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SME Action Day

thinking
BIG!

WEDNESDAY 21 NOVEMBER 2007

WHO ARE WE?

BUSINESSEUROPE, the Confederation of European Business, is the voice of more than 20 million small, medium and large companies.

BUSINESSEUROPE's members are 39 central industrial and employers' federations from 33 countries, working together to achieve growth and competitiveness in Europe.

BUSINESSEUROPE actively promotes the role of business in Europe: strong enterprises make a strong Europe. It advocates a favourable and competitive business environment to foster sustainable economic growth and sound economic governance.

BUSINESSEUROPE's Entrepreneurship & SME Committee, chaired by Arndt G. Kirchhoff, leads the organisation's work on matters relating to SMEs. It defines priorities for action to foster entrepreneurship and SME growth and to support SMEs in their efforts to innovate and remain competitive.

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SMEs - THINKING BIG!



Entrepreneurial activity and a thriving SME sector are essential for growth, job creation, innovation and social cohesion. Europe's economic future will to a large extent depend on its ability to release the potential of SMEs.

European SMEs are ambitious and think big! According to the survey conducted by KPMG for the SME Action Day, half of SMEs plan to achieve turnover growth of more than 10% over the next three to five years: about 30% target a growth rate of 11 to 20%, and one fifth aim at future growth of more than 20%.

If these targets are reached, this could result in the creation of more than 2.5 million jobs.

At the same time, the survey reveals that SMEs still face numerous obstacles to growth. Half of SMEs remain focused on the domestic market or have difficulties developing markets abroad. A majority of SMEs and entrepreneurs rely on their own financial means to finance growth, which limits possibilities for expansion, in particular if annual turnover growth rates are modest. Reported biggest barriers to growth remain taxation, red tape, inflexible labour markets and labour law, followed by regulation in general.

While SMEs are keen on growing their business, the EU and Member States must live up to commitments and make tangible progress in the creation of an environment that is more conducive to SME growth, in particular through the reduction of tax, administrative and regulatory burdens and implementation of the reforms for growth and jobs. SMEs in Europe also need improved access to finance and better access to foreign markets through a reduction of tariff and non-tariff barriers, in order to realise their ambitions.

Arndt G. Kirchhoff
Chairman Entrepreneurship & SME Committee
BUSINESSEUROPE

Philippe de Buck
Secretary General
BUSINESSEUROPE



On behalf of KPMG, market researchers conducted 840 interviews with small and medium-sized enterprises within the European Union. The focus was on expansion strategies, internationalisation behaviour, and perceived reform needs. As the survey shows, SMEs all over Europe are ambitious. However, SMEs also struggle, especially due to problems like skills shortages, high labour costs, and red tape.

As for internationalisation – despite some difficulties SMEs go abroad. 50% operate internationally. A fifth of them have established manufacturing operations in a foreign country or are planning to do so, primarily in EU-15 and Eastern Europe. Half of SMEs are very positive about Brussels achievements with regard to the monetary union and trans-European networks. Nevertheless, about one third also think the EU has not delivered enough on goals relating to fiscal policies, labour standards and solidarity among Member States.

Small and medium-sized enterprises are the backbone of our economies. 99% of all companies in Europe are SMEs and they provide two thirds of all jobs. Therefore, their future will have a large impact on Europe's economic future. Fortunately, as our survey shows, there is strong confidence and optimism among European SMEs. Growth is at the heart of this survey and, as its results attest, growth is what is on entrepreneurs' minds.

The survey conveys a clear message all over Europe: SMEs think big! This publication wants to give the reader the opportunity to learn more about this way of thinking.

Dr. Robert Gutsche
Member of the Managing Board
KPMG, Germany



SMEs CARE ABOUT EUROPE, DOES EUROPE CARE ABOUT SMEs?

