

Barriers to SME growth in Europe

SUMMARY

Small and medium-sized enterprises (SMEs), which represent 99% of all businesses in the EU, play a pivotal role in its economy. Nevertheless, in comparison to larger firms, they often face significant obstacles – internal, administrative and financial – which affect them disproportionately.

SMEs have been affected negatively by the economic crisis, which is manifested in a reduction in the sector's employment figures. The financial and sovereign debt crises have also had a negative impact on the financing of SMEs, especially in the hardest-hit countries. Perhaps unsurprisingly, important differences exist in access to finance both within the euro area and between the 'old' (EU-15) and 'new' (EU-13) Member States. Concerning the recovery from the crises, the picture also remains mixed.

Administrative and regulatory obstacles are often highlighted by SMEs as being a significant burden on their growth. It is substantially more costly for smaller firms to comply with regulations and few Member States actively support SMEs when it comes to tax provisions, or take their specific characteristics into account when drafting legislation. The European Parliament has been a long-standing advocate of an environment for SMEs that is conducive to growth.



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Issue

Main obstacles to growth

SMEs are widely recognised as being important [actors](#) in the EU economy.¹ Across the Union, the national and local environments in which SMEs conduct their business are diverse and so are the forms in which they operate: micro-enterprises, family-owned businesses or social economy enterprises. In comparison to larger firms (and despite many successful cases), SMEs often produce somewhat weaker results, such as lower profitability, higher staff turnover, lower rate of survival, less success in the field of innovation, lower capacity to invest in staff development and training, and so on. This can partially be attributed to the existence of significant [barriers](#) to entry and growth, which are inherent to most economies. Economic literature broadly classifies barriers to SME growth and development into three categories:

- internal (for instance, insufficient skills, resources at enterprise level);
- administrative/regulatory burdens (for instance, tax systems, complicated laws);
- financial (mainly access to finance).

This is in line with common regulatory and structural challenges faced by SMEs, as pointed out in the European Parliament's [resolution](#) on SME competitiveness and business opportunities of October 2012. Parliament has repeatedly highlighted in its [resolutions](#) the specific difficulties SMEs face due to their size, underlining that **reducing their administrative burden and meeting their financing needs** are central issues that need to be tackled in order to facilitate their development and enhance job creation.

The last comprehensive pre-crisis (2007) Eurobarometer survey concentrating on SME-specific difficulties [showed](#) that the biggest problems (apart from securing a customer base) were: **stringent administrative regulations, low availability and cost of appropriate human resources** (around a third of SMEs claim to have faced difficulties in these areas), **insufficient infrastructure** and **limited access to finance** (more than 20% of SMEs reported difficulties in these areas).

Barriers to SME job creation

In early 2016, EU agency Eurofound published a [study](#) on the obstacles to job creation that EU-28 SMEs face. It found that obstacles can be both external and internal. The former include, most importantly, the administrative and institutional business environment (for instance, regulation of shop opening hours, rigid labour laws), the current macroeconomic situation (and the resulting drop in demand, increase in payment delays and difficult access to finance), competition from larger or multinational companies and the shadow economy, and high labour costs accompanied by low availability of a skilled workforce. The latter include the economic performance of SMEs, lack of strategic planning, low capacity to internationalise and innovate, inefficient organisational structure and management capacity, inability to attract workers, as well as low motivation and negative attitudes of owners/managers. These findings are broadly consistent with a 2013 Parliament [resolution](#), saying that SMEs 'can generate employment provided that the right conditions are met, including administrative simplification, access to finance, skills, knowledge and qualified manpower and support for their innovative efforts'.

The European Commission and the European Central Bank (ECB) carry out annual [surveys](#) on access to finance for enterprises, which also monitor the most pressing issues signalled by SMEs. The main problems identified over the 2009-2015 period were: **finding customers** (decrease from 29% in 2009 to 25% in 2015), **the availability of skilled staff or experienced managers** (increase from 8% in 2009 to 18% in 2015), **competition** (increase from 13% in 2009 to 14% in 2015), **regulation** (increase from 6%

in 2009 to 13% in 2015), **costs of production or labour** (increase from 9% in 2009 to 13% in 2015) and **access to finance** (decrease from 17% in 2009 to 10% in 2015).

