

LET SMEs GROW !

EUROPEAN SMEs
SPEAK OUT THEIR NEED FOR
GROWTH



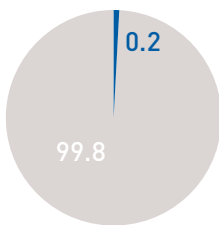
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FOREWORD

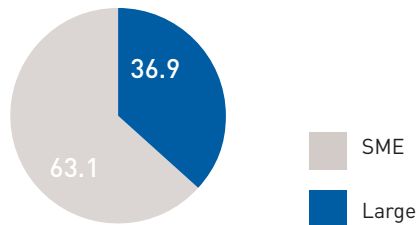
UNICE, representing almost 20 million entrepreneurs and small and medium-sized companies ('SMEs'), has prepared this document to state their concerns and push for change: 'Let SMEs grow!'

In the European Union ('EU'), nine out of ten companies are SMEs. They provide almost two out of three jobs. In the words of Commissioner Verheugen: 'entrepreneurs are the economic DNA which we need to build competitiveness and innovation'. They are the driving force of European growth and job creation. However, policy-makers must heed entrepreneurs 'and SMEs' requests if Europe is to reach the goal set by EU leaders in the Lisbon Strategy for Europe to become the world's most competitive knowledge-based economy in the world.

Number of firms
by size, 2001 (%)



Employment
by size, 2001 (%)



Source: *Observatory of European SMEs*

In recent months during the run-up to the mid-term review of the Lisbon strategy, UNICE has called on the European institutions to refocus this strategy. We highlighted to European leaders the urgency of implementing the right reform policies for growth and jobs.

An important first step towards achieving this was taken in the Commission communication 'Working together for growth and jobs' and President Barroso's and Vice-President Verheugen's personal commitment to get Europe back on track. The 2005 Spring Summit has now identified as essential a refocus of Europe's priorities on growth and employment.

It is crucial that EU policy-makers and Member States recognise that decisions taken at the EU level have major consequences for European entrepreneurs and SMEs: they affect the attractiveness of starting a business, the way in which a business operates and even the way a business may cease its activities.

UNICE Entrepreneurship & SME Committee, April 2005

ENTREPRENEURS AND SMEs MUST HAVE THEIR SAY

This document in its initial phase sums up the recommendations of entrepreneurs and SMEs on five main policy areas to foster Europe's entrepreneurial spirit and support growth of SMEs:

- COORDINATED, STREAMLINED, MEASURABLE AND STRONG ENTREPRENEURSHIP AND SME POLICY
- CONCRETE TRANSLATION OF COMMITMENT TO ENTREPRENEURSHIP EDUCATION
- EASY ACCESS TO FINANCE
- LESS OBSTRUCTIVE TAXATION, AND
- BETTER REGULATION: REDUCING ADMINISTRATIVE BURDENS AND RIDDING EUROPE'S ENTREPRENEURS OF UNNECESSARY RED TAPE

In the future, this document will be reinforced by fiches on additional and diverse policy issues ranging from 'company law' to 'accounting', 'state aid' to 'intellectual property', and many others.

