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SPEECH BY ROBERT GUTSCHE, KPMG GERMANY

Thinking BIG! – How SMEs plan to grow and internationalize

Dear Mister Kirchhoff,

thank you very much for welcoming us here in Brussels. In the name of KPMG I would also like to thank Business Europe for giving us the opportunity to present our mid-market survey at the "SME Action Day". I am sure we will have many fruitful – and very active – discussions.

Ladies and Gentlemen,
SME is a small word. It seems to indicate insignificance. However, as today's motto underpins, the opposite is true: SMEs not only think big. They stand for economic strength in Europe. And all over the world, they represent this strength.

Small and medium-sized enterprises are the backbone of our economies.

They make up 99 percent of all European companies. As Mister Kirchhoff said, SMEs provide two-thirds – around 75 million – of all jobs. No wonder that the European Commission calls them the "actual giants of Europe's economy".

The future of our economies will largely depend on how these "small giants" develop.

Fortunately, as our survey shows, SMEs all over the continent are confident. Growth is at the heart of the survey that I will present to you today. As its results attest, growth is also what is on the entrepreneurs' minds.

As Mister Kirchhoff already mentioned, KPMG engaged an independent and highly respected research institute for this survey. It conducted interviews with over 800 SMEs in different countries of the European Union. The focus of the survey was on expansion strategies and internationalization. At the same time, the researchers examined what obstacles SMEs face and which reforms they demand. Furthermore, the enterprises were asked to assess positive and negative aspects of EU policies, with a focus on environmental legislation.

Let me now give you a more detailed overview of the results.

One important finding of the survey is: All over Europe, **SMEs are ambitious.**

Four in five European SMEs say: Growth is very important to us. In some countries – Poland, Italy and Greece – nearly every entrepreneur thinks that way. Just in a few countries, this enthusiasm for expansion is limited: In Belgium, around two thirds of the companies are interested in growth and in the United Kingdom only half of the entrepreneurs consider growth as very relevant.

About 50 percent of European SMEs plan to grow more than 10 percent in the next three to five years. One fifth aim at a future growth rate even beyond 20 percent.

This optimism seems well-founded – over a third of the companies interviewed have achieved two-digit growth rates in the past. One in five SMEs actually accomplished to grow at a rate of more than 20 percent.

If the companies can reach their ambitious goals, this could mean a real boost for the European economy and its job market.

KPMG's survey confirms another SME characteristic:

Internal growth still counts much more than external growth.

About two thirds of European SMEs focus on the development of new products and services. Almost as many say it is important to expand into new domestic markets. Over 40 percent think so with regard to new foreign markets.

Yet, less than a third of European SMEs want to grow externally through joint ventures and cooperation. Only about 20 percent plan to expand through Mergers & Acquisitions of related business. Not surprisingly, M&A of unrelated business is even less relevant.

At this point, let us have a look at some important **differences across Europe**: For example, national expansion is especially important for enterprises in Greece and Poland. But only around half of the companies there want to expand into new foreign markets. Conversely, expanding into new foreign markets is particularly important for Italian SMEs, followed by French and Spanish firms.

As for external growth, Sweden is the only country where half of the companies say: It is important to grow through joint ventures, cooperation or M&A. In contrast, Danish, German and Greek firms have a particularly low interest in external growth. In those countries, not even one in five companies consider joint ventures or cooperation as options for expansion. Less than one in ten of them is interested in M&A.

However, innovation is a key factor for future growth in all countries.

SMEs are innovative. Half of them rely on in-house R&D activities to promote innovation. Around a third favour R&D alliances and purchased solutions. On the one hand, innovation is crucial for SMEs. On the other hand, not even one in five companies receive public subsidies for innovation. In this context, regional and national financial support programmes are much more common than European programmes.

So we see: Subsidies on EU level are not very common. But expansion in Europe and beyond is very important: **SMEs become more international.**

53 percent of the small and medium-sized firms interviewed operate on the European market or beyond. Generally, international business activities are more common amongst larger firms: 40 percent of the SMEs with more than 250 employees operate internationally, compared to 26 percent of those with less than 250 employees.

This difference is even more significant looking at the differences by revenue: 42 percent of the companies with a revenue of more than 50 million Euro operate on the international market, but only 34 percent of those with a revenue between 10 and 50 million Euro. Amongst the firms with a revenue smaller than ten million Euro, only 24 percent operate internationally.

Half of all European SMEs perceive operations within the EU as very important. For one third, international operations beyond European borders are also very relevant.

Again, **there are significant differences within Europe**. SMEs in Italy, Holland, Austria and Greece, for example, see much more importance in activities on the EU market than their counterparts in Denmark, Belgium or Hungary. Italian, French and Swedish firms are keener on doing business beyond EU borders than firms in other European countries.

20 percent of the SMEs have established manufacturing operations abroad, primarily in the EU-15 and Eastern Europe. Shifting production abroad is most common amongst Austrian, French and Dutch companies, followed by Italian, Swedish, German, Spanish and Danish firms. Between 40 percent of the companies – in Austria – and around 20 percent – in Denmark – maintain production facilities abroad. In Belgium, Poland and Greece, on the contrary, only around five percent of the SMEs manufacture abroad.

What are the **main incentives** for shifting production out of the country?

Lower production costs are the most important reason: 72 percent of the companies name this motive for going abroad. Just as many of the SMEs interviewed say that they want to be closer to their costumers. Being present in fast-growing markets is almost as important. Other common reasons to shift production abroad are more favourable tax environments, lower administration costs and a highly skilled workforce.