- FACTS
- PRIORITIES

FACTS

- SMEs are the driving force of the EU economy and preparing for further growth. One out of two SMEs sets ambitious targets for growth, according to a survey of 840 companies across Europe. Half of these SMEs plan to achieve turnover growth of more than 10% over the next three to five years: around 30% of them target a growth rate of 11 to 20%, and one fifth aim at a future growth rate of more than 20%.
- At the same time, while wishing to grow, one half are more pessimistic about the future, predicting less than 10% growth. Almost one fifth forecast growth rates below 5%.
- The survey also shows that internal growth, notably through the development of new products and services and the expansion into new national and foreign markets is perceived to be far more important than external growth through joint ventures or mergers and acquisitions.
- Cash flow represents the most important option for SMEs for financing future growth, far ahead of bank loans or venture capital.
- Taxation and administrative burdens are still considered to be the greatest obstacles to SME development. Tax compliance costs are estimated to account for up to 30% of taxable income for SMEs. Inflexible labour markets and regulation are also regarded as important inhibitors of growth.
- More than 80% of SMEs call for more flexible labour law, more qualified personnel and lower non-wage labour costs. Four out of five SMEs consider more flexible working time arrangements important to support their expansion.

Chart 1

How much SMEs are planning to grow in the future

Source: KPMG 2007

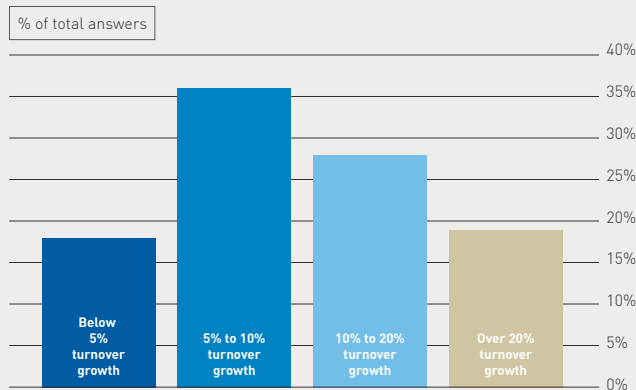


Chart 2

Options for financing future growth

Source: KPMG 2007

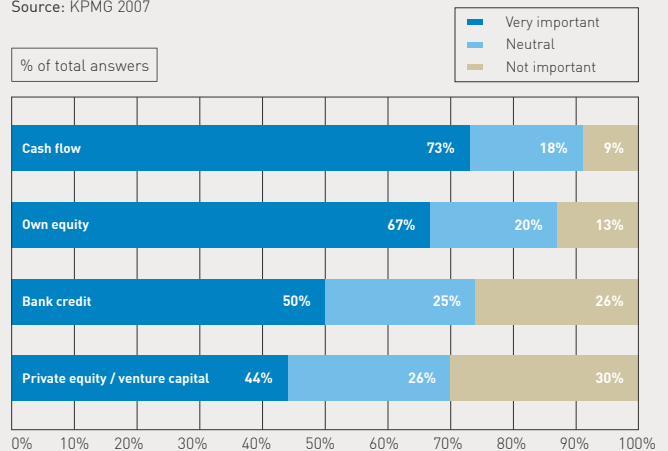
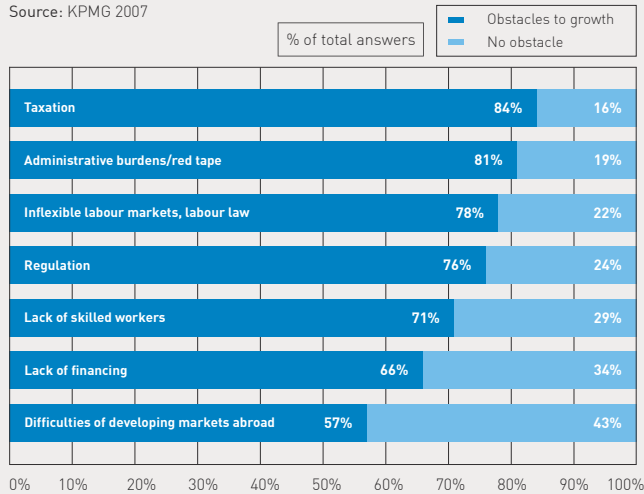