EUROPEAN ENTREPRENEURSHIP & SME POLICY

COMPETITIVENESS AND INNOVATION FRAMEWORK
PROGRAMME

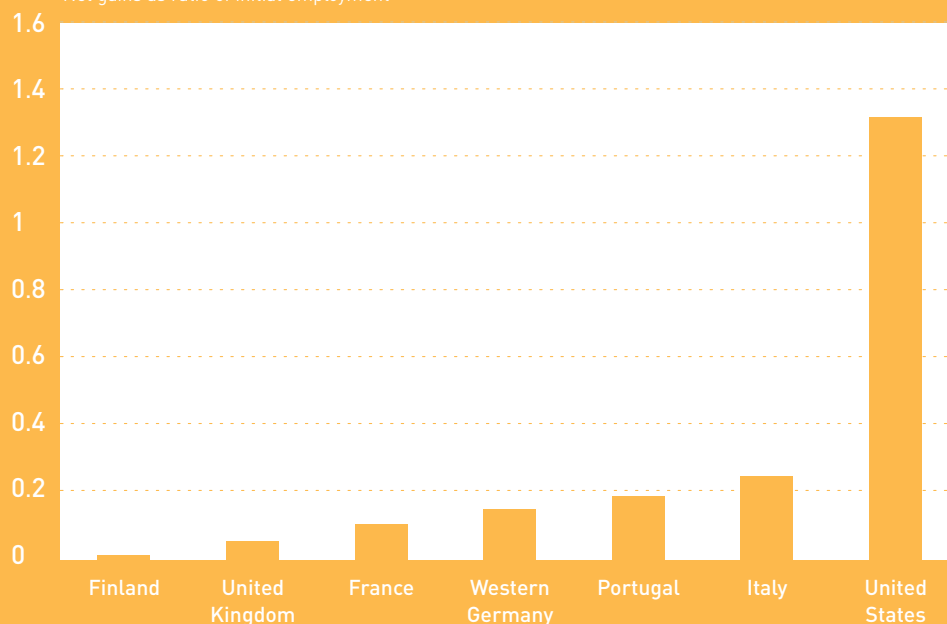
ENTREPRENEURSHIP ACTION PLAN

SME ENVOY

SME CHARTER

NET EMPLOYMENT GAINS MANUFACTURING FIRMS TWO YEARS AFTER CREATION, 1990s

Net gains as ratio of initial employment



Source: OECD

COMPETITIVENESS AND INNOVATION FRAMEWORK PROGRAMME

■ THE CURRENT SITUATION

On 6 April 2005 the European Commission presented a Competitiveness and Innovation Programme ('CIP') which should run from 2007 to 2013 and proposed a budget of € 4.2 billion. UNICE welcomes the CIP as an important policy step to refocus the Lisbon Strategy and expects it to ensure that 'competitiveness and innovation' are considered as horizontal policy issues which must not be addressed in self-contained action plans.

The CIP is a framework programme bringing together a number of existing and planned Community programmes in the fields that have been identified as most critical for boosting European productivity and sustainable growth: the

multiannual programme for enterprise and entrepreneurship and in particular for SMEs (2001-2005), the Intelligent Energy-Europe programme, the Modinis, e-Content and e-TEN programmes, certain innovation-related activities of the Research and Development Framework Programme.

UNICE appreciates that competitiveness is taken as the overriding theme that must inspire and drive the sub-actions on innovation, entrepreneurship, ICT, better regulation. Policy action for entrepreneurs and SMEs needs a coherent approach in support of their competitiveness and in this context it is appropriate that different policy actions fall under a single framework.

→ THE WAY FORWARD

- For optimum implementation of CIP we recommend that an effective multi-disciplinary horizontal structure mirroring the horizontal nature of the CIP, and responding to Commissioner Verheugen's 'competitiveness' competence, is put in place;
- We strongly urge the Commission to ensure effective links between the CIP and other programmes as opposed to what currently exists, notably between the CIP and its innovation activities and the 7th Research and Development Framework Programme;
- We encourage the Commission to involve representative business organisations in the policy-making process at an earlier stage, including in policies which fall under the responsibility of Commissioners other than the Commissioner for Enterprise and Industry. Such involvement should also be taken into account during national implementation;
- UNICE would welcome higher budgetary allocations for the Community financial instruments, provided primarily through organisations such as the European Investment Fund, for improving SMEs' access to finance;
- We consider that promotion and awareness campaigns to enhance the visibility of Community financial instruments should also be carried out with financial intermediaries, national financial organisations and business organisations;
- UNICE particularly appreciates the Commission's intention to earmark funding for innovative companies that experience problems in raising second- and third-round 'follow-on' finance to allow them to bring products/services to the market, helping them to grow;
- We reiterate our concern that what is needed in the field of entrepreneurship is more focus and not less. It is essential to avoid the CIP watering down the approach on entrepreneurship;
- Simplification of legislation, business impact assessments, reduction of administrative costs should be more prominent in the CIP.

