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MINISTRY  
FOR NATIONAL ECONOMY

# BE INNOVATIVE – GO INTERNATIONAL

Discussion Paper for the Informal Meeting of  
Ministers of Industry (Competitiveness Council)

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## Cover Picture:



**Litracon: Light Transmitting Concrete**  
**Litracon® products present the phenomenon of light transmitting concrete, available as widely applicable new building materials. The new material has been developed by Hungarian architect Áron Losonczi since 2001.**

The world's first commercially available transparent concrete, Litracon® is a combination of optical fibres and fine concrete. Due to the small size of the fibres, they blend into the concrete becoming a component of the material. In this manner, the result is not simply a mix of two materials - glass and concrete – but rather it is a third, new material, which is homogeneous in its inner structure and on its surfaces. Litracon® is a handmade product which provides an exceptional and unique pattern of light in each piece.

*Photo: Antal Szentendrei*

*Architect: Zoltán Bachman*

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## Preface

The potential of Europe to compete more effectively on a global stage is rooted in its ability to innovate and to internationalise those innovations: *be innovative – go international*. Innovation is the driving force behind a successful, progressive, growing economy, an economy which rises up from the financial crisis of recent years stronger and more competitive, able to respond to the opportunities and challenges of the 21<sup>st</sup> Century.

Small and medium sized enterprises (SMEs) have a vital role to play in this. SMEs are the backbone of the EU economy, creating jobs, shaping the local environment, catalysing community regeneration, and innovating. More than that, the successful, internationally competitive businesses of tomorrow are the small start-up enterprises of today.

But SMEs experience too many obstacles and challenges which inhibit their enterprise and initiative. Red tape is an on-going frustration, taking up undue time and resources. And the global economic downturn has highlighted the difficulties of SMEs in accessing finance. While the EU has recognised the key role of SMEs, this has not fully been followed through in policy and practice.

European countries and EU institutions are constructing a policy framework which will successfully tackle these obstacles and enable SMEs to “be innovative and go international”. The key areas which need to be dealt with are: *smart regulation* (to cut red tape and reduce administrative burdens), *finance* (optimising scales and scopes of policy), *internationalisation* (enhancing performance in international markets based on improved cooperation), and *governance*, such that the diversity and needs of SMEs are fully taken into account in policy.

It is by acting now and acting together that Europe can put in place the necessary foundations for SMEs to thrive, creating the prosperity that come from an internationally innovative and competitive economy.



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# 1 Introduction

It is clear that SMEs play a critical role in the European economy; at the same time there is considerable untapped potential for SMEs as innovators, in reaching international markets, and as drivers of economic growth. A primary aim for the EU therefore is to release this potential, and to create an enabling policy framework within which SMEs can thrive both within Europe and beyond, bringing innovations to market, and contributing to Europe's economic competitiveness.

SMEs are nimble, flexible and responsive economic actors. They are innovative, adapting quickly to new market opportunities and emerging market trends. In particular, SMEs are well placed to profit from current trends as markets become more personalised and localised, and as digital and green technologies become mainstream. But the lack of an asset base or track record makes **finance hard to access** and contracts hard to win. SMEs also experience the full weight of regulations and administration. **Dealing with red tape** is a greater burden than for larger companies; their transaction costs are higher; they are often isolated and lonely; and SME leaders are often committed and determined, but may lack core business skills. These are challenges where the EU and EU policies could make a real difference: supporting innovation; cutting red tape; and improving market conditions.

This chapter highlights the role of SMEs in Europe and goes on to outline the **Small Business Act** in Europe, its impact and its shortcomings. These form the basis for identifying **four main policy issues** if the EU is to better support SME innovation and internationalisation. These issues are then expanded on in the chapters of this publication. The final part presents a brief outline of the Hungarian SME sector and SME policy.

Many people and organisations contributed to this document. Special thanks are due to HBF Hungaricum Ltd, which provided organisational support and expertise, and to experts within the Hungarian administration, whose ideas were discussed and absorbed during this project.

## 1.1 European SME policy

EU policy puts SMEs centre stage. The **Europe 2020 Strategy** highlights the significance and potential of SMEs in strengthening Europe's economic competitiveness and growth. In particular the industrial competitiveness flagship initiative emphasised the importance of the sustained application of the **"Think Small First" principle** and the introduction of new initiatives to support SMEs competitiveness, such as access to eco-markets, fostering SME innovation, and ensuring that the right frameworks are in place to enable internationalisation.

**Table 1 – Highlighting the central role of SMEs in EU policy**

*“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.” (Small Business Act, 2008)*

*“At EU level, the Commission will work to improve the business environment, especially for SMEs, including through reducing the transaction costs of doing business in Europe, the promotion of clusters and improving affordable access to finance.” (Europe 2020)*

*“SMEs are keys to Europe’s competitiveness and have significant potential to create jobs.” (Strong Europe with a Human Touch: Strategic Framework, 2011. Hungarian Presidency of the Council of the EU)*

*“Small enterprises are the most sensitive of all to changes in the business environment. They are the first to suffer if weighed down with excessive bureaucracy. And they are the first to flourish from initiatives to cut red tape and reward success.” (European Charter for Small Enterprises, 2000. <http://ec.europa.eu/enterprise/policies/sme/best-practices/charter/>)*

In the European context the 2008 **Small Business Act** (SBA) has been the most significant policy in recent years. However, while the SBA has had some positive impact, its implementation has fallen short of creating the most conducive environment for SMEs, and there are a number of key issues which remain unresolved and require further action.

**Table 2 – Size matters**

According to the Europe in figures – EUROSTAT Yearbook 2010 - there were an estimated 20.2 million enterprises within the EU-27 non-financial business economy. Of those, approximately 43,000 were large-scale enterprises (LSEs). Hence, the vast majority (99.8 %) of enterprises in the EU are SMEs.

Small and medium-sized enterprises (with fewer than 250 employees) generated the majority of value added (56.9 %) and employed most (67.4 %) of the workforce in the non-financial business economy. Micro enterprises (those with fewer than 10 persons employed) played a particularly important role, providing employment to nearly as many persons as large enterprises.

### Small Business Act and its mid-term review

The Small Business Act for Europe (SBA) was introduced in June 2008, in recognition of the important role played by SMEs as providers of employment and as key players in local and regional regeneration. The SBA introduced **ten principles** to guide the conception and implementation of policies both at EU and Member State level, creating a comprehensive framework to ensure that SMEs operate with fewer obstacles and a more supportive environment. Perhaps most significant has been the principle of **“Think Small First”** which has raised the profile of SMEs across Europe.

**Table 3 – Action Plan of SBA**

The Competitiveness Council agreed in December 2008 on an **Action Plan** to guide the implementation of the SBA - Transforming intentions into actions – giving particular attention to the following priorities:

- improving **SMS access to finance**;
- enhancing **access to markets**, and;
- improving the **regulatory environment**.

In addition, the SBA provided for initiatives which have reduced the administrative burdens of public procurement, reduced the time and cost of setting up a company, established a new EU SME Centre in China, and have put SMEs at the core of innovation and research policy.

The 2011 **mid-term review of the SBA** assessed the implementation of the SBA, suggesting a set of new actions aiming to respond to the actual needs of SMEs operating in the current economic situation and ensuring development in line with the Europe 2020 Strategy. These will only be effective if based on **strong SME governance**, with business organisations in the front line. The implementation of the SBA is progressing, but there are further steps required to ensure that the aspirations of the European Commission, the Member States, and the entrepreneurs for sustainable future growth are met.

**Table 4 – Main proposals of the Mid-term Review of the SBA**

In the framework of the mid-term review of the SBA the following proposals were made:

- **smart regulation** to enable SMEs to concentrate on core business;
- improved access to **finance** to invest and grow;
- making full use of the **Single Market**;
- helping SMEs to **face a globalised market**;
- helping SMEs to contribute to a **resource-efficient economy**; and
- **promoting entrepreneurship**, job creation and inclusive growth.

## 1.2 Four main issues in SME policy

If SMEs in Europe are to be in a position to take full advantage of their strengths as innovators and their potential to internationalise, there are **four key issues** which must be addressed at both the EU and the Member State levels.

### *Smart regulation*

Reducing red tape and streamlining administrative processes are absolutely critical to the effectiveness of SMEs. Smart regulation has been developed in order to target these issues directly and pragmatically. The initiatives for smart regulations are organised around the SBA's "**Think Small First**" principle. Member States are especially encouraged to harness **SME tests** in order to improve the business environment. Other important factors are the '**only once**' principle, the role of **e-government**, and **one-stop-shop** solutions.

**Table 5 – Smart regulation: questions to consider**

- How should the reviewed SBA framework be constructed in order to support smart regulation goals and take SMEs' special needs into account at the same time?
- Which social, political, economic and administrative factors shape the optimal policy toolkit and institutional background?
- What steps will be needed in order to achieve smart regulation goals through the active involvement of the stakeholders?

### *Financing*

The challenges associated with the recent financial crisis (and the long recovery), accompanied by tightening credit conditions (especially for the more vulnerable SMEs), put special emphasis on the improvement of SME access to finance. The strengthening of loan guarantee schemes, a new legislative regime for venture capital funds and simplification are critical. SME-oriented rating mechanisms that include both qualitative and quantitative aspects need considering.

