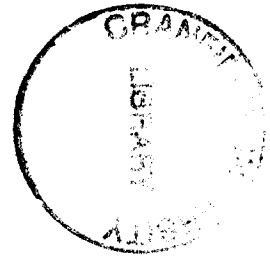




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**SWP 2/90 THE SMALL AND MEDIUM-SIZED ENTERPRISE
- IS THERE A EUROPEAN DIMENSION?**



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THE SMALL AND MEDIUM-SIZED ENTERPRISE - IS THERE A EUROPEAN DIMENSION?

Over the past ten years the "plight" of the Small and Medium-Sized Enterprise [SME] has received increasing attention in European politics. In the early 1980s, the contraction of over-manned, large corporations, and the changing profile and size of the available working population led to severe rises in levels of unemployment throughout the EEC. Seeking a solution to the problem, policy-makers were strongly influenced by the reported conclusions of a research project by Dr. David Birch of the Massachusetts Institute of Technology. Analysing data from the mid-1970s in the United States of America, the "Job Generation Process" concluded that 81.5% of new jobs were generated by firms with less than 100 employees - the small firm sector. Without questioning either the validity of the study in the USA, or the appropriateness of generalising these results to other economies, politicians throughout Europe sought to focus a significant part of their economic revival strategy on the encouragement of "enterprise". Led by the United Kingdom, which at the time had the greatest need for "miraculous" solutions to politically unacceptable levels of unemployment in increasing numbers of economically depressed regions, a completely new range of small business assistance agencies, training programmes, selective policies and schemes grew. Focussed primarily upon the more easily assisted new firm, and interventionist rather than facilitatory in nature, the programmes were mainly national, un-coordinated, and, ultimately, un-evaluated.

By the mid-1980s it became clear that a less parochial and more coherent policy for the SME sector in Europe was crucial if the Single European Act of 1986 was to become a reality in 1992. This was finally recognised in June 1986 when the Council of Ministers created a new SME Task Force headed by Commissioner Abel Matutes. In November 1986, a new resolution on the Action Programme for SMEs was adopted. The aims of the Task Force were three-fold.

- * to help create conditions in which the legal and administrative business environment met the needs of the European economy.
- * to encourage the creation of new firms and the development of small businesses.
- * to set a coherent framework for the ways in which other Community policies were implemented through the enterprise sector.

Almost overnight the "small beer" view of small firms was transformed into one in which the sector was seen as the engine room of the [new] "enterprise culture".

At the end of 1988 with the changing of Commissioners, the Task Force received the final accolade of respectability when it was subsumed into a new Directorate General, DGXX111, headed by Commissioner Cordoso. The new Directorate would be responsible for enterprise policy, tourism, and the distributive trades.

At last, it would appear that there is a clear acceptance, at least in principle, of a European dimension for the Small and Medium-Sized Enterprise. This is an encouraging start. However, the task which Directorate faces is not an easy one. There are severe difficulties in translating the principle into policies, mechanisms, and actions which ensure that SMEs are, at the very least, not disadvantaged in the plethora of European Directives, Statutes and Standards which will form the base for the Single European Market. This is the challenge facing Commissioner Cordoso and his Director, Alan Mayhew.

CHARACTERISING THE SME

Unfortunately for the Commissioner, and for policy-makers in general, the small firm sector is difficult to work with. It is not a small, easily identifiable, relatively homogeneous group of firms, but rather a large, diverse, and heterogeneous set of individuals, anxious to avoid contact with "authority" as much as possible. These differences can be illustrated in a number of ways.

1. The Size of the SME Sector: Throughout Europe there are no reliable or consistent statistics on the total size and membership of the population. Therefore, there are no comprehensive directories of small firms, and no easily accessible mailing lists. The reasons for this are simple. Although the SME sector has been defined by the Commission as including all firms with fewer than 500 employees, with net fixed assets of less than 75 million ECU, and with not more than one third of its capital held by a larger firm, this is not a definition which is used throughout the community. In the United Kingdom, for example, small firms are defined as those with 200 employees or less. Further, the data capture processes used in different countries also ensures that the larger firms are over-represented in any statistics quoted. For example, in the United Kingdom, a firm only enters the new firm statistics when it is first registered for Value Added Tax [VAT], not when it first commences trading. Moreover, the lower limit for VAT registration changes from time to time, making longitudinal statistics difficult to interpret.