ENTREPRENEURSHIP ACTION PLAN

■ THE CURRENT SITUATION

Following the debate launched by the **Green Paper on Entrepreneurship** in spring 2003, the Commission published an Action Plan on 11 February 2004 based on the extensive feedback received. The **Action Plan for Entrepreneurship** establishes a framework, around five strategic priority areas:

- Fuelling entrepreneurial mindsets
- Encouraging more people to become entrepreneurs
- Gearing entrepreneurs for growth and competitiveness
- Improving the flow of finance
- Creating a more SME-friendly regulatory and administrative framework.

UNICE voiced its support for the Commission's plan to boost entrepreneurship through this Action Plan.

Nevertheless, we consider that it can only succeed if Member States give a firm commitment to carry out concrete actions implementing it. The Action Plan is due to enter a second phase from 2006 onwards. UNICE believes that before phase II of the Action Plan with new sets of actions is embarked upon, a report on progress in the implementing actions currently foreseen should be issued.

→ THE WAY FORWARD

→ The Commission and Member States should agree on performance indicators, to benchmark progress in implementing the Action Plan. Setting clear targets for increased entrepreneurial activity is necessary to evaluate progress;

→ The Commission should report on progress in implementing the current Action Plan before embarking on phase II of the Action Plan.

SME ENVOY

■ THE CURRENT SITUATION

In December 2001, Commissioner Liikanen nominated the Director in charge of promotion of entrepreneurship and SMEs within the Enterprise Directorate General as the Commission's SME Envoy. The SME Envoy is to function as a contact partner for the SME community and act both inside and outside the Commission.

Within the European Commission, the SME Envoy is to ensure that the EU's policies and programmes consider SMEs' specific interests and needs. The Envoy should

influence the Commission policy areas and initiatives that have an effect on SMEs as well as act as a link between SME representatives and Commission services whose actions have an impact on SMEs (exercising a so-called '**watchdog**' function). Outside the Commission, the SME Envoy is to act as a visible link between the Commission and the SME community by maintaining direct, informal and regular contact with SMEs and their associations, by providing information and by forwarding feedback.

→ THE WAY FORWARD

→ UNICE encourages the Commission to strengthen the role of the SME Envoy, notably within the European Commission, to ensure that the 'think small first' approach is adopted;

→ Rapid implementation of Key Action 8 B of the Entrepreneurship Action Plan according to which better consideration of the SME dimension in EU policy-making processes should be ensured through reinforced coordination mechanisms inside the Commission: development of the interservice SME network which could encompass experts from the main European business organisations on specific topics.

SME CHARTER

■ THE CURRENT SITUATION

The summit meeting of the European Council held at Feira on 19 and 20 June 2000 endorsed the European Charter for Small Enterprises. In the Charter, the Commission and the Member States agreed to take measures that would support small enterprises in particular and provide appropriate assistance. Annual reports on the status of implementation highlights progress and remaining need for action. Since 2004, one such report is also being prepared for the acceding countries and the Western Balkan countries. The Commission published the 2005 SME Charter Report on 8 February 2005 (press release on 15 February 2005). UNICE applauded the SME Charter when it was adopted in 2000: the issues identified are appropriate and close to the interests of SMEs.

UNICE appreciates that the Charter is coupled with a reporting mechanism whereby Member States draw up reports on their implementation of the Charter. Annual reporting makes it possible to assess whether or not actions have been undertaken by Member States. In that sense, it is an important tool to maintain pressure on Member States to deliver on the actions promised in the Charter in 2000. In other words, there is an incentive to act and, as appears from the Commission's annual reports, some actions are being taken. We appreciate that the European Commission has adopted in its 2005 report a system of 'ranking' Member States, highlighting the number of measures adopted in the four priority areas (entrepreneurship education; better regulation and impact assessment; restructuring, bankruptcy and a fresh start; skills shortages).