**Table 6 – Access to finance: questions to consider**

- Should the European level policy continue its returns to scale approach, or move toward a return to scope one?
- What is the optimum set of policy instruments regarding the provision of additional funding and the contribution of other regulatory tools?
- How can we best utilize local lender information to decrease their lending costs?



## Internationalisation

Assisting SMEs' access to global markets is an area where Community initiatives play a major role, especially given common borders with non-EU partners. Important issues include Commission proposals to increase SME access to **Trade Defence Instruments** (TDI), the further elimination of non-tariff barriers, and the potential contribution of **network-building** and clusters to SME internationalisation.

**Table 7 – Internationalisation of SMEs: questions to consider**

- What are the specific problems and demands of SMEs concerning trade policy measures? What are the possibilities for increasing their awareness with regard to these measures?
- What are the opportunities to improve the implementation of trade policy instruments so that the special needs of SMEs are reflected better?
- How can we increase SMEs' participation in making the European trade policy?
- What should be the priorities of cluster and network building from an internationalization perspective? How do specific types of clusters and business networks differ in this respect?

## Governance

The results achieved since the launch of the SBA suggest that governance needs improvement as well. In addition to the **annual competitiveness reports** that serve as a basis for peer review and exchange of good practices, the Commission is proposing to set up an **SBA Advisory Group** as well as launching an annual **SME Assembly**.

**Table 8 – Governance: questions to consider**

- How is it possible to find the best tools, measures for governance? What would be the elements of an optimal portfolio?
- What are the most appropriate ways of involving stakeholders that provides them with opportunities to contribute most to the implementation of the SBA?
- Considering individual tools of governance which approaches are best suited from the perspective of manager-leadership dilemma?

## 2 Smart Regulation

Smart regulation regarding SMEs refers to regulation that has a **minimal impact on the cost** of doing business and a **maximal impact on the ability of firms to attract investment**. To achieve these two main impacts, legislation might have the following characteristics:

- it must be **accountable** and predictable;
- it must operate within a **transparent** and fair system;
- it must be based on the close **co-operation** of government, industry, non-governmental organisations, international actors and local communities<sup>1</sup>;
- it should not cause unnecessary, unevenly burdensome or irritating costs and obligations.

Overall, the aim is to ensure that policies are effective in making the EU a more entrepreneur-friendly and competitive environment for SMEs. SMEs are therefore free to innovate, to compete effectively, to grow, and to internationalise.

### 2.1 Red tape and regulatory obstacles

SMEs experience a **disproportionate burden** from red tape and excess administration, which affects their performance and therefore their competitiveness. On average, where a big company spends one Euro per employee to comply with a regulatory duty a medium-sized enterprise might have to spend around four Euros and a small business up to ten Euros<sup>2</sup>. It takes each SME on average seven hours a week to comply with administrative tasks<sup>3</sup>.

**Table 9 – Reasons for the disproportionate distribution of regulatory costs**

- A large part of regulation results in **costs that are fixed** or do not change with the size of business. Filling in a form takes a certain amount of time, and it makes little difference whether the figures are for a larger business or a small enterprise.
- Larger businesses can employ specialists to deal with regulatory obligations more efficiently.
- In small enterprises the most valuable human resource, the entrepreneur himself, will often be responsible for the regulatory obligations.

1 Banigan, J.: "Smart regulation, smart governance: the federal government has set itself a daunting task with its smart regulation report, but there are signs it might be creating worthwhile change." CMA Management. (June-July 2005) [http://findarticles.com/p/articles/mi\\_hb6419/is\\_4\\_79/ai\\_n29208254/?tag=content;col1](http://findarticles.com/p/articles/mi_hb6419/is_4_79/ai_n29208254/?tag=content;col1)

2 Report of the Expert Group Think Small First – Considering SME interests in policy-making including the application of an 'SME Test'; European Commission Enterprise and Industry Directorate General (March 2009)

3 <http://euractiv.blogactiv.eu/2011/02/15/eu-must-reduce-administrative-burden-on-smes/>

**Table 10 – Classification of administrative expenses**

<b>Expenses of the state</b>	<b>Expenses of market impacts caused by the government</b>
All the charges incurred because of the regulatory and governing role of the state	<ul style="list-style-type: none"> <li>• transactions liabilities and their costs</li> <li>• regulatory conditions and requirements</li> <li>• providing controlling possibility</li> <li>• law enforcement, legal and financial security</li> </ul>
<b>Expenses of adaptation</b>	<b>Risk of non-transparent bureaucracy</b>
All of impacts related government regulations and operations which do not match the economic reality	<ul style="list-style-type: none"> <li>• loss of economic possibilities</li> <li>• loss of efficiency caused by deviance from reasonable and economical operation</li> <li>• irritating regulations</li> <li>• losses caused by the pressure of informal economic operation</li> </ul>
<b>Administrative expenditure</b>	<b>Burdens of government regulations which are unreasonable</b>
Time and manpower expended for the fulfilment of supplying of data assessed by the government	<ul style="list-style-type: none"> <li>• paperwork</li> <li>• bureaucracy</li> <li>• unnecessary supplying of data</li> <li>• procedures which shift off the responsibility</li> </ul>

## 2.2 Principles, tools<sup>4</sup> and best practices

A range of SME specific principles and measures have been developed which form the basis for smart regulation. Taken together, the intention is that these form a comprehensive framework for ensuring that SMEs do not experience any commercial disadvantages as a result of red tape and administrative obligations.

Smart regulation is obviously relevant generally across all fields of economic activity and in all EU legislation. Experts highlighted statistics and the internal market as suitable policy areas for the application of SME-specific measures. More problematic policy areas were deemed to be employment conditions, consumer and health protection, and occupational health and safety, where smart regulation would also need to ensure that the public interest was being met.

<sup>4</sup> For further more detailed information see: [http://ec.europa.eu/enterprise/policies/sme/small-business-act/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm)

### Think Small First principle<sup>5</sup>

This **core principle** implies that policy makers give full consideration to SMEs at the **early stages** of policy development. In fact, SMEs should be considered by public authorities as their “prime customers” as far as business regulation is concerned.

In the light of the “Think Small First” principle the following points should be considered during the legislative process:

- How will a business obtain the **information** it has to be passed on because of public administration?
- Will a small business be able to **comply with regulation** without external help/or at all?
- Will new investment be necessary (and can it be expected)?
- Will it be necessary to reorganize internal processes?

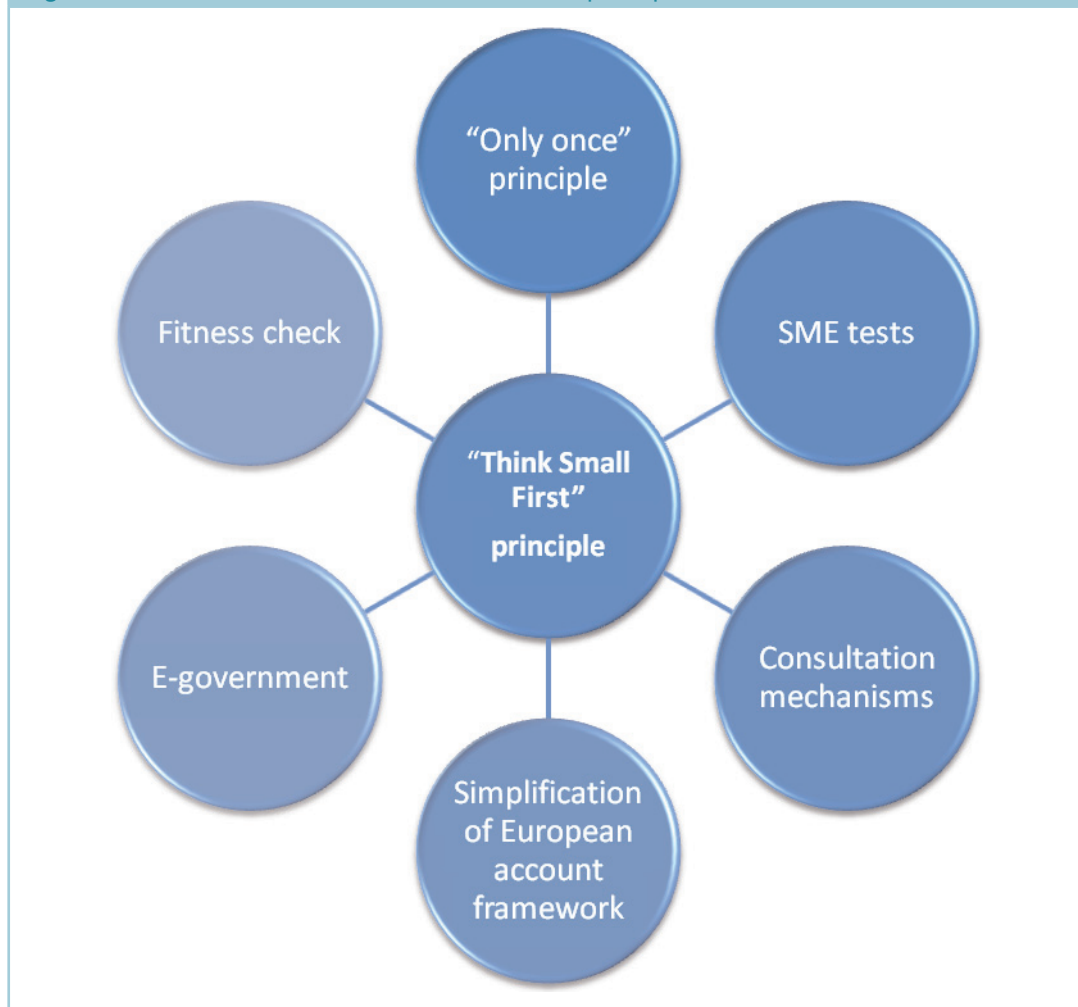
**Table 11 – “Think Small First” principle: best practice example**