European SMEs in the 2008-2014 period

The Commission's 2015 [Annual report on European SMEs](#) noted that after 2013 (in which SMEs' value added grew by 1.6% and employment declined by 0.5%) European SMEs showed improved performance in 2014 with value added increasing by 3.3% and employment by 1.2%. However, some Member States² showed a decline in value added, sometimes coupled with reduction in employment. The picture is also mixed concerning recovery from the crisis.³ Over 2008-2014, as many as 20 Member States showed net SME employment reduction, and eight of them⁴ signalled double-digit net employment losses. Importantly, [micro-SMEs](#), which are most vulnerable to the effects of the crisis, market cycles and tight financing conditions, play a relatively larger role in southern and eastern Europe compared to the EU-28 average. In some cases, the net decrease in average SME employment occurred mainly due to the losses micro-SMEs experienced.

In roughly two thirds of Member States, the majority of industries showed a negative performance in SME employment from 2008 to 2014. In 2012, the highest survival rates of micro-SMEs established in 2008 (more than 60%) were in Finland, Sweden, Belgium, Luxembourg and Austria. In contrast, in Portugal and Lithuania, only one in three firms created in 2008 survived until 2012. In all other Member States, the percentage of firms that survived over the above period ranged between 40% and 60%, which implies that during the economic downturn, only about one in two newly established firms survived.

Financial barriers

In its 2011 [action plan](#) to **improve** access to finance for SMEs, the Commission reiterated that difficulties in accessing finance are one of the main barriers to SMEs' growth. The document mentions multiple causes for these obstacles, which can be cyclical⁵ or structural in nature. Issues such as information asymmetries between the suppliers and demanders of funds and fragmentation of venture capital markets also play a significant role. In a [resolution](#) from 2013, Parliament highlighted that the financial and economic crisis had an aggravating effect on SMEs' difficulties in accessing finance. The document underlined that limited access to appropriate sources of risk capital, especially when occurring during the early stages of business establishment, is one of the most important constraints on the creation and development of growth-oriented SMEs. Furthermore, MEPs recalled that, because the EU banking sector – the main source of

EU Single Market and SMEs

Activities of SMEs in the EU Single Market are also important: more than one third of SMEs (36%) have imported goods and services from other EU countries, and 30% have exported within the Single Market. At the same time, 49% of SMEs have neither engaged in export or import. In general, those which do business beyond their country's borders are in a better financial condition and have better growth prospects. In the 2015 Eurobarometer [survey](#), SMEs mentioned **complicated administrative procedures** (52%), the **need for substantial financial resources** (42%) and **complicated tax regimes** (39%) as important barriers to export inside the Single Market. SMEs which do not currently export relate this to the lack of access to finance (54%), while complex administrative procedures are the biggest single barrier to importing. EU SMEs signal the existence of many obstacles to growth and internationalisation in various fora, but there is no definite and universal enumeration of these, despite quite a few elements being consistently highlighted. For example, the main issues [identified](#) at the November 2015 SME Assembly were: complicated VAT regime, absence of information on EU rules, complicated product certification, cost of labour, problems with access to finance, and varying tax regimes.

financing for SMEs – is fragmented, there are significant divergences in lending rates and credit supply among countries. At the same time, SMEs need to comply with new and all too often increasingly stringent regulatory criteria (for instance, personal guarantees necessary to obtain finance). Noting that problems in accessing credit vary among Member States, MEPs further stated that 'a differentiated approach to improving SMEs' access to funding is necessary, taking into account the country-specific circumstances'. The Small Business Act [mentions](#) another problem: 'SMEs often have a weak equity position, which is further undermined by the late payment culture in Europe. In fact, depending on the country, SMEs have to wait between 20 and over 100 days on average to get their invoices paid. One out of four insolvencies is due to late payment. This leads to the loss of 450 000 jobs and of €25 billion every year.'

In its [survey](#) 'Access to Finance of Enterprises in the euro area', the ECB notes that despite an overall decrease in the level of concern of EU SMEs about access to finance, important differences across countries persist. Some 30% of SMEs in Greece, and 13% of SMEs in Ireland, Italy and the Netherlands mentioned that access to finance was their most significant problem, compared with around 7% of SMEs in Austria, Finland and Germany (the euro area average being 11%). Other heavily affected countries such as Spain and Portugal reported 12% and 11%, respectively. The only eastern/central European country examined, Slovakia, showed a level of 8%. Furthermore, SMEs in Ireland, Spain and Portugal considered that the availability of loans is higher than their needs, with Greece being the only crisis country declaring the opposite.