The motives for shifting production abroad are linked to some important reform needs that SMEs demand. More than half of the European companies say they strongly require better skilled personnel. Just as many demand more flexible labour laws and more flexible forms of contracts, respectively. Half of Europe's SMEs call for more flexible working time arrangements. 44 percent state that high non-wage labour costs obstruct their growth. 39 percent say that a more mobile workforce is strongly needed.

In particular many Spanish and Greek SMEs say that skills shortage is a big problem for them. High non-wage labour costs is a major difficulty for companies in Poland, Italy, France, Belgium and Germany. Greek companies also perceive a very strong need for more efficient public employment services.

Bureaucracy and taxation are considered as a limitation for growth. According to more than a third, inflexible labour markets and labour laws, respectively, obstruct their growth. 32 percent say that they lack financing means in order to growth.

This brings us to another important finding of KPMG's survey: How do small and medium-sized enterprises finance their future growth?

In fact, **mostly, they rely on themselves.**

Here again, the survey conveys a clear message: Cash flow and own equity represent the most important options for financing future growth. Around 70 percent of the companies depend on internal financing.

In Greece, Sweden, Hungary and Denmark, this trend is even stronger. Over 90 percent of Greek SMEs use their cash flow and own equity in order to finance growth. In Spain, only around 60 percent of the SMEs rely on cash flow and own equity. Just as many Spanish firms use bank credits to finance their growth.

But in general, cash flow and own equity are much more vital for SMEs than bank loans, private equity or venture capital. Bank credits, but also private equity and venture capital are much more common amongst bigger firms.

Only a minority of European SMEs uses, or plans to use, stocks or bonds to finance their expansion. Just six percent of them currently use stocks, 4 percent intend to do so. More than half of those who raise capital though stocks want to grow in their national market. Only 4 percent of European SMEs currently use bonds for financing, and 3 percent plan to do so. Again, half of them use this means of finance for national expansion.

The SMEs view on EU matters is less homogeneous.

In general, SMEs are positive about Europe.

Half of them think that the EU has achieved a well functioning and efficient monetary union. Just as many appreciate the trans-European networks – energy, transport, and telecommunication – because they foster business efficiency. 45 percent praise the macroeconomic stability within the EU. 42 percent say that Brussels has succesfully created a highly competitive economy. Just under 40 percent say that the European Union has created an internal market where competition is free and undistorted.

More than a third thinks that the EU has put in place a common trade policy up to the challenges of globalisation. Just as many say that the EU strongly supports scientific and technological progress.

At the same time, about one third also think the EU has not delivered enough regarding the effective coordination of fiscal and economic policies. Just as many say that the EU has not achieved good results on the subject of territorial cohesion and solidarity between EU member states. 30 percent are also very critical about the development of employment-friendly labour standards.

Then again, most European SMEs agree with the potential positive effects of Brussels' **environmental regulations.** This is particularly visible with regard to ecological protection and company images: 63 percent of SMEs are of the opinion that the regulations protect the environment. 56 percent say this may help to improve the image of a company. Almost half of the companies think that the regulations are a driver for higher energy efficiency and for innovation.

On the contrary, 41 percent of the SMEs also confirm the negative effect of high compliance costs. At the same time they say that the environmental regulations form a competitive disadvantage compared to companies in non-EU countries.

A third say it is negative that they require external advice due to the high complexity of rules. Just as many complain about high adminstrative burdens distracting them from their core competences. For all these reasons, the majority of SMEs call for supportive measures to comply with environmental legislations.

After all, SMEs face many obstacles.

They struggle with numerous difficulties, both on EU and global level.

44 percent of the firms that operate on the EU market claim that they are not sufficiently provided with instruments to facilitate internationalization. Just as many say they only have limited access to information about doing business abroad. This is specifically the case for Greek SMEs. Amongst them over 80 percent claim this. In Sweden, Hungary and Denmark over 50 percent say that they lack EU instruments to favour SME internationalization.

More than a third is worried about tax compliance, regulatory restrictions and non-tariff barriers. A third say that intellectual property rights are not sufficiently enforced. Just as many say that investment restrictions are a big obstacle to operations in the EU market.

As for expansion beyond the EU market, there are similar perceptions. But the hierarchy of the obstacles is different.

Tariff and non-tariff barriers, tax compliance and regulations are seen as the main obstacles to operations beyond the EU. Approximately one third of the SMEs interviewed do not perceive these barriers as important. Limited access to information about doing business abroad is a problem just as strong as on the EU market. The same is true for missing EU instruments to favour SME internationalization.

It should be mentioned that there are significant concerns about the protection of intellectual property rights and investment restrictions. They are even stronger on the global level compared to the EU.

Let me sum up the main messages of KPMG's SME survey in brief.

SMEs are ambitious. They want to expand on national and international markets. For them, internal growth is much more important than external growth. SMEs stand for innovation. In-house R&D is their most important source for that.

SMEs become more international. More than half of them operate on the European market or beyond.

SMEs rely on themselves. Cash flow and own equity are the most important options for financing future growth.

SMEs still struggle with many obstacles, mainly missing instruments to facilitate internationalization, tax compliance and regulatory restrictions.

Ladies and Gentlemen,
SMEs might be a small word. But its meaning is powerful. All over Europe, SMEs want to grow. All over Europe, SMEs think BIG!

The SME Action Day gives us the opportunity to share this way of thinking.

Thank you very much for your attention.

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