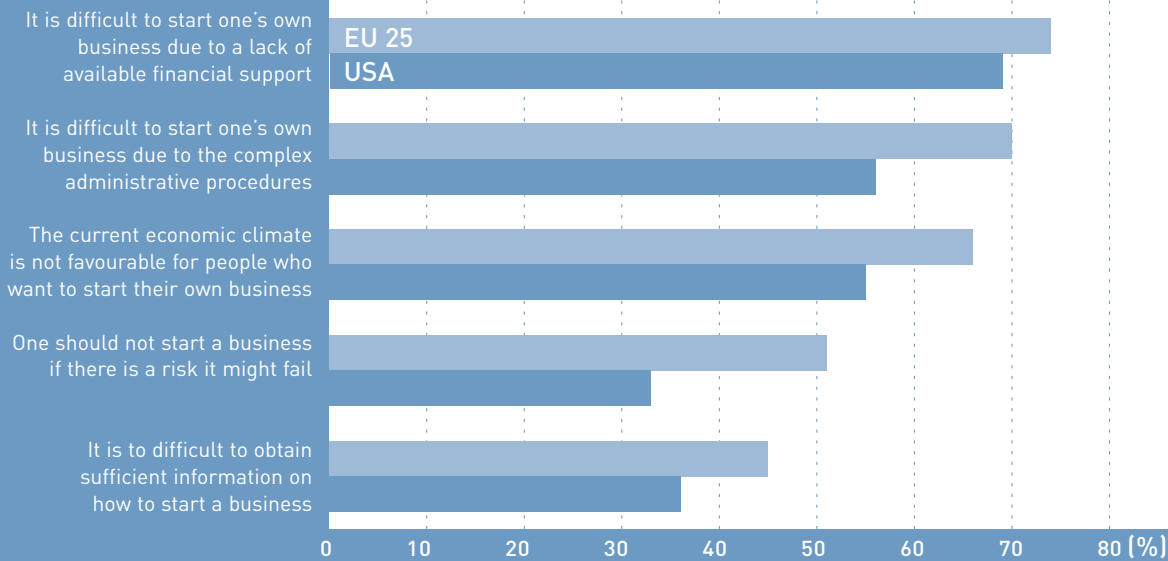
→ THE WAY FORWARD

- UNICE believes that Member States' progress in implementing the Charter must be benchmarked against performance indicators. This view was expressed also by the Competitiveness Council in March 2004 when it called on the Commission and Member States to 'identify and jointly agree appropriate indicators of performance and progress as a basis for the subsequent voluntary setting of targets for increased entrepreneurial activity';
- To avoid overlap, progress reports on the SME Charter and the Entrepreneurship Action Plan should be linked, and UNICE encourages the Commission to integrate entrepreneurship-related issues addressed by the Action Plan into the Charter.

ENTREPRENEURSHIP EDUCATION

AN ENTREPRENEURS' OBSTACLE COURSE

DO YOU AGREE/STRONGLY AGREE WITH THE FOLLOWING OPINION?



Source: Flash Eurobarometer n°160: Entrepreneurship (2004)

■ THE CURRENT SITUATION

There is a relationship between entrepreneurship and economic performance, achieving progress in employment growth, competitiveness and innovation. Nonetheless, Europe's entrepreneurial potential is not being exploited: although 47 per cent of Europeans prefer self-employment, only 17 per cent actually realise their ambition whereas in the US entrepreneurs are twice as numerous. Lack of an entrepreneurial culture leads to opportunities being missed: 51 per cent of Europeans agree that 'one should not start a business if there is a risk it might fail' whereas only 33 per cent in the US agree.

Entrepreneurship in the broad sense is first and foremost a state of mind which is beneficial to individuals in all walks of life. Indeed, it can be characterised by personal qualities such as creativity, responsibility, spirit of initiative, taking risks, rising to challenges. Such personal qualities must be nurtured at an early age (primary and secondary education) so that the entrepreneurs of tomorrow are equipped to fully realise their potential. Entrepreneurship should be seen by young people as a career opportunity and an essential part of personal development. Entrepreneurial activity creates jobs, drives efficient resource use and accelerates the process

of generating, diffusing and applying innovative ideas and concepts. SME creation and development, source of growth and jobs, is to a certain degree dependent on the entrepreneurial mindset of the owner/manager and its employees.

An essential element to releasing Europe's entrepreneurial potential and developing an entrepreneurial culture is through appropriate education. The European Commission has published two expert reports on Entrepreneurship education (November 2002 and March 2004), the conclusions of which UNICE welcomes. Commissioners Verheugen (Enterprise and Industry) and Figel (Education and Culture) aim to present a Communication before the end of 2005.