Nevertheless, whatever the difficulties of data collection, it is clear that the sector is large. Estimates suggest that SMEs account for approximately 95% of all enterprises in the European Community [COM(86)40], and employ between 34% [United Kingdom] and 59% [Belgium] of the manufacturing workforce [OECD 1985]; 42% of the private sector employment in France is found in firms employing less than 100, and 42% in the Netherlands [OECD 1985].

2. **The Effect of National Policies:** The very diversity of national characteristics across Europe means that policy decisions may have very different effects on both aspirations and behaviour in different countries, and that these effects may not always be quantifiable or forecastable. For example -

- * The effect of a low VAT threshold in the United Kingdom is to force a number of self-employed to operate partially in the "black" or "cash" economy, or to create a multitude of interlocking "unregistered" firms. Unfortunately, and naturally, there are no reliable statistics nor any significant research on this section of the economy and so we know very little about its magnitude or about the real motivations of its members. We do know, however, that this mode of operation constrains growth, if for no other reason than the fear of tax penalties.
- * The requirement for firms in Italy which employ more than 15 people to unionise has led to a plethora of firms in the same industry, often with the same owners, employing 14 or less. There is no doubt that avoidance of one piece of legislation has led to a significant sub-optimisation of the growth potential of these firms.
- * In a study of the effect of national culture on entrepreneurs in 11 countries, Alange, Miettinen and Scheinberg [1988] found that the welfare of the family and close community was not a strong motivator in the Scandinavian countries, but was very important in China, Italy and Portugal. They concluded that this was probably due to the "governmental welfare systems and safety nets in the Nordic countries [which] have taken away the immediate concern for the welfare of the extended group".
- * In Sweden, academics are allowed to hold the patent and copyright of intellectual property developed in the University. In benevolent Institutions, this has produced

a true Science Park, where academics develop their products and their businesses on University premises whilst at the same time continuing to research and to teach their students part-time [McQueen and Wallmark 1989].

3. National Culture: Differences also emerge in the ways in which national culture and old rivalries affect behaviour. The entrepreneur's personal network is his most valuable asset base, particularly during the start-up period. In Northern Ireland, personal networks are based upon small, tightly-knit, local communities with few external links. As a consequence, the entrepreneur has a poor base from which to explore wider markets. By contrast, in Baden Wuttenburg, Germany, firms are required to register with the local Chamber of Commerce, which automatically draws them into a large and efficient support network. FORMAPER in Italy, and the Boutiques de Gestion in France are attempts to replicate this effect. These are, however, locally-based networks. Trans-national networks are more difficult to build. I recently ran a series of seminars, sponsored by the SME Task Force, and jointly organised by Cranfield School of Management, England; the Universite de Technologie, Compiegne, France; and IFL, the Brussels campus of the Stockholm School of Economics. The aim of the seminars was to provide a forum for the building of links between new and small firms in France and the United Kingdom in two industries, biotechnology and computer software, both of which need to operate in trans-national markets if they are to survive. The aim was modest. The results? The most interesting and lively session was a discussion of the significant cultural divide between the two countries; the main linkages built to date have been intra- not inter-national!

4. The Availability of Finance: The availability of resources in the Member States also affects the base from which the entrepreneur is working. This is most clearly marked in the provision and availability of Venture Capital which is highly concentrated in a few countries. For example, in 1988 the United Kingdom

accounted for 60% of the European Venture Capital Pool; France, the Netherlands, and Italy accounted for 26% of the Pool; and further 12 European countries accounted for the remaining 14% of the Pool [Nathusius 1989]. Moreover, the financial structure of the industry also varies from country to country. For example, 53.4% of the funds raised in the United Kingdom are from pension funds and insurance companies whereas in Germany 72% of funds are direct investments by banks; in Belgium 58% of firms are Government owned, whereas in France 1% are Government owned and 51% are independently owned. Current evidence suggests that a consequence of this is that attitudes to risk will also vary, that those funds owned by organisations sheltered from the pressures of equity owners are more likely to take a longer term view of their investments, and to invest at the early stages of development of the firm. This is, moreover, within an industry not particularly renowned for taking high risks. It is no coincidence that 37.5% of investments made by the European Venture Capital Industry in 1988 were into the lower risk management buyouts and 50.4% into development or expansion capital; only 11.0% was invested in start-ups, and a tiny 1.1% in seed capital.