The initiative<sup>6</sup> of the **Saxony’s Economy and Labour Ministry** in 2007 awarded the local authorities which were identified as small-business friendly. The authorities had to prove their SME-friendly manner with their own best practices. The project ensured that the local authorities pay a greater attention to the small business and find out their needs; moreover the authorities tailored their services to those needs. With this attitude the local authorities can attract firms actively, because they are considered as key players of the regional economy.

<sup>5</sup> [http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index_en.htm)

<sup>6</sup> [www.kommtest-sachsen.de](http://www.kommtest-sachsen.de)

**Figure 1** – Toolkit around the “Think Small First” principle



The “Think Small First” principle introduced by the Small Business Act proved to be a very fruitful idea. During the past years a wide arsenal of tools have been explored and introduced both at the EU-level and Member State level. Using **synergies** between these tools can lead to a significant **paradigm shift** that creates a favourable environment for small businesses to flourish.



### “Only once” principle

“Only once” principle means that public authorities and administrative bodies should refrain from requesting information, data, documents or certificates which have already been made available to them in the context of other procedures<sup>7</sup>. This is central to the idea of the “one stop shop”.

**Table 12 – Only once principle: best practice example**

The aim of the **Belgian** project<sup>8</sup> was to cut red tape by setting up an electronic data system, which ensures the opportunity to collect the documents for the calculation of social security contributions and of all salary and working time related social security benefits from the employers only once. There are only four events when the data collection can occur: the beginning of an employment relationship, the three-monthly payments of social security contributions, the occurrence of a social risk and the end of an employment relationship. Another advantage of the system is that all actors can reach their own database and exchange electronic messages. The replacement of 190 types of documents was successful and about 500 million messages were exchanged through the online system.

### “One stop shop”

“One stop shop” is a tangible expression of the “only once” principle. Creating a **single point of contact** where small businesses can properly deal with all of their administrative and bureaucratic tasks is one of the most widely known forms of the realisation of this principle. Its advantages are clear: **it reduces significantly the transactions costs** of small businesses and provides a clear picture of the administrative requirements of different offices. In particular, start-ups can benefit from “one stop shops”.

**Table 13 – One stop shop: best practice examples**

One of the best practices concerning one-stop-shop solutions is the **German** method<sup>9</sup> which allows the start-ups to complete all formalities at one site. The database saves all inputs and fills in the other required forms, so the correct completion and submission of registration forms is guaranteed. The submission can be realized by post or via an EDP interface. With this solution the enterprises save time and bureaucratic expenditure. There is more than 150 entrepreneurs who have already used this service to set up their business.

Another initiative<sup>10</sup> for the support of starting a business was realized in **Italy**. It puts the emphasis on the procedures related to the opening, life and closing of production facilities. Because of the complexity of the procedure, the city governments collected all required forms, information and permits from the authorities involved. With this measure the charges and time of start-ups is reduced, moreover, the relation between the entrepreneurs and the government became simpler. The numbers also prove this. The time for procedure completion for individual enterprises was reduced from 16 to 1 day and the charges from €1,150 to €340.

<sup>7</sup> See above.

<sup>8</sup> [www.ksz-bcss.fgov.be](http://www.ksz-bcss.fgov.be)

<sup>9</sup> [www.one-stop-shop-trier.de](http://www.one-stop-shop-trier.de)

<sup>10</sup> [www.sportelloimpresa.it](http://www.sportelloimpresa.it); [www.formez.it](http://www.formez.it)

### SME tests<sup>11</sup>

SME tests are a special form of **impact assessment** that determine whether SMEs are disproportionately affected or disadvantaged by public policies compared to large companies and, if so, what options should be made available to help SMEs. Relevant steps are:

- **Consultation** with SMEs' representatives,
- **Preliminary assessment** of businesses likely to be affected,
- Measurement of the impact on SMEs, and
- Assessing alternative options and mitigating measures.

### Fitness check<sup>12</sup>

Fitness check is a **comprehensive policy evaluation** assessing whether the regulatory framework for a policy sector is fit for purpose. Their aim is to **identify excessive administrative burdens**, overlaps, gaps, inconsistencies and/or obsolete measures which may have appeared over time, and to help to identify the cumulative impact of legislation. Their findings will serve as a **basis for drawing policy conclusions** on the future of the relevant regulatory framework<sup>13</sup>.

#### Table 14 – Fitness check: best practice example

The **Danish Burden Hunter Programme**<sup>14</sup> has helped the government understand better what is particularly burdensome for companies and led to the identification of a number of new initiatives to cut red tape. The programme involves sending officials to visit companies and interview them on which burdens they find most frustrating and unnecessary<sup>15</sup>.

### Consultation mechanisms<sup>16</sup>

These mechanisms include **mandatory consultation periods and processes**, consultations of business associations, consultation databases, and public consultation websites which enable the early involvement of stakeholders.

11 [http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index\\_en.htm#h2-3](http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index_en.htm#h2-3)

12 [http://ec.europa.eu/dgs/secretariat\\_general/evaluation/docs/fitness\\_check\\_en.pdf](http://ec.europa.eu/dgs/secretariat_general/evaluation/docs/fitness_check_en.pdf)

13 Commission Work Programme 2010 : "Time to act" - COM(2010)135 (21 March 2010); Commission communication on Smart Regulation in the European Union - COM(2010)543 (8 October 2010)

14 [http://www.eogs.dk/graphics/Regelforenkling/The\\_burden-hunting\\_technique.pdf](http://www.eogs.dk/graphics/Regelforenkling/The_burden-hunting_technique.pdf)

15 Small Business Act 2010 Implementation Survey

16 [http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index\\_en.htm#h2-5](http://ec.europa.eu/enterprise/policies/sme/small-business-act/think-small-first/index_en.htm#h2-5)

## E-government

E-government is defined as government use of information communication technologies to offer citizens and businesses the opportunity to **interact and conduct business with government by using different electronic media**. It is about how government organises itself: its administration, rules, regulations and frameworks set out to carry out service delivery and to co-ordinate, communicate and integrate processes<sup>17</sup>.

**Table 15 – E-government: best practice example**

The need for a faster and easier on-line government service for SMEs was recognised and an e-portal supported by the adopted new technologies was set up by the **Greek Ministry of Development**<sup>18</sup>. The portal meets the information and submission needs of SMEs. The site informs investors of the procedures for submitting on-line a business plan and required documentation. The website is supported by a central on-line information help-desk, which replies to SMEs' requests within 3 days. More than 3,000 SMEs have already used the portal.

## Simplification of European account framework<sup>19</sup>

Simplification of European account framework means that the **administration surrounding the preparation of financial statements should be reduced**. This could be achieved through introducing new more relevant rules to replace older, more complex or burdensome requirements<sup>20</sup>. As for SMEs, a major step would be combining reporting for different purposes (such as tax, statistics, social security, employment reporting) at Member State-level and creating exemption or reduced obligations according to the size and the inherent characteristics of smaller enterprises, thereby reducing the overall burden of keeping different accounting and reporting systems.

## 2.3 Challenges and priorities for smart regulation policy

While the EU sets the objectives and a general framework for improving the business environment of SMEs, the actual implementation takes place at the level of the Member States. In practice, the implementation of SME policies across Europe is **fragmented and inconsistent**. The mid-term review of the SBA emphasised the need to strengthen the commitment of the EU and the Member States to smart regulation and to the comprehensive implementation of the principles. Across the EU and the Member States the following priorities were identified:

- **the need to reduce administrative burdens** in connection with cross-border business;
- **completing the integration of the SME test** into the national legislation processes of all Member States;

17 Almarabeh, Tamara and Amer AbuAli "A General Framework for E-Government: Definition Maturity Challenges, Opportunities, and Success", (2010), European Journal of Scientific Research, Vol.39 No.1: 29-42; <http://www.eurojournals.com/ejsr.htm>

18 [www.ggb.gr](http://www.ggb.gr); [www.ypan.gr](http://www.ypan.gr)

19 [http://ec.europa.eu/internal\\_market/accounting/sme\\_accounting/index\\_en.htm](http://ec.europa.eu/internal_market/accounting/sme_accounting/index_en.htm)

20 European Commission Internal Market and Services DG : Free movement of capital, company law and corporate governance (MARKT/F3/AD/KnT/UL D(2006))

- **bankruptcy procedures** require greater harmonisation;
- **distinctions between different types of SMEs are critical**, especially between micro-small (up to 10 employees) and medium enterprises (up to 250 employees).