Chart 3

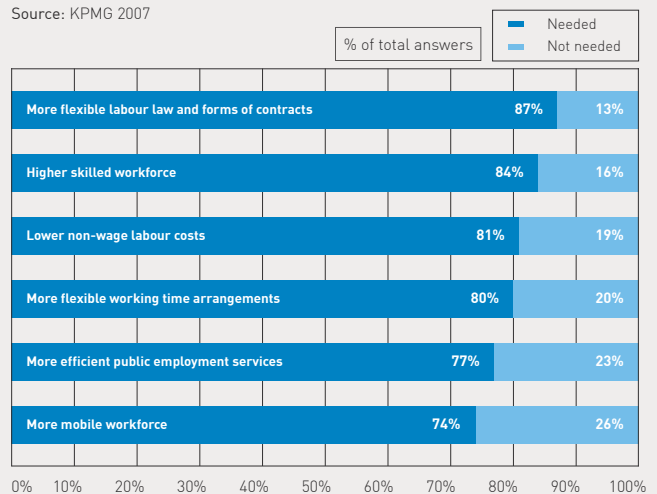
Obstacles to growth

Source: KPMG 2007

**Chart 4**

Labour market reforms needed to support SME growth

Source: KPMG 2007



PRIORITIES

- 1 Remaining internal market barriers for SMEs need to be removed. Reduction of tax obstacles, application of the mutual recognition principle for non-harmonised products, implementation of the services directive and introduction of the European private company statute are important to ease expansion of SMEs into new EU markets.
- 2 A shift from commitment to coherent action is needed: better implementation of the “think-small-first principle” in EU and national law-making and a true reduction of administrative and regulatory burdens that can be felt on the ground are required.
- 3 Member States must reform labour markets and enable a wide variety of contractual arrangements that correspond to the needs of companies and the workforce.
- 4 Improving access to external sources of finance for SMEs in general and diversification of the financing offer in order to better serve the financing needs of different segments of SMEs remains important, in order to support growth and expansion.

INNOVATIVE SMEs: IS EUROPE HINDERING OR FOSTERING THEM?

- FACTS
- PRIORITIES



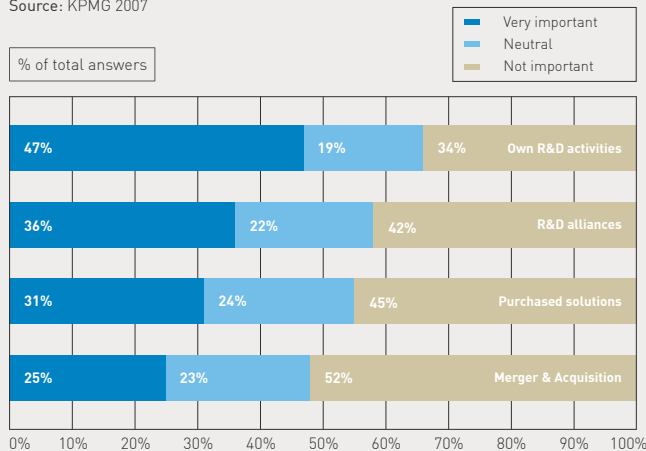
FACTS

- European SMEs consider in-house R&D activities to be a key source for innovation, and to a lesser extent R&D alliances and purchased solutions.
- The survey also highlights that one out of five SMEs receives financial support for innovation activities, whereby regional and national support programmes are a more predominant source than European programmes.

Chart 5

Sources of innovation

Source: KPMG 2007



- SMEs carry out nearly a quarter of business R&D in the EU, which is more than in the US (14.1%) and Japan (7%). However, when related to gross domestic product (GDP), overall business R&D

expenses are substantially higher in Japan (2.36% of GDP) and the US (1.78% of GDP) as compared with the EU (1.23% of GDP). Source: European Commission 2005

- The European patent system is much more expensive than the US or Japanese patent systems, which puts SMEs in particular at a disadvantage. A European patent that is renewed for 20 years in three countries costs about € 43,000, against approximately € 14,500 for a US patent or € 17,300 for a Japanese patent.

Source: European Patent Office 2006

- R&D activities and the availability of seed and venture capital are key for the development of innovative SMEs. Current gaps inhibit SME growth. Only 16% of the EU's current largest companies were established after 1980 as against 30% in the US. Out of these large companies created after 1980, only 37% were created from scratch in the EU compared with 82% in the US. Source: European Commission 2005

- In 2003, the US's total investment in venture capital in high-tech sectors was about three times the amount invested in the EU (as a % of GDP). US early-stage venture capital investment in high-tech sectors was twice as high as in the EU-25. At the expansion stage, it was five times the amount invested in EU-25.