Clearly the Venture Capital Industry in the United Kingdom is large and well developed, whereas in much of the rest of Europe it is still in the embryo stages. However, the results presented by Nathusius at the 1989 Conference of the European Venture Capital Association [EVCA] in Berlin also suggests that members of the industry are essentially parochial in their investment strategies, 95% of new investments in 1988 being in domestic firms. This view is supported by Manning's [1989] study of the internationalisation strategies of 68 European funds. He concluded that "whilst there is a very high level of awareness of the likelihood of the increasing trans-European nature of the venture and development capital markets there does not appear to be an equal level of enthusiasm for pursuing trans-European strategies".

Investors are also faced with different national scenarios when the time comes to "exit" their investment. Taking the most obvious route of a Public Listing, Geary found the Junior Equity Markets to vary significantly in their level of activity. At the time of his study a mere two firms were listed in Belgium, Spain had 21, Ireland 10, France 261, and the United Kingdom 369 [Geary 1989].

AN IMPOSSIBLE TASK FOR DGXX111?

From this brief outline of some of the national differences it is tempting to conclude that, since the majority of SMEs are locally or nationally based, and since much of their resource base is equally parochial, there is no European dimension and that DGXX111 has either an impossible job or, indeed, no job at all. I do not believe this to be the case. There are large pan-European firms, almost all of which started from very small beginnings, and some of which lay dormant as small family firms for many years until the founder was succeeded by a second or even third generation [1]. The aim of DGXX111 must be to create a climate where this becomes more prevalent. Beyond this, whatever the size of their firm, the industry in which they operate, their sphere of operation, or their personal aspirations, all owner-managers will face two significant changes in 1992.

1. New opportunities to move into markets more freely, and the countervailing effect of possible competition from new, or unanticipated, sources in the home market.

In his report on "The European Challenge: 1992", Cecchini [1988] found that with regard to administrative formalities and border controls "customs costs per consignment....can be up to 30% to 45% higher for companies with under 250 employees than for larger companies." He concludes that there is no getting away

¹ See, for example, the history of the Salomon Ski Company [Calori and Bonamy, 1989]

from the basic fact that "the smaller you are, the greater the cost of custom-related paper-work, the more you pay - and the more you stand to gain by moves to eliminate customs controls."

2. The changing nature of trading conditions due to Europe-wide Directives.

Demonstrating the barriers to trade in Business Services, a sector which has a predominance of small firms, Cecchini found sharp differences in the conditions for doing business. For example, "in Germany, advertising and PR firms are barred from raising money through public share issues, leaving them vulnerable to competition from UK companies with unrestricted access to stock markets."

It is clear from these two simple examples that there are circumstances where the owner-manager is likely to be affected whatever the size of his firm, his geographic location, the industry in which he competes, or his personal aspirations. Moreover, not all is bad. There are many instances where the removal of barriers, the deregulation of trading conditions, and the creation of European-wide standards and incentives can be to his advantage. The danger which we must guard against is that the creation of uniformity can produce more punitive regulation, not less; that the corridors of power in Brussels become even more removed from the realities of commercial life. There are a number of areas of EC regulation which fall into this category, but to illustrate the point I will focus on one, that of **Standards**.

In any Member State there are a wide range of consumer protection laws, but because they are often different from country to country they give rise to **technical barriers to trade**. To alleviate these barriers, the Commission originally used the mechanism of a Directive which set out the detailed requirements a product must satisfy in order to be sold throughout the Community. This proved to be a slow and laborious process, and so in May, 1985, the Council of Ministers decided upon a

"New Approach to Technical Harmonisation and Standards" whereby Directives set out the "essential requirements" regarding safety, written in general terms, which must be satisfied before products may be sold anywhere in the Community. European "standards" are to be the main way in which businesses demonstrate that the requirements have been satisfied. These will mainly be prepared by the European standards making bodies, Comite European de Normalisation [CEN] and Comite European de Normalisation Electronique [CENELEC], in response to mandates from the Commission.