### Challenges at the EU level

It is evident in the EU's approach that SME specific measures are not universally understood or applied, in some cases at the most basic level.

- The first problem is the definition of what constitutes an SME, and therefore which businesses should be subject to SME measures.
- Second, there has been a lack of coherence in terms of which SME measures are applied to particular policy areas, and which measures are used to tackle particular types of compliance or administrative burden.

**Table 16 – Challenges of smart regulation at EU-level**

Improving smart regulation and implementing its toolkit at European level require further decisive steps, among them:

- introducing **proper consultation processes**, which take account of the specific needs of SMEs;
- introducing **review processes** which could help assess to what extent SME specific legislative measures are effective;
- **"SME tests"**, assessing impact of new legislation on SMEs, have become an integral element of the Commission's legislative process. However, these tests are then not followed through when amendments are made<sup>21</sup>.
- ensuring a common interpretation of law by making the language of legal acts as simple and as comprehensible as possible, clearly informing affected parties of all their rights and obligations, and providing quality preparatory documents to stakeholders.

Overall, the comprehensive application of the "Think Small First" principle would be a starting point for achieving more consistent implementation of smart regulation across EU policy areas, and would be a major step forward. In addition, the dissemination of good practice and lessons learnt could help even out inconsistencies and contribute to improving the environment for European SMEs.

<sup>21</sup> European Court of Auditors; Special Report: Impact Assessments in the EU institutions

### Challenges at the Member States level

All the Member States declared themselves committed to the goals of smart regulation and recognised the policy goals as useful and worthwhile. However, only a **patchy implementation** can be observed at the Member State level. These challenges are reflected both in **legislative issues** and in the **implementation** of smart regulation.

**Table 17 – Challenges in legislation and implementation of smart regulation principles at Member States level**

Legislative challenges	Implementation challenges
The “one size” principle should be considered as a starting point at all levels of legislation.	Lack of clarity as to how Member States can operationalise SME-specific measures.
Improving the quality of policy design and legislation preparation.	The institutionalized ex-post evaluation regarding EU legislation and national regulation is mostly missing on the national level.
The overall objective of reducing administrative burdens is clear, but new legislation has tended not to contain specific measures and guidance on how to achieve this.	Information on developments regarding the implementation should be made transparent and available for the enterprises.
All SME-specific measures cannot be applied across all policy areas, and it must be carefully considered which measures are most effective for which policy areas.	E-government solutions should be realized by the Member States, especially given that the technology exists and many e-government procedures are routinely in operation.
Only every second Member State incorporated the SME Test into its impact assessment procedure, and even when those tests are applied their quality is not always satisfactory <sup>22</sup> .	The evaluation of already implemented SME-specific measures/projects is needed.

<sup>22</sup> Small Business Act 2010 Implementation Survey



### The role of national administrative systems

The Member States' different approaches, and the differences in legal systems and law-making also have an important impact on the implementation of SME-specific measures. Despite these differences there are some common problems Member States face when deploying the smart regulation toolkit:

- **Administration is naturally biased toward minimising risk** and not toward simplification.
- Interested administrative branches have strong tools to block business friendly red tape cutting initiatives.
- General interests of business community are not always well represented in the administrative and legislative processes because business groups frequently opt for advantages and exemptions instead of general streamlining of public activities.
- Modification of administrative procedures frequently needs too much attention and time of political leaders and offers only unknown future benefits.
- Active participation of the stakeholders is needed for a functional system.
- Some SME-friendly measures require a degree of being proactive on the part of businesses, therefore awareness-raising is important in order to ensure that SMEs are aware of the measures available to them.

## 2.4 Main points for discussion

**Table 18 – Smart regulation: questions to be addressed**

Given the challenges faced by SMEs in dealing with red tape, and the difficulties in implementing smart regulations at both the EU and national levels, the following questions are posed:

- How should the new SBA framework be constructed in order to support smart regulation goals and take SMEs' needs into account?
- Which political, economic, social and administrative factors shape the optimal policy toolkit and institutional background?
- What steps are needed in order to achieve smart regulation goals through the active involvement of the stakeholders?

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## 3 Finance

Small and medium-sized enterprises are the backbone of Europe's economy. And to operate to their full capacity, SMEs need to access the right kind of finance and investment, at the right time, with the right conditions attached. The finance needs to be appropriate to the size, asset base, administrative capacities, and ambitions of SMEs. Improving access to finance for SMEs has taken on a new priority in the light of the **recent financial crisis**, the on-going recovery, and the accompanying tightening of credit conditions.

### 3.1 Challenges to accessing finance

SMEs experience particular challenges in accessing finance because of their smaller size, their **lack of a track record**, and their lower creditworthiness when compared with larger companies. SME finance policies should focus on defining policy toolkits that mitigate and account for the different circumstances, strengths, and needs of SMEs.

- At **different stages** of business development, SMEs and financial institutions face different risks and have different information requirements.
- The formal financial system generally either does not provide the necessary funding or provides it at a much higher cost, making finance either unavailable or unaffordable to most SMEs.
- **Due to the higher risks associated with SMEs**, they face higher credit costs than larger firms.

### 3.2 Policy considerations for SME financing

The first steps of an SME entering a market, and then moving forward on a path of expansion and growth, are extremely demanding and a **supportive policy framework** can make the difference between success and failure. Enterprises at **different stages of development** have different needs and constraints regarding financing. These differences have to be taken into account by programmes supporting access to finance for SMEs. An appropriate **policy portfolio**, providing optimal measures supporting the SME sector should be shaped by:

- the **size and sectoral structure** of SMEs,
- the **local legislative, social and economic conditions**, and
- key political goals and challenges.

In addition, administrative and financial steps to support SMEs should include the tools to **improve the business environment** for both innovative companies with significant growth potential, and less dynamic small firms which provide the bulk of employment.

### *Start-up phase*

During the start-up stage, **firm survival** is the primary, if not only, consideration for entrepreneurs. At this stage they usually hold a largely undiversified portfolio, have secured bank loans against personal assets, and enjoy sizeable private benefits of control. **Information asymmetries** between firm-insiders, i.e. the entrepreneur, and outside financiers are large, as no historical information is available on newly established ventures. These firms lack a prior financial and operating history. Moreover, start-up firms do not have a reputation at stake that can reduce asymmetric information and moral hazard concerns.

### *Early growth*

In the first few years after start-up entrepreneurs may have **incentives to boost** short-term profitability, when information asymmetries are large. These incentives are likely to rise with the firm's debt ratio, as the probability of default tends to increase with leverage because of higher interest payments and capital instalments.<sup>23</sup>

### *Innovation and expansion*

In too many cases, insufficient credit is available for sound or "bankable" propositions.<sup>24</sup> In particular, new and **technology-based enterprises** with innovative propositions often fail to raise the finance they need, as market intelligence is limited and asymmetric information is more acute.

### *Alternative legal forms*

There are SMEs which adopt **non-traditional business models** including foundations, co-operatives, mutual societies, social enterprise, and similar legal forms. These may be unfamiliar to traditional financing bodies.

## **3.3 Best practice examples in Europe**

### *Credit mediation in France*

Credit mediation was set up in November 2008 in order to assist SMEs resolve their liquidity problems by maintaining or obtaining credit. To start the process the enterprise must establish a "mediation file" on the website of the **Credit Mediator** who has been appointed at the national level to coordinate and act as a final "**referee**". He is assisted by departmental mediators who are the regional directors of the Bank of France. After the file is received, the banks are notified by mail and they have five business days to reply to the enterprise. After this, the departmental mediator has five business days to review the file and indicate how the file should be treated. When the mediator has identified solutions, the enterprise is notified by mail. If the enterprise is not satisfied, it may appeal to the national mediator.

<sup>23</sup> <http://www.suerf.org/download/studies/study20093.pdf>, 27.

<sup>24</sup> Stiglitz, J. and A. Weiss. "Incentive Effects of Terminations: Applications to the Credit and Labour Markets," (1983) American Economic Review 73, 912-27.

**Table 19 – Access to finance for SMEs: best practice example from France**

In France credit mediation has proved to be a very successful tool for solving the financial problems of SMEs, in particular during the first wave of the credit crunch. At the heyday of credit crunch, between November 2008 and February 2009:

- 8,000 enterprises were seen by credit mediators;
- 90% are SMEs with less than 50 employees;
- the main cause of referral to the mediator was the need for short-term credit (69% of referrals);
- the rate of successful mediation within 15 days is 66%;
- 60,000 jobs were preserved.<sup>25</sup>

### *Széchenyi Card, the SME Credit Card Program in Hungary*

Based on the outlining principles of the European Union, and understanding the problems of micro, small and medium enterprises a special financial tool was created in 2002 to help the SME sector to access finance. This tool is the **SME-oriented special credit**, the Széchenyi Card, which is a credit arrangement with loans at **state supported preferential interest rates**. The card is offered in an easy way, free of bureaucracy. Loans from 0.5 million HUF up to a maximum of 25 million HUF can be requested **without collateral**, with owners guaranteeing deposits.