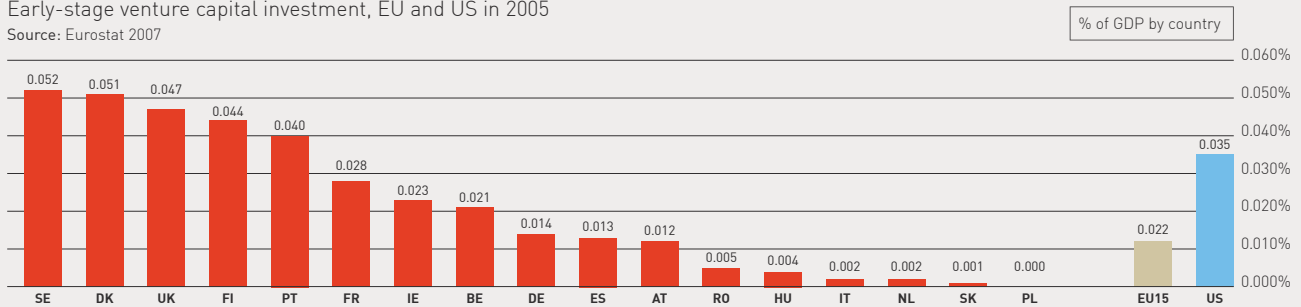
Source: European Commission 2005

- In 2005, early-stage venture capital investment amounted to € 3.47 billion in the US (0.035% of GDP) as opposed to € 2.28 billion in EU-15 (0.022% of GDP). There are large differences between EU Member States with regard to the level of investment.

Chart 6

Early-stage venture capital investment, EU and US in 2005

Source: Eurostat 2007



PRIORITIES

- 1** Venture capital markets in the EU need to be further developed. In particular, the early- and expansion-stage financing offer needs to be increased with a view to stimulating creation and growth of innovative and high-tech SMEs. In addition, cross-border investments of venture capital funds within the EU should be facilitated.
- 2** A focus must also be put on improving access to bank finance and further developing innovative financing instruments such as loan guarantees and mezzanine finance.
- 3** Governmental innovation and R&D support programmes and in particular European support programmes must become more accessible for SMEs, through better information, reduced bureaucratic hurdles and more focus on knowledge transfers.
- 4** Indirect policy measures such as tax incentives should be considered, in order to stimulate research and innovation activities of SMEs.
- 5** Clusters and networks that are based on public-private partnerships should be developed in order to help SMEs overcome a lack of internal know-how and size constraints.
- 6** The innovation capacity of SMEs should also be strengthened by putting in place a stronger, more comprehensive and cost-efficient system of protection of intellectual property rights. Creation of a truly unitary Community patent is important in this respect.



HOW CAN SMEs BECOME MORE GLOBAL?

- FACTS
- PRIORITIES

FACTS

- SMEs are aware of competitive challenges and increasingly planning to go international. According to the KPMG survey, half of SMEs remain focused on the domestic market, but the other half think that operating within the EU market is very important. One third consider that extending activities beyond the EU is very important.
- 69% of SMEs operate or intend to operate in the European market. 44% of them believe that more EU instruments and policies are needed to favour SME internationalisation. Around 40% of them see limited access to information about doing business abroad, tax issues and regulatory restrictions as the main barriers to extending operations within the EU.
- More than half of European SMEs are active beyond the European market or intend to extend operations beyond the EU. Almost half of them describe tariff and non-tariff barriers as the most important obstacles to internationalisation, followed by tax compliance rules, regulatory restrictions and the insufficient enforcement of intellectual property rights.
- One fifth have established manufacturing sites in another country or are planning to do so. Lower production costs are only one reason for shifting production abroad, the proximity to customers and presence in fast-growing markets being equally important. A more favourable tax environment and lower administration costs are also important considerations.