On the basis of member federations' first-hand experience and through the difficulties they have encountered, UNICE, in a spirit of constructive dialogue, has developed a set of recommendations to release young Europeans' entrepreneurial potential.

→ THE WAY FORWARD

MEMBER STATES MUST

- **recognise** the benefits of entrepreneurship education and adopt/implement national strategies on entrepreneurship education in primary, secondary and higher education;
- **translate** at national level through concrete measures the will to develop entrepreneurial mindsets among young people (integrate entrepreneurship education into school curricula, starting at primary level, run entrepreneurship education courses in teacher training institutes, promote and facilitate in-house training in companies, notably through a reduction of administrative procedures).

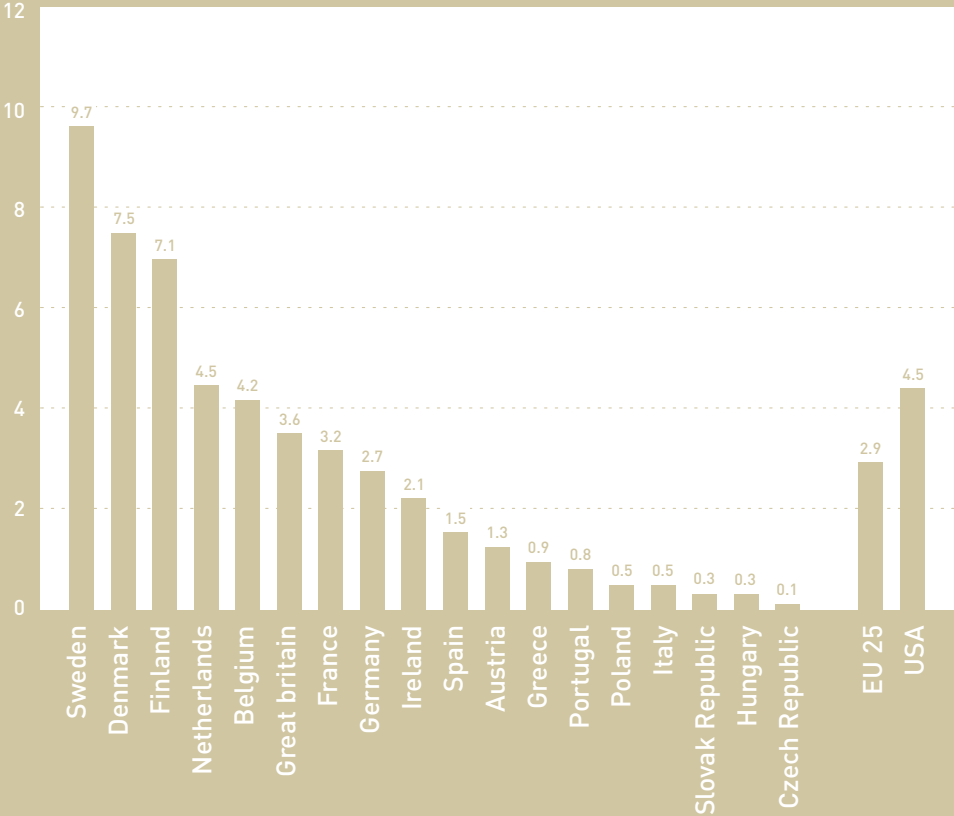
THE EUROPEAN COMMISSION SHOULD

- **agree** with Member States quantitative targets to assess progress on entrepreneurship education among young people. This should be done as part of the Entrepreneurship Action Plan (Key Action 1) and be assessed during evaluation of the relevant chapter of the SME Charter;
- **adopt** regular reports on progress achieved by Member States regarding the recommendations of the final report of the expert group 'Education for entrepreneurship' completed in 2004;
- **coordinate** and widely disseminate good practice regarding entrepreneurship education in Member States.

ACCESS TO FINANCE

EARLY STAGE VENTURE CAPITAL

PERCENTAGE OF GDP, 2002



Source: Eurostat

■ THE CURRENT SITUATION

In spite of the growing importance of alternative sources of financing, many SMEs still depend to a large degree on bank loans. Improving the equity base of SMEs remains a great challenge. There is a need for improved access to capital through further integration of Europe's financial markets and through the development of alternative means of financing.

