

A Critical Analysis of the “Small Business Act” for Europe

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Abstract: In this article we give a critical approach of EU’s “Small Business Act” which is the latest official initiative of the European Commission for making European SMEs more competitive on the global markets. We put stress on the necessity of working out an even more sophisticated policy for the subsidy of small enterprises both on community and national levels. Or historical reasons SMEs of the new Member States had to start from a backward position, among others that is why we need a differential approach for the SME policy. From the point of view of the needs of SMEs of new Member States we shall criticize the Commission’s “Small Business Act”.

Keywords: competitiveness, SMEs, policy making

In our analysis we do not take into consideration all of the points of the Commission’s “Small Business Act”, but try to concentrate on the ones which are the most important for the Hungarian SMEs.

“In a globally changing landscape characterised by continuous structural changes and enhanced competitive pressures, the role of SMEs in our society has become even more important as providers of employment opportunities and key players for the wellbeing of local and regional communities. Vibrant SMEs will make Europe more robust to stand against the uncertainty thrown up in the globalised world of today.”

It seems to be quite unrealistic to expect SMEs to stand against the uncertainty in the globalised world of today. They are rather victims of globalization than possible balance makers. It is not SMEs who cause problems, and it is not them who has to make the balance. To be able to become providers of wellbeing on local and regional levels, SMEs have to be protected from the pressure of multinational companies. They are providers of employment opportunities, but it is jeopardized by globalization. Unfortunately in statistics it is very seldom pointed out that in most of the cases free market access destroys more jobs than it creates. In case of emerging markets the net balance is even worse.

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The EU has thus firmly placed the needs of SMEs at the heart of the Lisbon Growth and Jobs Strategy, notably since 2005 with the use of the partnership approach, which has achieved tangible results. Now it is time once and for all to cement the needs of SMEs in the forefront of the EU's policy and to translate the vision of the EU Heads of State and Government of 2000 into reality — making the EU a world-class environment for SMEs.

Many of the researchers and even politicians share the opinion that today the requirement of more growth and jobs of the Lisbon Strategy is even more unrealistic than it was in 2000.

“The national and local environments in which SMEs operate are very different and so is the nature of SMEs themselves (including crafts, micro-enterprises, family owned or social economy enterprises). Policies addressing the needs of SMEs therefore need to fully recognise this diversity and fully respect the principle of subsidiarity.

This one of the statements of the document that I fully agree. Much to my regret, among the proposals the application of these principles can not be found.

The second point of the document insists on a time for a breakthrough in EU SME policy.

In the Commission's opinion the mid-term review of the EU's Modern SME policy from 2005 to 2007 showed that both the Member States and the EU have made progress in creating an SME-friendlier business environment. The Commission has made real efforts to cut red tape for SMEs and has significantly increased the SME focus in major EU support programmes for 2007-2013. Member States have substantially improved the business environment for SMEs, taking inspiration from best practice exchanged in the context of the European Charter for Small Enterprises endorsed in Feira in 2000 and by implementing the 2006 Spring European Council conclusions, e.g. by introducing one-stop shops for company.

Small Business Act states that EU's strategy for better regulation is crucial for SMEs, which will greatly benefit from the modernisation and simplification of existing EU legislation and from the ambitious programme to reduce administrative burdens arising from EU legislation by 25% by 2012.

EU calls for driving an ambitious policy agenda for SMEs, a "Small Business Act" for Europe.

According to the document, at the heart of the European SBA is the conviction that achieving the best possible framework conditions for SMEs depends first and foremost on society's recognition of entrepreneurs. Being SME-friendly should become mainstream policy, based on the conviction that rules must respect the majority of those who will use them: the "Think Small First" principle.

The symbolic name of an “Act” given to this initiative underlines the political will to recognise the central role of SMEs in the EU economy and to put in place for the first time a comprehensive policy framework for the EU and its Member States through a set of 10 principles to guide the conception and implementation of policies both at EU and Member State level.

A set of new legislative proposals are given by the document which are guided by the “Think Small First” principle:

- General Block Exemption Regulation on State Aids (GBER) will in the field of aid to SMEs, for training, employment, R&D and regional aid simplify and harmonise existing rules for SMEs and increase investment aid intensities for SMEs. Hopefully this regulation enables governments both on state and regional level to give efficient aid to their SMEs while trying to compete with multinational companies.
- Regulation providing for a Statute for a European Private Company (SPE)
- Directive on reduced VAT rates which will offer Member States the option of applying reduced VAT rates principally for locally supplied services, which are mainly provided by SMEs.

In Hungary there is a debate on the level of VAT rates. Our government will raise VAT from 20 to 25% which is the highest in Europe irrespective of the size of the companies. The possibility of differentiating between companies by size was not even mentioned. Average SME owners do not simply know about this initiative. Municipalities and local authorities together with the SME organizations could support this idea. From regional development point of view we could have lots of advantages by implementing this opportunity.