Chart 7

Obstacles to operations in the EU market

Source: KPMG 2007

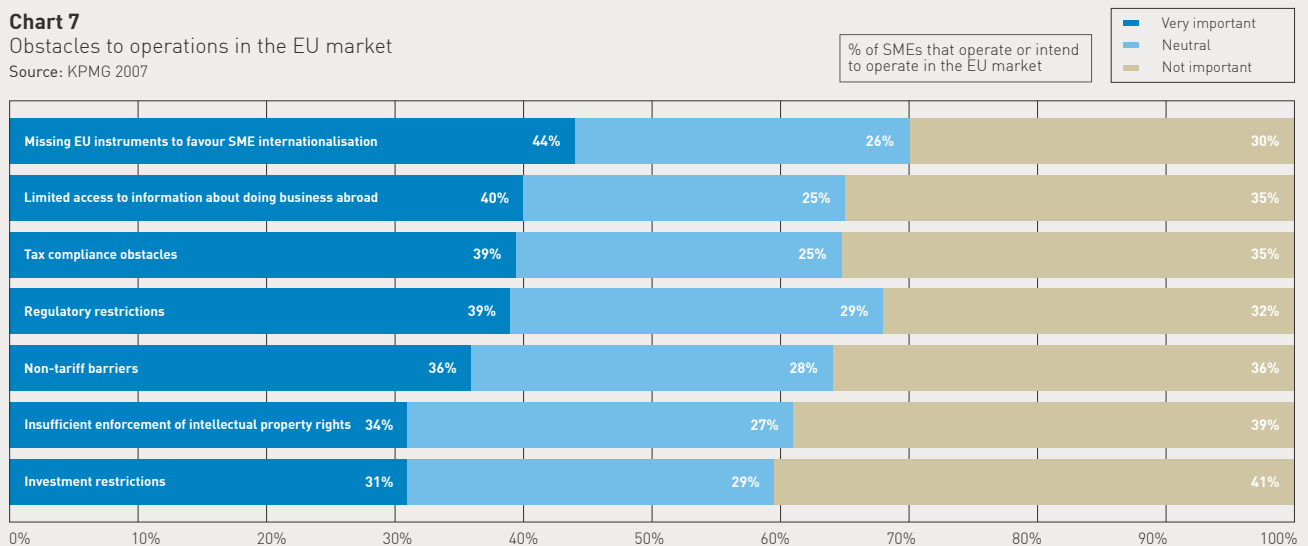


Chart 8

Obstacles to operations beyond the EU market

Source: KPMG 2007

% of SMEs that operate or intend to operate beyond the EU market

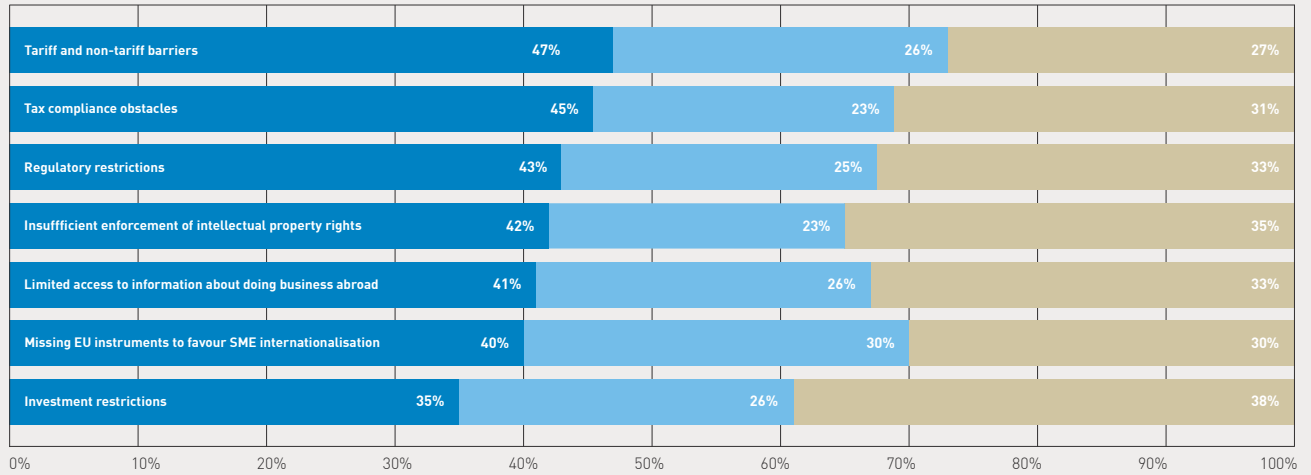
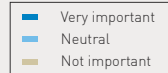
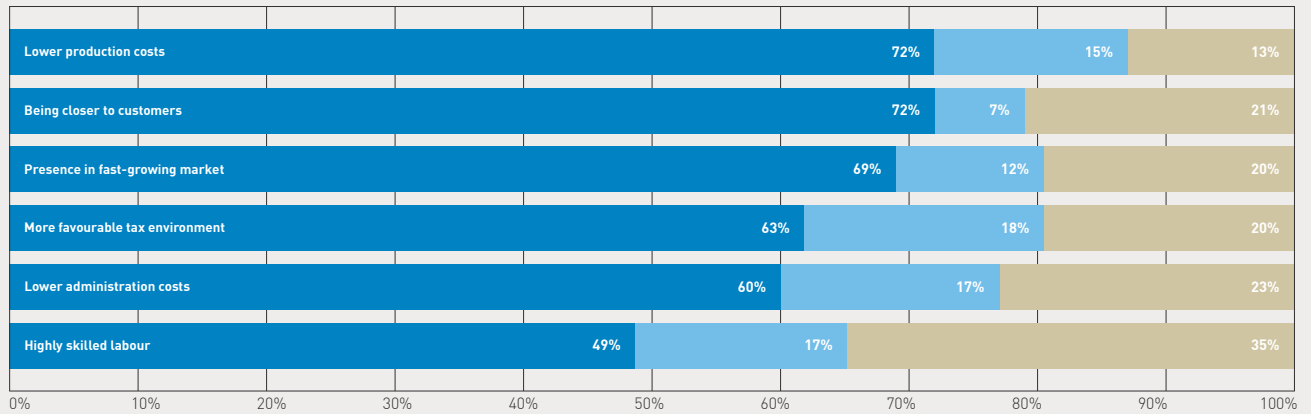
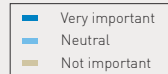