The financial needs of SMEs are often at their greatest during the start-up and growth phases. However, such companies are often considered as a high-risk investment with return on investment only in the medium or long term and, in a new rating culture, banks may be reluctant to provide credit. Despite considerable advances over the last decade, European venture capital markets are functioning well below their potential. Although external equity investments are a relevant option only for a very small number of firms compared with loans, external equity capital is important for the rapid growth of innovative firms. Improved access of SMEs to venture capital and

private equity firms specialising in the provision of funds to new companies is thus of vital importance.

The new regulatory capital requirements for banks ('**Basel II**'), to be implemented in the EU through the **European Capital Adequacy Directive-III** (so-called CAD III Directive), may have an impact on banks attitudes towards and pricing of SME financing. The regulatory capital banks and investment firms are required to set aside for loans to and equity holdings in SMEs will be more closely linked to the individual risk of default by the recipient as reflected in external or banks internal ratings.

Under the CAD-III Directive, banks should face lower capital charges for loans to SMEs than at present. Also, the new framework will allow banks to set prices for their loans which better reflect the individual risk profile of the borrower.

→ THE WAY FORWARD

- SMEs must be informed by their banks about the criteria applied in ratings procedures;
- Capital requirements for banks must fully reflect the lower risk represented by loans and equity provision to SMEs. While recognising improvements made, it is probable that rating SMEs might under certain circumstances be more costly for banks than rating multinationals, as banks, in addition to estimating the probability of default, may also have to calculate the potential loss in the event of default. In this context further work may have to be done in order to reduce capital charges for equity participations in SMEs;
- Speedy and consistent implementation of the Financial Services Action Plan measures in Member States is key to the much needed creation of deeper and more liquid capital markets. This will lead to lower cost of raising capital for entrepreneurs and to lower trading costs for investors;
- Increased financial market integration and further development of innovative instruments for financing SMEs, such as the securitisation of loans, will in turn provide SMEs with increased access to investors and lenders in other EU countries;
- Member States' tax policies must put greater emphasis on fiscal neutrality between debt and equity finance.

TAXATION

COMPANY ESTIMATES OF TOTAL COMPLIANCE COSTS

	SMEs	Large
Absolute total compliance costs (in 1000 euros)		
Weighted average	203	1460
Un-weighted average	984	1662
Absolute total compliance costs/taxes (Cost-to-tax revenue ratio)		
Weighted average	30.9%	1.9%
Un-weighted average	15.3%	1.4%
Absolute total compliance costs/sales		
Weighted average	2.6%	0.02%
Un-weighted average	1.3%	0.01%

The table takes into consideration five types of compliance costs:

- (1) domestic VAT compliance
- (2) domestic Company Taxation
- (3) other EU Member States' VAT compliance
- (4) other EU Member States' Company Taxation
- (5) any non EU tax related compliance costs

Source: European Commission, European Tax Survey, Working paper n° 3/2004

■ THE CURRENT SITUATION

In the area of **indirect taxation**, the European Commission's Entrepreneurship Action Plan foresees actions aimed at simplifying value added tax ("VAT") compliance especially for SMEs. It is recognised that **current VAT obligations hinder especially SMEs from fully exploiting the advantages of the internal market.**

Applying the current system where companies are required to pay their VAT in the country where consumption takes place leads to the situation that many companies pay VAT in a Member State where they have no branch office.

In line with the Communication 'Review and Update of VAT Strategy Priorities' from October 2003, the Commission designated the simplification of tax liabilities as a focal point of its future activity and announced a project concerning a single coordinating body for VAT, which it calls VAT One-Stop-Shop. In May 2004, the

Commission introduced a consultation process for the VAT One-Stop-Shop system, in which a company could fulfil its VAT liabilities for all of its business activities within the EU exclusively in the Member State where it is based. The results of this consultation will form the basis of a proposal to be put forward by the Commission.

In the area of **direct taxation**, tax compliance procedures can be substantially alleviated by the Commission's proposal for introducing 'Home State Taxation' for SMEs. Under this scheme SMEs could calculate their EU-wide taxable profits based on the tax base rules of their country of establishment. This tax base would then be allocated among the different countries where the company has been active which would apply their national corporate tax rates. Participating Member States would agree to mutually recognise the different national methods of calculating taxable profits.