So far so good. In theory this approach provides a flexible system in which manufacturers can choose either compliance with set standards or with the principles of the Directive, making their own case that their products do, in fact, comply. In practice, the latter route is bound to be risky for the SME, and particularly for exporters, and certainly costly if they are dragged into a legal dispute. Consequently, the setting of standards is crucial. Unfortunately, Member States would appear to be in too much of a hurry to sign up Directives covering a whole range of products without looking closely at either their coverage, the detailed standards which will be needed, or the ways in which the standards will emerge. Many questions remain unanswered. By whom will the data be captured? How long will the process take? How will investment decisions be affected if the process grinds on? How many products may disappear from the shelves? How flexible can standards be once set? How quickly can they be changed in response to innovations? In reality, when the pressure is on, either from the Commission or from the Presidency, there is no incentive for any Member State to address what have now become second order questions.

The Construction Products Directive is a good example of a Directive [formally adopted by the Council of Ministers in December 1988] which has an unquantifiable potential to be burdensome. Interestingly, it was a Directive supported by much of

the British Construction Industry which perceived new export opportunities. After agreement by the Council there is a 30 month implementation period in which the Commission, advised or instructed by Member States, will look at the details. The details include the production of interpretive documents putting the essential requirements of the Directive into a form that can be used as a basis for the preparation of standards and other technical specifications. The standards will also be divided into various categories of critical products, which must comply with harmonised EC standards, and of non-critical products, where manufacturers will be required to prove compliance directly with the essential requirements. It is therefore crucial that manufacturers understand into which category their products are likely to fall.

Unfortunately, this is not all for the [now] beleaguered manufacturer. As a result of the Directive, there will be more third party certification requirements; and there will be other, overlapping, Directives such as Health and Safety in the Workplace with which they will have to comply.

THE ROLE OF DGXX111

This is but one example of the route which is being taken to a Single European Market. Clearly, if it is to be effective, consultation with those likely to be affected is crucial if 1992 is to herald a brave new market rather than the characteristics of the roads in France on July 31!. For some this is not a problem. Civil servants and the captains of industry talk all the time. Large firms devote whole departments to monitoring and influencing legislative changes. Owner-managers do not. Moreover, large bureaucracies find it very difficult to create mechanisms for consultation with the owner-manager and so often simply ignore him. Even worse, those bureaucrats who are charged with guarding his interests are often drawn from unrelated fields, and are usually in post for relatively short periods of time. Consequently, they spend

a significant part of their time in post developing an understanding of the issues - or not! I recently met a civil servant from Brussels who was responsible for administering significant funds for the SME sector, and who was proud to announce that he had never met a "real owner-manager"! Yet he had a very clear view of their [poor] skills, [self-directed] motivations, and [irrational] behaviours, all based upon popular myth and legend, almost all unsupportable, and almost all negative.

On the face of it the solution to such ignorance and intransigence is simple - Mohammed must go to the mountain. The owner-manager must do more to make sure that trading conditions are acceptable and equitable for him before they are embedded in Statutes or Directives. The Department of Trade and Industry in the United Kingdom has produced a booklet suggesting how to go about this. Entitled "Brussels Can You Hear Me?" [HMSO 3/89] it lists five key points:

- * **Get in early** before the Commission has reached decisions and produced formal drafts of EC proposals.
- * **Work with others** the view from Brussels is of 12 Member States, all of whose interests must be taken into account when drawing up proposals.
- * **Think European** it is important for you to show that you understand how a particular measure fits with the Single Market programme.
- * **Be prepared** try to find out what those in the same sector in other Member States think about the proposal...try also to find out what the Commission is trying to do.
- * **Get involved** remain plugged into the Brussels network so that you will be able to react quickly to events affecting your business as and when they arise.