<sup>25</sup> "The impact of the global crisis on SME and entrepreneurship financing and policy responses", OECD, (May 2009).

**Table 20 – Access to finance for SMEs: best practice example from Hungary**

In order to respond to the global financial crisis the **new government** that took office in June 2010 immediately re-launched the Széchenyi Card Programme. The widening of the programme addressed the two most acute problems facing Hungarian SMEs: lack of resources for development, and lack of sufficient applicants' own capital needed for EU tenders. Hence, the following measures have been introduced:

- providing private businesses with **investment credits** up to a maximum of 50 million HUF;
- providing **applicants' own capital credit** allowing SMEs to apply for a maximum of 50 million HUF<sup>26</sup>; and
- extending the Széchenyi Card Program to family farms.

The Széchenyi Card Programme has an impressive track record:

- From the beginning of the programme in 2002, 179,000 Széchenyi Cards have been handed over;
- 786 billion HUF distributed to SMEs in 8 years time;
- 300 offices and 1,700 branches (75% of the Hungarian bank sector) were involved in the financing of SMEs.

### *Creation and extension of loans and guarantee schemes for SMEs in the United Kingdom*

Through the **Enterprise Finance Guarantee Scheme**, the government will guarantee lending by commercial banks to viable businesses to ensure that they can get the working capital and investment that they need. This £1.3bn scheme will support bank lending, from 3 months to 10 year maturity, to UK businesses with a turnover of up to £25 million which are currently not in a position to easily access the finance they need. It will enable them to secure loans of between £1,000 and £1 million. In addition the UK set up a **Working Capital Scheme** in direct response to the constraint on bank lending to ordinary-risk businesses with a turnover of up to £500m a year. The Government will provide banks with guarantees covering 50 per cent of the risk on existing and new working capital portfolios worth up to £20bn.

### *Long-term investment in Spain*

Instituto de Credito Oficial grants credits on preferential terms to self-employed and entrepreneurs to launch new businesses and may finance up to 90% of investments in new productive assets. The same institution also supports extension projects of SMEs by financing up to 80% of new productive assets - the programme is endowed with € 600 million.

<sup>26</sup> [http://www.kim.gov.hu/english/activities/briefing/en\\_20100818.html](http://www.kim.gov.hu/english/activities/briefing/en_20100818.html)



### 3.4 Policy and practices in the EU

#### Access to funding

The EU has adopted a wide range of policies and practices aimed at improving the financing of SMEs.

**Table 21 – Access to finance for SMEs**

Financial solutions and supports for SMEs provided by the European Union embrace a **growing number of instruments**, such as

- High Growth and Innovative SME Facility (GIF),
- JASMINE (Joint Action to Supply Micro-finance Institutions in Europe),
- European Progress Microfinance Facility,
- Risk Sharing Finance Facility (RSFF),
- European Investment Bank European Investment Fund, and
- JEREMIE (Joint European Resources for Micro to Medium Enterprises).

#### High Growth and Innovative SME Facility (GIF),

High Growth and Innovative SME Facility (GIF) operates within the **Competitiveness and Innovation Framework Programme (CIP)**, contributes to the establishment and financing of SMEs and reduces the lack of equity capital in the markets. GIF is operated by the European Investment Fund (EIF) on behalf of the European Commission. **It provides risk capital for innovative SMEs** in their early stages (GIF1), as well as for SMEs with high growth potential in their expansion phase (GIF2). A part (more than €160 million) of the overall budget of this facility is specifically earmarked for the support of eco-innovation oriented investment funds.

#### JASMINE

The **Joint Action to Supply Micro-finance Institutions in Europe (JASMINE)** is an initiative which seeks to improve access to finance for small businesses and for **socially excluded people**, also ethnic minorities, who want to become self-employed. JASMINE's purpose is to help **non-bank micro-credit** providers or microfinance institutions, reach high standards and become convincing partners on the micro-credit scene. In the longer term, JASMINE seeks to improve the situation in the micro-credit sector and to develop a financial environment where banks and non-bank lenders would work in partnership on micro-credit issues and complement each other in economically sustainable conditions. Two instruments are being made available on behalf of the Commission to both banks and non-banks to increase the loan offer by the EIF: guarantees (€25m) and equity/loans (up to €225m) by means of a Specialised Investment Fund (SIF).<sup>27</sup>

<sup>27</sup> [http://ec.europa.eu/regional\\_policy/sources/docgener/presenta/jasmine/microcredit2010\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docgener/presenta/jasmine/microcredit2010_en.pdf), 5-7.

### *European Progress Microfinance Facility*

The European Progress Microfinance Facility was established by the European Commission. It provides **microcredit to small businesses** and to people who have lost their jobs and want to start their own small businesses. It aims at easing access to finance for people who want to start up or further develop their own business but have difficulties in accessing banking loans. An initial budget of €100 million is expected to leverage to a total amount of €500 million in micro-credit. This will be realised in cooperation with the European Investment Bank (EIB) Group and expected to result in around 45,000 loans over a period of up to eight years.<sup>28</sup>

### *Risk Sharing Finance Facility (RSFF)*

This instrument was set up by the European Commission and the European Investment Bank. RSFF is an innovative scheme to improve **access to debt financing** for private companies or public institutions promoting activities in the field of RDI. RSFF is built on the principle of credit risk sharing between the European Community and the EIB and extends therefore the ability of the Bank to provide loans or guarantees for investment with a higher risk and reward profile. The RSFF has a €2bn capital cushion, €1bn from the EIB and the same amount from the Commission's 7<sup>th</sup> Research Framework Programme (2007-2013), enabling the Bank to lend more than €10bn for this kind of investment.

### *European Investment Bank / European Investment Fund*

European Investment Bank / European Investment Fund also have lending and investment programmes that can benefit small businesses. These programmes can be accessed via financial institutions in the Member States. In 2009, the EIB made €12.7bn available in credit lines to intermediary banks for on-lending to small businesses.

### *JEREMIE*

The **Joint European Resources for Micro to Medium Enterprises** (JEREMI) promotes increased access to **finance for the development of SMEs at regional** level through the Structural Funds. It operates as a toolbox of financial instruments that enables regions to set up targeted financial actions in favour of SMEs. Under the JEREMIE initiative, national and regional authorities can opt to deploy money made available by the ERDF in the form of market-driven financial instruments, instead of offering grants.

In addition to these instruments the **Cohesion Policy** plays a decisive role in funding of SMEs. In the framework of Cohesion Policy during the planning period from 2007 to 2013 some €55 billion are being invested in the field of business support – half of this allocation (€27 billion) is specifically dedicated to SMEs. 65% of SME funding supports technology and innovation investments (modernisation of machinery, process innovation etc.), while 35% supports eco-friendly SMEs, ICT in SMEs and innovative start-ups.

<sup>28</sup> <http://ec.europa.eu/social/main.jsp?langId=en&catId=836>

## Venture Capital Markets

**The European venture capital industry is much more integrated than previously believed.** It also has significant links to the US, and is increasingly emulating US investment practices. However, some aspects remain distinctively European, such as the prominence of banks and corporations as investors. Bank venture capital firms have different investment styles compared to other corporate investors. They are less likely to invest in early-stage deals, and they are less likely to monitor the invested companies or to sit on the board of directors.

**Table 22 – Venture Capital in Europe**

It is often believed that European venture capitalists are purely local investors who do not venture beyond their country borders. The Survey of **European Venture Capital Study** disproves this belief, showing that the European venture capital market is surprisingly integrated.

- 27% of all venture firms in the sample have a secondary office in a foreign country.
- 25% of all venture capital firms have partners that come from another country.
- 24% of investments are made in foreign companies.
- The proportion of deals with foreign investors is particularly high in industries such as in financial services (42%), media and entertainment (34%), and telecommunications (31%).
- The US is by far the most popular destination for foreign investments, accounting for almost a third of all foreign deals. In fact, the links between the European and US venture capital markets are multi-faceted, for example, as many as 34% of all European venture capitalists have work experience in the US.

Despite these strengths, **venture capital markets in Europe need to be enhanced** if they are to serve SMEs well. The average financial returns to venture capital investors in early stage European technology companies have for many years been much lower than other asset classes. As a result very few professional fund managers have been prepared to invest in such early stage ventures, and venture capital fund sizes are often below the critical mass needed for investment efficiency. Hence one of the European Commission's goals has become the development of a much stronger European venture capital industry as a crucial step to foster entrepreneurship, competition, innovation and growth.<sup>29</sup>

<sup>29</sup> [http://bmf.hu/users/vecseya/RePEc/pkk/sfyr07/Kovacs\\_Balazs.pdf](http://bmf.hu/users/vecseya/RePEc/pkk/sfyr07/Kovacs_Balazs.pdf)

### 3.5 Main points for discussion

Although **many of the European policy instruments are designed to ensure the optimum level of returns to scale**, and to reach as many SMEs as possible, we must take into account the rich diversity of these enterprises. They are at different stages of development, face different industrial or local problems, therefore the policy instruments should be equally diverse in serving them.