Chart 9

Reasons for shifting production abroad

Source: KPMG 2007

% of total answers



PRIORITIES

- 1** Internationalisation is important for enhancing market shares, strengthening competitiveness and innovation capacity. SMEs will increasingly need to develop their markets within and beyond the EU in order to grow and stay competitive in a globalised world.
- 2** Remaining tax and regulatory barriers in the EU need to be removed in order to facilitate SME expansion into new markets in Europe.
- 3** SMEs are under-represented in international trade flows and strongly affected by remaining obstacles. Governments must progress in multilateral and bilateral trade negotiations with a view to further reducing tariff and non-tariff, tax and regulatory barriers to trade.
- 4** Governments need to ensure better protection of intellectual property rights in markets beyond the EU through full compliance with the trade-related aspects of intellectual property rights agreement (TRIPs) as well as better enforcement.
- 5** SMEs need better access to information and qualified advice when they consider going international and developing new markets.



ENVIRONMENTAL POLICIES AND COMPETITIVENESS: CAN SMEs COMBINE THESE GOALS?

- FACTS
- PRIORITIES

FACTS

- Four out of five SMEs consider themselves well informed about EU and national environmental legislation according to the KPMG survey.
- Among those SMEs, most agree that a positive result of environmental legislation is improved protection of the environment.
- Looking at the way environmental legislation affects its business, one in two SMEs believes that compliance with higher standards is a driver for higher energy efficiency and also improves the company image. A similar proportion also considers it a driver for product and process innovation.
- At the same time, more than one third of SMEs state that they are negatively affected by high-compliance costs and have a competitive disadvantage as compared with companies in non-EU countries. One third stress the high complexity of environmental rules and high administrative burdens as being negative side-effects of the current legislative framework.
- Two thirds of SMEs strongly call for a reduction of administrative burdens, financial support and free-of-charge expert advice to support them in their efforts to comply with environmental legislation. More than half of European SMEs would welcome more online information sources, and more generally less regulation and a stronger focus on self-regulation.