Beyond this the reader is warned that they should "keep the DTI informed of your progress in Brussels - so that we can work together effectively".

It is a nice idea, and one that is difficult to argue with - in principle. However, when the advice is applied to the owner-manager, it is often impractical. Certainly it is commercial suicide for him not to monitor and contribute to discussion on industry-based Directives - if he is aware they are in the pipeline, and if there is an effective trade association through which he can operate. But in the world of regulated European airlines and increasingly militant air traffic controllers it is an expensive and time-consuming game to try to penetrate the interminable corridors of Brussels - or should it be Strasbourg!?

The aim of DGXX111 is to "stimulate enterprise" - in other words to encourage more people to create their own business. Equally important is the need to guard their interests once established. Their role in creating a market in which the new and small firm can flourish is crucial. To do this, they need information and understanding of the practical difficulties which owner-managers face. Unfortunately, as with everything else about the sector, the available research is sparse and parochial. Certainly, the multitude of research projects commissioned over the past three years by the SME Task Force must have aided this process. However, there is very little research which seeks to learn from dramatic growth and which explores the critical factors for success in those few companies which have grown to become large firms trading at a pan-European level. Indeed, that is the reason that one successful Dutch entrepreneur, Bert Twaalfhoven, decided to seek funds to sponsor the new European Foundation for Entrepreneurship Research [EFER].

Research is important but it is clearly not enough. Documents can be ignored or misinterpreted. It is more difficult to ignore individuals with a mission. I would like

to see Commissioner Cardoso facilitate the process by setting up an effective international mechanism for consultation with the owner-manager to help him ascertain that his interests are kept firmly in the forefront of the Commission Mind. Beyond this, I would like to see a clear and strong statement of the action which Commissioner Cardoso will take on three issues as they affect the SME sector.

1. **Market liberalisation:** As Cecchini so clearly demonstrated, the removal of trade barriers can only be of advantage to the SME sector. However, it would seem that there are countervailing effects as firms will simply be halted at the new Standards Barriers. As the Construction Products Directive demonstrates, there is a danger of too much harmonisation, too much standardisation, and not enough liberalisation. For the small firm, with a small or single product range, the costs of complying with, or waiting for, changing standards can be catastrophic. When, as is often the case, all that is required is the mutual recognition amongst countries of product standards rather than full harmonisation, we would seem to be in danger of creating standards for their own sake rather than to protect the purchasing public.
2. **Avoidance of unnecessary legislation:** The proposed Company Law Directive is but one example which is not viewed by business as a significant barrier to a Single Market. Moreover, the proposed requirement to include employment legislation in the statutes will create serious difficulties both for firms and for national legislators. The same applies to many of the Social Dimension and Tax Harmonisation proposals. In seeking to create a level playing field, the Commission is in danger of producing excessive and inefficient regulation to the detriment of both the consumer, and to Europe's competitive position world-wide.
3. **Minimising costs:** Clearly there are times when it is necessary to change trading conditions, either through Directives or through legislation. There is a danger,

however, of ignoring the cost-benefit [more usually the cost] to the affected firms. Moreover, these costs are not always born evenly across the size bands, and can often affect the small firm disproportionately. The United Kingdom has now had a system of Compliance Cost Assessment [CCA] for four years. It has not been easy to implement, possibly because Ministers are reluctant to submit their decisions to such close scrutiny. However, if the adverse effects of legislation on business are to be minimised, they are essential. In Europe, proposals for legislation which have an impact upon business must be accompanied by a "Fiche D'Impact". Unfortunately reality falls somewhat short of theory, with inadequate fiches produced, often, and curiously, with no quantified base!. This is almost certainly because of the reluctance or unwillingness of Directorates General to submit their decisions to close commercial scrutiny. The responsibility for improving the situation, for monitoring and challenging the Fiches D'Impact, lies with DGXX111.

On June 7, 1988, the Internal Market Council stressed that market forces must be strengthened, the costs of compliance with Community legislation must be minimised, that unnecessary legislation should be avoided, and that existing legislation should be reviewed with a view to simplification. To date there would appear to be a serious gap between these words and the deeds we observe.

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