In the document a set of new policy measures are also given which implement the 10 principles according to the needs of SMEs both at Community and at Member State level.

In the fourth part of the document we can find the ways how EU Commission wants to turn the above mentioned principles into policy action.

“The EU and Member States should create an environment within which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded. They need to care for future entrepreneurs better, in particular by fostering entrepreneurial interest and talent, particularly among young people and women, and by simplifying the conditions for business transfers.”

Referring to the 2007 *Flash Eurobarometer* on entrepreneurial mindsets which shows that 45% of Europeans would prefer to be self-employed, compared to 61% in the US, the document like People in Europe to be made more aware that self-employment is a potentially attractive career option and be provided with the necessary skills to turn their ambitions into successful ventures.

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As far as our experience in Hungary and most probably in all other Post-Soviet countries are concerned, there is no need to convince people on the importance of entrepreneurship. It was done twenty years ago after ruining the socialist industry and privatizing elements of state properties for the favour of foreigners, mostly for multinational companies. In these times, entrepreneur was 'The Man of the New Era' while 1,5 million of the former employees became unemployed. A considerable amount of them had to start a kind of entrepreneurship. Most of them became a sole entrepreneur. At the moment we have 1,2 million registered enterprises, out of which approximately 75% is operating. They do not have to ideologically be convinced but government has to simply let them work. This is among others one of the outcomes of my empirical survey done in 2006-2007. Entrepreneurs regret very much that in the communication of the authorities enterprises are supported, but in reality they do not want to see so much enterprises, because it is complicated to control them and most of them is considered to be a potential cheater. On the other hand in our country and in all countries around us neoliberal economic policy was forced by different international organizations such as IMF, World Bank, OECD etc. in the so called transition period. This way of thinking is based on the "Free Market" dogma. Free market automatically grants equilibrium, enterprises and individuals have to take care of themselves, state is not allowed to interfere into market transactions etc. Based on the so called Washington consensus liberalization, privatization and deregulation are the key elements of this theory. This framework is absolutely against the interests of small entrepreneurs, the most of which started their business by necessity. Our example clearly proves that it is not enough to agitate people for becoming entrepreneurs, but it is at least as much important to help them being able to keep their enterprise on the market.

In the next chapter the Commission states that transfer of business should be given the same support as setting up a new business. Recognition of the special role of SMEs and in particular family-based enterprises, their typically local base, socially responsible attitudes and capacity to combine tradition with innovation, underpins the importance of simplifying the transfer of businesses and the skills associated with them.

This is the first time when the importance and role of SMEs is so clearly defined and accepted as a value in an EU document. It is also true that there is a certain contradiction between the competitiveness and innovation aspect and the family-based character of SMEs. Very few of the small firms are really innovative because they have their traditional and accepted role locally. I do not think we should always force the innovation side without making differences between firms. A sophisticated approach is needed, traditional activities are at least as important as innovative solutions.

The document also calls the attention of entrepreneurs to the opportunity to contribute to a better business environment by stepping up their cooperation and networking, by exploiting more fully the potential of SMEs, and especially family

enterprises, as important training grounds for entrepreneurship and by acting in a socially responsible way. In the former socialist countries like Hungary it is quite difficult to convince people on the importance of networking and cooperation. Because of historical reasons, in communist type cooperatives cooperation was forced by authorities and people could not keep their properties, people are quite redundant of cooperation and networking.

“The Member States should ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance”

According to a previous EU document bankruptcies account for some 15% of all company closures. Around 700 000 SMEs are affected annually and some 2.8 million jobs are involved throughout Europe on an annual basis. In the EU, the stigma of failure is still present and society underestimates the business potential of re-starters. 47% of Europeans would be reluctant to order from a previously failed business, while the average time to complete a bankruptcy in the EU varies between 4 months and 9 years. That is why, among others, Commission wants to ensure that re-starters are treated on an equal footing with new start-ups, including in support schemes. In Hungary academics and policy makers very rarely take into consideration the possible support for re-starters, because they try to find out how to select between existing SMEs when working on theoretical approaches. Mainly in agriculture we can find extraordinary theories. Some policy makers say: There is no life under 5.000 hectares ! No wonder that less than 200 of agricultural companies get the vast majority of subsidies coming from the EU.

“*The EU and Member States* should design rules according to the “Think Small First” principle by taking into account SMEs’ characteristics when designing legislation, and simplify the existing regulatory environment.”

According to the Report from the Expert Group on “Models to Reduce the Disproportionate Regulatory burden on SMEs”, the most burden existing ensome constraint reported by SMEs is compliance with administrative regulations. It has been estimated that where a big company spends one euro per employee because of a regulatory duty, a small business might have to spend on average up to 10 euros. 36% of EU SMEs report that red tape has constrained their business activities over the past two years. To improve the regulatory environment in view of the “Think Small First” principle, the Commission decided to come forward with all the proposals to reduce the administrative burden on business which are necessary to achieve the EU reduction target of 25% by 2012. Unfortunately administrative burden is not measurable, although it sounds good for the public. In his presentation one of the officials of the Hungarian Academy of Sciences compared this attitude to the unrealistic plans of the former Soviet Union.