Chart 10

Potential positive aspects of environmental rules

Source: KPMG 2007

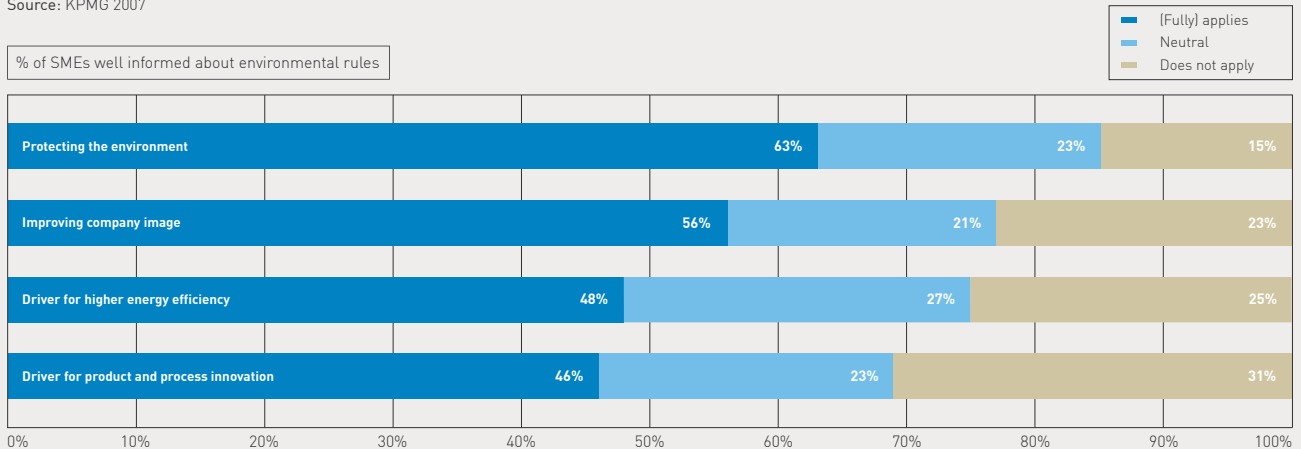
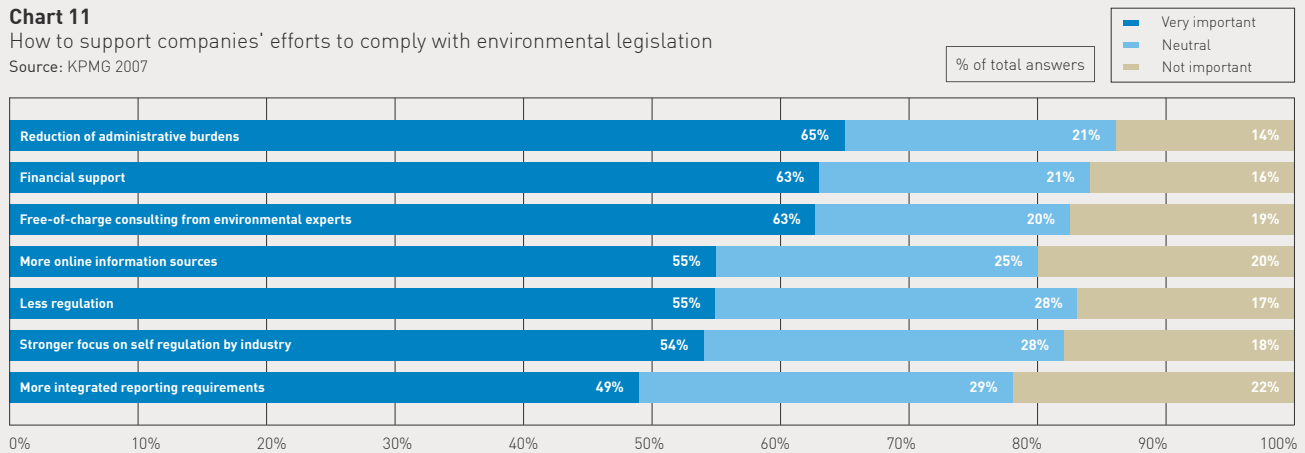


Chart 11

How to support companies' efforts to comply with environmental legislation

Source: KPMG 2007



PRIORITIES

- 1** The EU and Member States should screen the complex legislative framework within the better regulation agenda, simplify rules, reduce red tape and compliance costs, e.g. through more integrated reporting requirements.
- 2** Both, the European and national levels should develop support services for SMEs. In particular, programmes that back SMEs' efforts to become more energy-efficient should be developed.
- 3** At the same time, in order to sustain their activity, SMEs need security of energy supply and access to energy at a reasonable price.
- 4** When facing new environmental challenges, the EU and Member States need to ensure that policies aimed at addressing them are proportionate, do not impose unnecessary burdens on SMEs and do not hamper competitiveness.
- 5** Climate change is a global issue. Without a truly global agreement including all major emitters, the challenge cannot be addressed effectively. While many EU companies will seize opportunities for innovation arising from new environmental challenges, it is important to avoid putting disproportionate burdens on them, which lead to a competitive disadvantage.

The survey run by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft ran from June to July 2007. It consisted of computer-assisted telephone interviews with top management of 840 SMEs in manufacturing industries. The survey covered SMEs in 14 different EU Member States. 60 interviews were conducted per country.



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