- Thus, the main question is whether the European level policy should continue its returns to **scale** approach, or move toward a return to **scope** one?

Many of **the policy instruments are dedicated toward increasing the supply of funding**.

- Most of the European instruments are geared toward two very special groups: either fast growing, high potential – often research intensive - start-up companies, “**gazelles**” in the form of venture capitals; or toward underprivileged entrepreneurs, leaving unemployment behind, in the form of microcredit solutions.
- However, it is not clear, what is the optimum set of policy instruments versus other regulatory tools, easing the transaction costs and financial risks of the smaller businesses.

Often **small enterprises are deeply embedded in their local community** – which is the case especially in the rural environment. However, this “face-value” information is not mirrored in the credit rating practices. Is there any way to utilize this social information, which would ensure a more balanced regional development?

**Table 23 – Access to finance: questions to be addressed**

Given the challenges faced by SMEs in straggling for access to finance the following questions are to be considered:

- Should European level policy continue its returns to scale approach, or move toward returns to scope one?
- What is the optimum set of policy instruments regarding the provision of additional funding versus other regulatory tools?
- How can we draw on local assurances to decrease lending costs of financing bodies?

## 4 Internationalisation

According to an EC study<sup>30</sup>, SME Internationalisation has many significant positive effects on the competitiveness of the European economies:

- International SMEs create more jobs. Internationally active SMEs report an employment growth of 7% versus only 1% for SMEs without any international activities.
- International SMEs are more innovative. 26% of internationally active SMEs introduced products or services that were new for their sector in their country; for other SMEs this is only 8%.
- **Public support goes largely un-noticed.** Only 16% of SMEs are aware of public support programmes for internationalisation and only a small number of SMEs use public support.
- European SMEs are more internationally active than US and Japanese SMEs. Overall, European firms are more active than their counterparts in Japan or the US. Even if only extra EU exports are considered they still perform better.
- Most often SMEs start international activities by importing. SMEs that both import and export started with import twice as often (39%) as with exports (18%).

### 4.1 Barriers to internationalisation

Despite the strengths of European SMEs in international markets, SMEs experience a number of challenges in accessing these markets and need assistance in two key priority areas:

- **Trade policy instruments (non-tariff barriers and trade defence instruments)** must be made more SME friendly, and their implementation must reflect the specific needs of SMEs. At the same time, awareness and understanding of trade policy among SMEs must be raised, and the participation of SMEs in policy-making processes must be broadened.
- **Cluster development and network-building policies** must improve access for SMEs and include SME specific instruments, so that SMEs can benefit from enhanced cooperation when accessing international markets.

### 4.2 EU priorities and policies on international trade

The EU has developed a raft of policies to further its commitment to **free and fair trade** both within the Europe and internationally. The three areas of policy are:

- tackling **non-tariff barriers**;
- **trade defence instruments**; and
- globally competitive **clusters and networks**.

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<sup>30</sup> [http://ec.europa.eu/enterprise/policies/sme/market-access/internationalisation/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/market-access/internationalisation/index_en.htm)



### *Tackling non-tariff barriers*

In November 2010 the European Commission issued a Communication on the EU's new trade policy, under the title "**Trade, Growth and World Affairs: trade policy as a core component of the EU's 2020 strategy**". As the title suggests trade policy aims to support European competitiveness give particular priority to SMEs.

### *Trade related regulatory measures*

In the field of international trade, multilateral liberalisation in the GATT/WTO framework and the **proliferation of bilateral and regional free trade agreements** substantially reduced the importance of tariffs. Hence, the significance of trade related regulatory measures which may constitute barriers to the international flow of goods, services and investments have greatly increased. The latter, referred to as **technical barriers to trade** (TBTs) have emerged as a central concern for the trade barrier discussions, as in many of the cases, they have a great impact on market opportunities for exporting enterprises.

### *Non-tariff barriers*

Non-tariff barriers to trade are of special significance from the perspective of SMEs. **Complying with differences in laws and regulations**, or the absence of common standards or mutual recognition, often constitute important additional business costs. Thus, reducing or eliminating regulatory barriers to trade are especially important for European SME policy.

### *Market Access Strategy*

The EU Market Access Strategy implemented by the European Commission in close cooperation with Member States and the business community intends to ensure that trade opportunities created through multilateral and bilateral negotiations are translated into real market access for European exporters. The pillars of the strategy are the **Market Access Database** and the **Market Access Partnership**. This partnership with Member States and business led to the creation of local market access teams in third countries that focus on the removal of key trade barriers.

### *Trade Defence Instruments*

While the EU is committed to open trade, it expects fair conditions for competition between domestic and foreign producers. In case of market distortions or disruptions EU Trade Defence Instruments are applied, conforming to WTO rules, to **protect the European markets from unfair trade practices**. Actions against dumped or subsidized imports may be taken under strict conditions and procedures to the extent they are necessary to remedy the injury or threat. The application of the Community interest test during trade defence procedures is to ensure that appropriate account is taken of all economic interests – including: the domestic producers, the importers, European industries using the imported product, and, where relevant, the end consumer.

### Strategy for Globally Competitive Clusters and Networks

Clusters are powerful engines of economic development and drivers of innovation in the European Union. They provide a fertile business environment for companies, especially SMEs, to collaborate with research institutions, suppliers, customers and competitors located in the same geographical area.

**Table 24 – Supporting Globally Competitive Clusters and Networks**

The European Commission assures possibilities for European clusters and networks for cluster development and to become world-class clusters through two of its programmes:

- **South East Europe Transnational Programme** (3rd call for proposal, Priority 1.: Policy Learning Mechanisms in Support of Cluster Development<sup>31</sup>). Its overall objectives are to foster European cluster cooperation in view of internationalisation strategies outside Europe, by building upon and further developing successful support schemes already implemented in some Member State.
- **Grant Programme 2011** (by EC Enterprise & Industry Directorate General: Promotion and development of world-class clusters in Europe<sup>32</sup>). This call consists of two strands: Promoting international cluster activities in the EU, and Promoting excellence of cluster management in the EU.

Even though most actors involved in clusters are interested in learning from and developing concrete activities with partners in other geographical locations internationally, **there are few examples of systematic strategies** and structured activities at the organisational level aimed at fostering international cluster cooperation.

Following the adoption of the 2008 Commission Communication “**Towards world-class clusters in the European Union: Implementing the broad-based innovation strategy**” the concept of world-class clusters has gained a lot of interest, political acceptance and widespread support from stakeholders.

In its conceptual framework paper, the **Belgian Presidency** called for enhancing “the networking on European level of innovative clusters” and putting in place “pooling facilities to access resources, to exchange best practices, to professionalise the management of clusters”.

<sup>31</sup> [http://www.southeast-europe.net/en/downloads\\_section/calls/third\\_call/](http://www.southeast-europe.net/en/downloads_section/calls/third_call/)

<sup>32</sup> [http://ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item\\_id=4968&lang=en&tpa=0&displayType=fo&ref=newsbytheme%2Ecfm%3Flang%3Den%26displayType%3Dfo%26fosubtype%3Dp%26tpa%3D0%26period%3Dlatest%26month%3D%26page%3D1](http://ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item_id=4968&lang=en&tpa=0&displayType=fo&ref=newsbytheme%2Ecfm%3Flang%3Den%26displayType%3Dfo%26fosubtype%3Dp%26tpa%3D0%26period%3Dlatest%26month%3D%26page%3D1)

## 4.3 Main points for discussion

### Trade policy

Formulation of trade policy focuses on the dominant actors and dominant issues of international economic relations. On the one hand, SMEs have a relatively small role in these matters, and on the other, trade issues are crucial only for a minority of SMEs. This situation presents us with a dual task.

- First, to raise **awareness and understanding among SMEs** of existing opportunities for involvement in the formulation of trade policies. Upgrading and expanding the channels and tools of information and interaction is a key element in that respect.
- Second, to achieve a **more intensive involvement of SMEs in policy implementation** through improving the procedures in a manner that would be more receptive to their specific problems and demands. Concerns related to the legal complexity and the cost element of proceedings, in particular in trade defence investigations should be addressed.

### Reputation building

The role of clusters and networks in building international reputations are a critical part of economic policy, though have received little attention in recent years. Establishing a good reputation and a brand profile in foreign markets is as important as ensuring that labour, production, marketing, and distribution are geared up for international activities. Open debate and inquiry could contribute to the definition of priorities and measures in the field of network development which enhances Internationalisation.

**Table 25 – Internationalisation: questions to be addressed**

- What are the specific problems and demands of SMEs concerning trade policy measures? What are the possibilities for increasing their awareness with regard to these measures?
- What are the opportunities to improve the implementation of trade policy instruments so that the special needs of SMEs are reflected better? How can we increase SMEs' participation in making the European trade policy?
- What should the priorities of cluster and network building be from an Internationalisation perspective? How do specific types of clusters and business networks differ in this respect?