“*The EU and Member States* should make public administrations responsive to SME needs, making life as simple as possible for SMEs, notably by promoting e-government and one-stop-shop solutions.”

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Modern and responsive public administrations can make a major contribution to the success and growth of SMEs by saving them time and money and hence freeing resources for innovation and job creation.

In the Commission's opinion e-government and one-stop shops, in particular, have the potential to help improve service and reduce costs. They invited Member States to reduce the level of fees requested by the Member States' administrations for registering a business, taking inspiration from EU best performers and to continue to reduce the time required to set up a business to less than one week, where this has not yet been achieved. It seems to be one of the few areas where Hungarian authorities did much to achieve the EU goals. Registering new businesses became much quicker and fees were also reduced, but there is much to do for the competition of e-government procedures.

"The EU and Member States should facilitate SMEs' access to finance, in particular to risk capital, micro-credit and mezzanine finance and develop a legal and business environment supportive to timely payment in commercial transactions."

Small Business Act states that raising the right kind of finance can be a major difficulty for entrepreneurs and SMEs, and comes second after the administrative burden on the list of their concerns.

This is in spite of EU public support such as the Competitiveness and Innovation Framework Programme (CIP), which provides over €1 billion to support SMEs' access to finance, a substantial amount of it channelled via the EIB Group. By 2013, Cohesion Policy will provide some €27 billion explicitly dedicated to the support of SMEs. Around €10 billion will be contributed through financial engineering measures, including JEREMIE and some €3.1 billion through venture capital. The European Agricultural Fund for Rural Development also benefits SMEs as it promotes, among other things, entrepreneurship and encourages the economic diversification of rural areas.

The material emphasizes that risk aversion often makes investors and banks shy away from financing firms in their start-up and early expansion stages. Possible market failures in SME finance provision must be identified and corrected to further develop the European risk capital markets, to improve SMEs' access to micro-credit and mezzanine finance and to develop new products and services.

This is the field where EU Commission's approach differs greatly from the outcomes of my survey and my private opinion. Almost none of the entrepreneurs I asked would welcome risk capitalists. They know exactly that this solution is not for the favour of the entrepreneurs, but rather for the investors. Entrepreneurs would like to get simple loans at reasonable interest rates. It is also important that micro funds should not be created by international banks, but national or local banks.

“The EU and Member States should support and encourage SMEs to benefit from the growth of markets outside the EU, in particular through market-specific support and business training activities.”

Small Business Act considers the fact that only 8% of European SMEs report turnover from exports while 7% of micro-enterprises reported exports, which is significantly lower than the figure for large enterprises (28%) as a problem. Only 12% of the inputs of an average SME are purchased abroad.

As in many other cases this approach handles very different enterprises homogenously, and expects the same role and same way of thinking from micro and multinational companies. As it is well known from the business literature, to be able to export requires a certain size and power. Experiments of many authors say that companies have to have around one hundred employees for stable and competitive export ability. It's no use forcing the international turnover. The only reason, sorry to say, why it is worth pushing small enterprises to sell abroad is that within a short time even the good ones may become bankrupt while it is possible for the large companies to skim the profit.

“Fast-growing markets present untapped potential for many European SMEs. In particular, recent EU enlargements have created important new business opportunities for companies from both “old” and “new” Member States. This demonstrates the importance of fully exploiting the potential of market opportunities in the EU candidate and neighbourhood countries.”

From the “new” Member States side this picture is not so clear. The “old” member countries have a well established, long and uninterrupted tradition of market economy and most of them have much higher GDP/capita than the new ones. Their companies have the experience how to penetrate into foreign markets. In this situation the opportunities and the possible strategy of the firms coming from the old and new Member States are quite different. For example in the equity of the Hungarian SMEs the proportion of foreign capital is gradually growing from the date of our accession to the EU. It is also very easy to follow the basic tendencies as far as the division of labour between the companies of old and new Member States are concerned. Research and Development are done in the old Member States, capital and know-how are exported to the new members and assembling activities are done in these countries by making use of the low wages. This recipe is general and fits well into the direction of global movement of capital. It is important to state that not only large enterprises bring capital to the territory of new members, but SMEs are present on these markets with capital and with goods, too. From our SMEs point of view it seems to be crucial to show for the EU officials the above mentioned facts and be able to express their interests in coalition with the SME organizations and authorities of the new Member States. As it turned out from our analysis EU's policy for SMEs became more sophisticated in the last few years, but there are certain points where even more differential way of thinking and action is needed.

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