→ THE WAY FORWARD

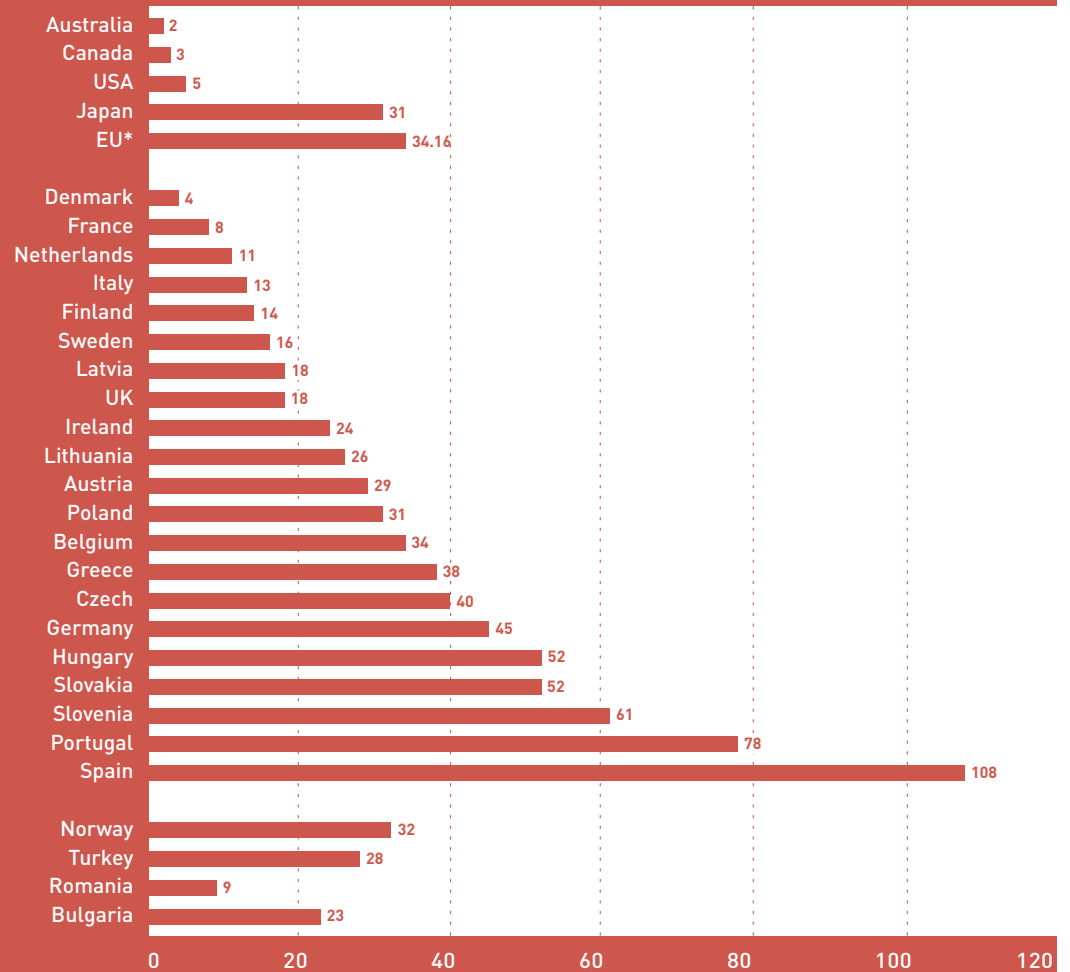
Basically, the efforts **on the part of the Commission to simplify** compliance with tax obligations are very welcome. Precisely SMEs could profit from less bureaucracy in the VAT system.

→ **ONE-STOP-SHOP** : The official goal of simplification as proposed by the Commission changes nothing when it comes to the tax liability forced by companies that conduct taxable business in several Member States of the EU. Nevertheless, **compliance with these obligations** should be simplified, e.g. by permitting the possibility of filing a tax return electronically and creating a tax and revenue authority to take over the function of a clearing centre for all participating tax and revenue authorities in the EU. Basically, then, this initiative is **welcomed**, especially by SMEs.