## 5 Governance

Governance in the context of the European Union concerns the way in which the Union uses the powers granted by its citizens. The European Commission established its own concept of governance in the White Paper on European Governance<sup>33</sup>, in which the term “European governance” refers to the **rules, processes and behaviour** that affect the way in which powers are exercised at the European level, particularly as regards:

- openness;
- participation;
- accountability;
- effectiveness; and
- coherence.

These five “**principles of good governance**” reinforce those of subsidiarity and proportionality.

### 5.1 Limitations of current governance practices

The main factor which determines the environment in which SMEs operate is the competence of national regional and local authorities. And SMEs throughout the EU are facing very similar obstacles which hamper their growth and development potential. The Commission’s main role is **ensuring coherence among various policy actions** and consistency in implementation. Moreover, EU action in a number of areas, such as the internal market, competition policy or social affairs, directly affects SMEs.

### 5.2 Principles and tools of governance

As governance works through a wide range of measures, one aspect of the question is not so much about the appropriateness of the respective tools, but rather the **composition and structure of the governance portfolio**. On the basis of evaluation of previous experiences both by SME organizations, and the mid-term review of the SBA itself, **three main pillars** of such a portfolio can be identified, that provide a basis for discussing how to combine the potential tools in order to facilitate implementation:

- Stakeholder involvement,
- Knowledge and Technology Support, and
- Institutional Arrangements.

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33 [http://ec.europa.eu/governance/white\\_paper/index\\_en.htm](http://ec.europa.eu/governance/white_paper/index_en.htm)

**Table 26 – Structure of governance portfolio**

Main elements of the structure of governance portfolio

- **Stakeholder involvement:** Even though more intensive “stakeholder involvement” is a general principle emphasized with respect to SME policy as a whole, some governance tools have been identified with the primary function of actually ensuring the involvement of stakeholders. (The **SBA Assembly** is certainly one of the most important elements of the group accompanied by the **Advisory Group** as well.)
- **Knowledge and Technology Support:** This group of tools (or in some cases functioning as services provided for SMEs) refers to initiatives that aim at collecting and distributing information and knowledge, both directly to SMEs or among Member States regarding their domestic practice. (The Annual Competitiveness Report and exchanges of best practices based on art. 173. being one of them.)
- **Institutional Arrangements:** Institutional solutions created to address governance issues are specific structures, administrative procedures or positions, like the one of the **SME envoy**, whose role and function is clearly defined.

### *Approaches to governance*

Apart from the possible ways of structuring governance tools outlined above, there are more **theoretical approaches to governance** which may help determine how certain tools and measures are best designed and applied. Dilemmas of governance in SMEs may be considered through the lens of the **classic dichotomy of leader and management roles in organisations**.

In SMEs the leadership and management roles would often be filled by a single person, the founding entrepreneur. Nevertheless, the roles are distinct and Kotter’s<sup>34</sup> **management-leader model** is a useful intellectual tool for thinking about how approaches to governance may influence the outcomes of SME policy.

- He proposes an understanding, where **managers set goals** by devising detailed short and long term plans accompanied by calculations for necessary costs and resources. **Leaders on the other hand are looking for visions** of the desirable future, and define broad strategies to achieve them.
- A manager will focus on providing the formal conditions for the implementation of the plans, by designing the necessary structures and functions, while the conditions provided by a leader are more “communicational” and motivational in nature.
- Managers will measure **success by internal efficiency** and pre-determined targets, while the leaders will be **looking for end results** and personal fulfilment.

<sup>34</sup> Kotter, J.: A Force for Change: How Leadership Differs from Management. (New York: The Free Press, 1990).

**Table 27 – Approaches to governance**

The analogy of the management-leadership model may be applied to thinking about elements of the pillars of the governance portfolio.

Main Pillars	Management	Leadership
<b>Stakeholder involvement</b>	<p>The aim of involving stakeholders is to choose between possible solutions and policy alternatives.</p> <p>(The issue to be addressed by stakeholders is the evaluation of potential measures.)</p>	<p>The aim of involving stakeholders is to define a shared vision about how SMEs function in an integrated European market, what kind of role they envisage for the community and the Member States.</p> <p>(The issue to be addressed by stakeholders is defining the principles of a policy.)</p>
<b>Knowledge and Technology Support</b>	<p>The nature of the provided support is similar to a map, or a set of guidelines for the implementation of SME policy. Focus on the exchange of views, recommendations are more about best practices, applicable solutions.</p>	<p>The nature of the provided support resembles a compass, by pointing out recommended directions, core values to be respected. Focus of the exchange of views is more about comparing broad strategies.</p>
<b>Institutional arrangements</b>	<p>Institutions aim at supporting rigorous implementation of policy initiatives.</p>	<p>Institutions aim at ensuring that the main actors work towards similar goals.</p>

## 5.3 Policy Framework

Assessment of SME organizations and the SBA mid-term review suggest that further progress in implementation is essential for SMEs, particularly in the aftermath of the financial crisis. SMEs are vital for the competitiveness of the European economy and while there is no shortage of political commitment to make policies more SME friendly and promote entrepreneurship in the EU, without translating these commitments into actions SMEs cannot be supported effectively. In the mid-term review the Commission found that in order to address problems of implementation, the governance of the SME policy framework has to be strengthened, and this can best be achieved through more intensive stakeholder involvement.

**Table 28 – Proposals for governance in mid-term review of SBA**

The mid-term review of the SBA proposes the following tools and solutions for strengthening the governance of European SME policy:

- Annual competitiveness report,
- SBA advisory group,
- SME assembly, and
- SME Envoy.

### *Annual competitiveness report*

In the framework of annual competitiveness reports, the Commission collects information on Member States' actions on the basis of Article 173 of the Lisbon Treaty. Results of this monitoring provide a basis for peer review and facilitate exchange of best practices.

### *SBA advisory group*

The SBA advisory group is made up of **representatives of governments and business organisations**. The group has the aim of:

- contributing to evaluating and reporting on the uptake of the SBA;
- facilitating the distribution of information on SME policy; and
- promoting the exchange of good practices.

The group is supposed to be tasked to further develop the SME Performance Review, focused notably on the measures in the SBA Action Plan, in order to monitor and assess Member States' performance in implementing the SBA on the basis of a wide range of indicators.

### *SME assembly*

The Commission proposed launching an annual SME Assembly, closely linked to the SBA good practices conference, in order to **mobilise all relevant stakeholders** in the implementation of the SBA and to foster dialogue between them.<sup>35</sup> The continuity of the work of the SME Assembly will be supported by a Secretariat.

<sup>35</sup> [http://ec.europa.eu/enterprise/policies/sme/small-business-act/files/sba\\_review\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/small-business-act/files/sba_review_en.pdf), 18.

### SME Envoy

The aim of reinforcing and emphasizing the position of an SME envoy is to create **a new channel between the Commission and SMEs** in order to ensure that views of SMEs are able to reach decision makers at the European level. The main role of the envoy is ensuring the **flow of information both from the Commission to SMEs, and from the SMEs to the Commission**. Furthermore, the SME Envoy acts as the promoter of SMEs' interests throughout the whole Commission, mainstreaming SMEs in key strategies and policies.

### Other elements of governance in EU policy on SMEs

There are many other important elements of the EU SME policy. Rethinking their function and role in the light of initial SBA goals – SBA friendly policies and promoting entrepreneurship – and from the perspective of better implementation, these instruments can also contribute to improving governance of SME policies:

**Table 29 – Elements of governance in EU SME policy**

Given the nature of governance, several other measures or institutional solutions directly aimed at SMEs and entrepreneurs should be considered as contributing elements:

- Erasmus for Young Entrepreneurs,
- The European SME Week,
- The European Network of Female Entrepreneurship Ambassadors,
- Enterprise Europe Network,
- Your Europe Business Portal,
- Good practices in SME policy, and
- Competitiveness and Innovation Framework Programme.

### Erasmus for Young Entrepreneurs

An exchange programme which gives entrepreneurs who intend to start a business or have recently started one the chance to learn from experienced owners of small businesses in other European Union countries.

### The European SME Week

A campaign to promote entrepreneurship across Europe and to inform entrepreneurs about support available for them at European, national, regional and local level, by providing information and advice.



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### *The European Network of Female Entrepreneurship Ambassadors*

The aim of the Ambassadors Network is to have successful entrepreneurs campaigning on the ground to inspire women of all ages to become entrepreneurs and to set up their own businesses.

### *Enterprise Europe Network*

It provides a wide range of services to SMEs and entrepreneurs, among others, helping them to access market information, overcome legal obstacles and identify potential business partners across Europe, including innovation support and transnational technology transfer services.

### *SME Finance Forum*

A high-level conference with SMEs, banks and other financial institutions, on how to address the current challenges in access to finance for SMEs.

### *EU SME centre in China*

The Centre will help European SMEs overcome challenges they face when operating on the Chinese market, in particular at their early stages of business development.

### *Your Europe Business Portal*

It provides companies who are planning cross-border activities with information and interactive services that help them expand their businesses abroad.

### *Good practices in SME policy*

In many areas of SME policy, the European Commission works in partnership with the Member States by facilitating the identification and exchange of good practices. A database of good practices identified is available.