→ **HOME-STATE TAXATION** : The Commission's proposal for a Home-State Taxation pilot scheme was met with reservations in most Member States, in particular regarding the question of the basis on which taxable profits would be allocated to the different countries and, thus, what the impact on fiscal revenue would be. From an SME point of view, a voluntary Home-State Taxation scheme can make cross-border business much less costly in terms of compliance costs. While in the long run the best solution to cross-border tax problems is a common consolidated tax base in the EU that is open to companies of all sizes and legal forms, a voluntary Home-State Taxation system can make an important difference in the medium term.

BETTER REGULATION

NUMBER OF DAYS TO START A BUSINESS, 2004



* Weighted average of EU-25 for which data are available
Source: World Bank, 2004

■ THE CURRENT SITUATION

Reducing administrative burdens and ridding Europe's entrepreneurs of unnecessary red tape is a prime concern if problems surrounding Europe's competitiveness are to be addressed. In general SMEs have less capacity to handle all the legislation due to their limited resources and the proportionate costs for a small company to comply with regulations are nearly six times higher than for a medium-sized or large company.

According to a document released by the Irish Government during its Presidency of the EU, it is estimated that in a firm employing 8 people, 50 per cent of one person's time is spent filling out forms. According to the same document, it is estimated that the cost of unnecessary regulation to the EU as a whole is somewhere in the region of 0.45 per cent of European GDP or nearly € 40 billion!

In the context of the renewed Lisbon strategy, which has been refocused on growth and jobs, the Commission on 16 March 2005 released a Communication entitled 'Better regulation for Growth and Jobs in the European Union'.

This initiative builds on the Commission's 2002 initiative for better regulation.

This Communication proposes three key action lines:

- Promotion of design and application of better regulation tools at EU level, particularly insofar as impact assessments and simplification are concerned;
- Working more closely with Member States to ensure that better regulation principles are applied consistently throughout the EU by all regulators;
- Reinforcing constructive dialogue between all regulators at the EU and national levels and with stakeholders.

UNICE considers it encouraging that the European Commission has made better regulation a central piece of its policy action. Emphasising both the European and national level is the right approach. To prevent administrative burdens becoming worse, simplification of legislation is important and a 'better regulation' approach to new proposals all the more so, especially for SMEs.

→ THE WAY FORWARD

- The European Commission must provide a sufficient budget for it to fulfil its mandate from the Spring Council 2004: i.e. to 'refine impact assessments for new legislative proposals', 'to put a particular emphasis on measuring administrative burdens on companies' and to enhance the competitiveness dimension of impact assessments;
- Member States must further develop better regulation at national level (impact assessments, simplification of existing legislation and improve implementation of EU legislation at national level);
- The European Commission must take steps to enhance quality control and credibility of impact assessments and in this context draw on independent external control;
- UNICE favours the introduction of the so-called Standard Cost Model as the common methodology for measuring administrative burdens as it is currently used by an increasing number of Member States This method provides for a clear and transparent evaluation of business costs, which is relatively easy to apply.

YOU ARE INVITED TO INSERT HERE IN THE FUTURE THE ADDITIONAL POLICY DOCUMENTS WHICH UNICE WILL RELEASE RESPONDING TO THE BROAD IMPACT OF EU POLICY ON ENTREPRENEURS AND SMEs. THESE DOCUMENTS WILL COVER POLICY ISSUES RANGING FROM COMPANY LAW TO ACCOUNTING, STATE AID TO INTELLECTUAL PROPERTY, AND MANY OTHERS.



UNICE

THE VOICE OF BUSINESS IN EUROPE

					
Austria	Belgium	Cyprus	Czech Republic	Denmark	Denmark
					
Finland	France	Germany	Germany	Greece	Hungary
					
Iceland	Iceland	Ireland	Italy	Luxembourg	Malta
					
Norway	Poland	Portugal	Portugal	Spain	Sweden
					
Switzerland	Switzerland	The Netherlands	Turkey	Turkey	United Kingdom
					
Bulgaria	Croatia	Estonia	Lithuania	Rep. of San Marino	Romania
					
Slovak Republic	Slovenia				

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