### *Competitiveness and Innovation Framework Programme*

It supports innovation activities, provides better access to finance and delivers business support services in the regions. It encourages a better take-up and use of information and communication technologies and helps to develop the information society.

## 5.4 Main points for discussion

The implementation of the comprehensive policy framework for SMEs faces considerable challenges, given that it takes place at both the levels of the EU and the Member States. In practice, the EU has more of an indirect influence, where the Member State level is more directly responsible for implementation. Both stakeholders and the Commission agree that to be successful, the governance of the Small Business Act has to be addressed.

**Table 30 – Governance: questions to be considered**

- What kind of approach to governance leads to the successful completion of the SME policy goals of the EU and its Member States?
- How is it possible to find the best tools, measures for governance? What would the elements of an optimal portfolio be?
- What are the most appropriate ways of involving stakeholders that provides them with opportunities to contribute most to the implementation of the SBA?
- Considering individual tools of governance which approaches are best suited from the perspective of manager-leadership dilemma?

## 6 The SME sector in Hungary

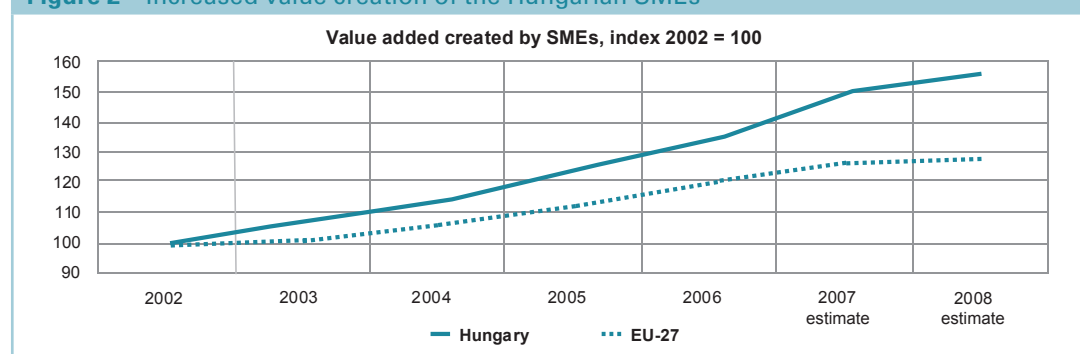
### 6.1 Overview of the Hungarian SME sector

The SME sector in Hungary shows a **higher percentage of micro enterprises than the EU-average**, whereas the percentage of medium-sized and small enterprises is correspondingly lower. The contribution of SMEs to employment in Hungary is 71%, compared to the European average of 67%.

The productivity of micro enterprises in Hungary has been improving rapidly, though on average from a lower starting point than the EU27 average. **The value added of Hungarian SMEs has grown substantially**, by 55% in the period between 2002 and 2008, whereas value added of EU SMEs grew by 28%.

The Hungarian SME sector is made up of businesses 25% working in real estate, property management, and business activities, and 20% of companies in the wholesale and retail trade.

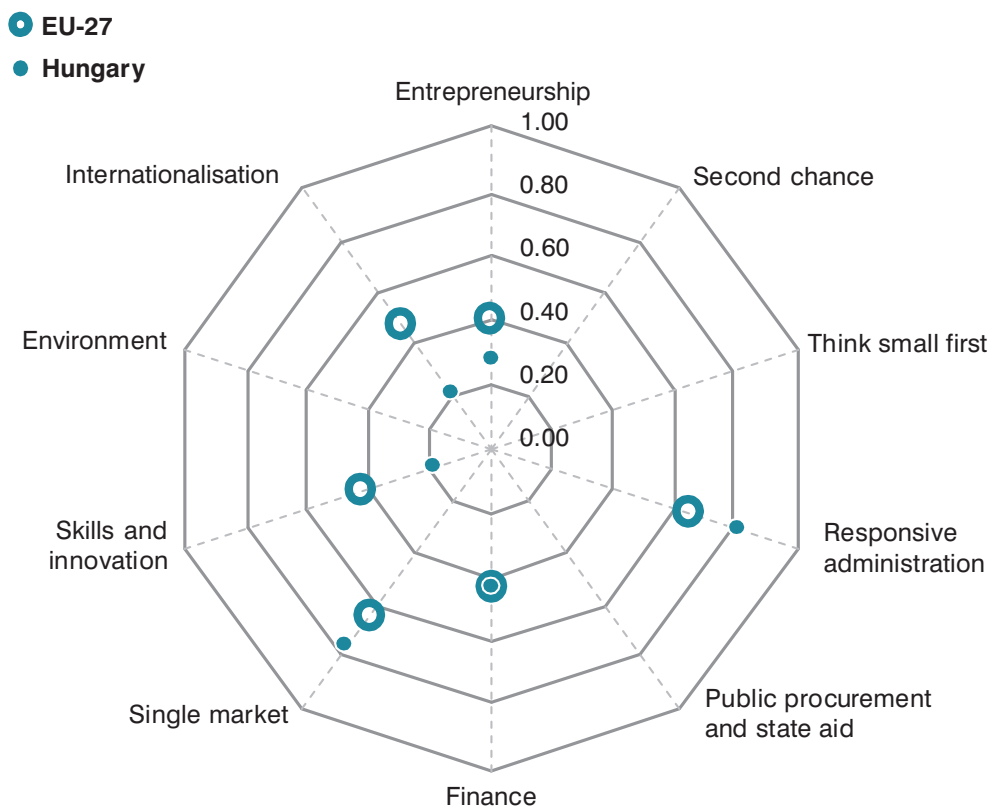
**Figure 2 – Increased value creation of the Hungarian SMEs**



Looking at the SBA priority areas and comparing Hungary with other parts of Europe, the following statements can be drawn:

- **Within the SBA priority area 'Responsive administration', Hungary performs significantly better than the EU-27 average.** This is mainly due to relatively straightforward procedures for hiring and firing staff, and the short time required for starting a new business or registering property.
- The area of '**Finance**' is largely on a par with the EU-27 average: indicators related to obtaining credit (legal rights index, depth of credit information index) perform in line with the average.
- On the other hand, results for '**Internationalisation**', '**Entrepreneurship**' or '**Skills and innovation**' in Hungary **significantly underperform** their respective European mean values.

**Figure 3 – SBA priority areas in Hungary (compared to EU-average)**



## 6.2 The SME policy of the Hungarian Government

### *Fundamentals of SME Policy*

The new Hungarian government aims to **increase the number of legally employed people by one million until the end of the decade**. Enhancing competitiveness and dismantling the obstacles which are hampering the growth and potential of SMEs are essential if this is to be achieved. Hence, SME policy is based on the following tasks:

- **reducing administrative costs**, including state generated risks and incentives to organise business in the informal sector;
- **supporting enterprises** as the main organisers and innovators within local economies and communities;
- reducing the effects of competition biases and growth barriers;
- **stimulating cooperation** among companies in production, innovation and market access;
- raising the profile of entrepreneurs as champions of value creation;
- sharing the risks of innovation with positive social externalities;
- building vital cooperation with the corporate sector to fulfil the overarching social and political goals of the Government.

SME policy is a key element of the competitiveness agenda of the Hungarian government. **Competitiveness is an important political concept** and public bodies should take steps to support people who live their lives with the values of excellence, competition, and cooperation. Furthermore, Hungary aims to become one of the 30 most competitive countries within a 5-year period according to recognised systems of competitiveness ranking.

The new Hungarian government considers the development of the SME sector as one of its top priorities. During its ten months in office, the Hungarian government has taken several steps to improve the competitiveness of small and medium enterprises.

**Table 31 – SME-friendly economic policy – Actions of the new Hungarian government**

In order to improve the competitiveness of the economy and SMEs, the new Hungarian government took decisive steps in the **past ten months**, such as:

- **lowered corporation tax** from 19 to 10 per cent for enterprises with annual revenue of less than 500 million HUF (cca. €2 million).
- introduced a wide reaching income tax reform, a **flat tax system with the income tax at 16 per cent**.
- **abolished death duties** for direct family members.
- implemented a package of measures to **reduce administrative burdens** – with a total value of 100 billion HUF (cca. €400 million).
- **restructured the institutional system of distributing EU funds**. In the framework of the **New Széchenyi Plan** allocation of EU-fundings is significantly simpler and more inclusive (now 50% of fundings go to SMEs and productive sector investments compared to 16% share of SMEs in previous times).
- increased funding and broadened applicability of the popular SME finance scheme via **Széchenyi Card**.
- **consolidated the budget** without adding new burden to SMEs.

### *Further Steps*

The government introduced its **mid-term structural reform programme**, the **Széll Kálmán Plan**, in March 2011. The plan has outlined additional steps of SME policy as follows:

- The government is to implement a **second package of measures for reducing the administrative burden** imposed on the corporate sector. The second package is of value of 400 billion HUF (cca. €1,6 billion).
- As the **reduction of sovereign debt** is being implemented, the government plan to introduce further tax reductions.
- Until 2013, in the framework of the **New Széchenyi Plan**, 516 billion HUF (cca. €2 billion) is to be made available for SME financial support.