Impact of the crisis on SME financing

In a recent [overview](#) of research on SME financing, Professor of Finance Gregory F. Udell notes that the impact of the strengthened post-crisis capital requirements for banks that need time to recover, might limit their lending to SMEs to a higher extent than for banks that are not in need of recovery. This implies a worse situation in the most severely affected countries. An [IMF paper](#) on European SMEs concludes that in comparison with large firms, SMEs are more highly leveraged, are more reliant on bank financing and have significantly higher [non-performing loans](#) ratios. Unpaid loans reflect the recession that affected SMEs negatively, both through the collapse in domestic demand and the tightening of credit conditions. Restructuring debt-distressed SMEs in the EU is challenging: their sheer number, small size and weak balance sheets increase both the fixed costs and the risks of loan restructuring faced by the banks. The IMF argues that SMEs' high indebtedness and bad loans may slow economic recovery and affect financial stability in Europe.

Regarding the rejection of applications for [bank loans](#) submitted by SMEs, the highest percentage has been recorded in the Netherlands (25%), followed by relatively high levels in some of the EU-13 and crisis countries. Another [study](#) on the effects of the crises on SME financing confirmed that the programme countries recorded a particularly high level of loan rejections. It also observed that small and young firms are more likely to be refused a loan (these types of firms suffer amongst other things from insufficient collateral or guarantees, and lack of credit history). Tightened credit conditions contributed to SMEs' difficulties in accessing finance. Furthermore, in many cases the funds accessed were less than those originally planned for. The size of the loans obtained also varies widely across the EU: small loans were most often reported by SMEs in Lithuania and Croatia, and large loans in the Netherlands. Within the EU-28, Germany's SMEs (61%) most often did not expect to run into obstacles when getting finance, while only 5% of Greek SMEs enterprises had the same confidence.

A 2015 study by the Organisation for Economic Co-operation and Development (OECD) on [financing SMEs](#) for the 2007-2013 period, observed negative SME loan growth in several countries, while SME bankruptcies more than doubled in many EU Member States.⁶ New SME business loans contracted for three consecutive years in Finland, Ireland and Spain. Countries which experienced the acute effects of the financial, economic and sovereign debt crises have still not fully recovered in terms of lending to SMEs. Furthermore, their SMEs faced more severe credit conditions (deteriorating since the beginning of the crises) than large enterprises. The OECD concludes that in the euro area, access for large enterprises to finance is easier, and financing conditions are more favourable, and that the crisis countries report limited access to finance as a pressing concern. This is further compounded by a high percentage of non-performing loans in the banking sector, which impact negatively on lending to SMEs. The OECD also noted that even though non-bank finance instruments are gaining in popularity, they cannot compensate for reduced bank lending.

Another OECD [study](#) underlined that since 2009, banks' assessments of heightened macro and micro risks as well as the firm-specific outlook, in particular of SMEs, have contributed to the tightening of business credit standards and the reduced availability of external financing, particularly in crisis countries. It also argues that the deleveraging of European banks as an effect of the crisis has led them to reduce their exposures to SMEs, thus requiring dedicated policy measures to counter that tendency (with only partial success). In particular, the paper argues that three simultaneous developments have had distinct effects on SME financing: (i) the weak real economy affecting credit demand, (ii) the sovereign/financial crisis negatively affecting credit supply decisions and conditions, and (iii) the [debt overhang](#) affecting all aspects of SME financing.⁷

A Deutsche Bank [paper](#) argues that SMEs from southern Europe are less resistant to macroeconomic shocks and deteriorating domestic demand. At the same time, SMEs from countries hardest hit by the crises struggle most with access to finance, and pay higher interest rates than before. Researchers conclude that it is unclear if the higher rates are due to SMEs' structural weaknesses, banks' risk aversion, liquidity constraints or their bleak assessments of the economic outlook for SMEs. Similarly, an ECB [paper](#) confirms the existence of significant differences in financing costs since 2011 between SMEs in Germany and France, and those in Italy and Spain. Countries worst affected by the crisis showed deterioration in those factors which affect the availability of external finances (such as gloomy outlooks for SMEs as well as for the general economy), higher rates of loan rejections and higher credit risks. The ECB argues that the sovereign debt crisis increased banks' financing costs in these countries, which were then passed on to SMEs in the form of higher lending rates or smaller loans. Finally, the [IMF study](#) underlined that higher uncertainty in crisis countries resulted in reduced investment.

Access to finance in EU-15 and EU-13

A comprehensive [study](#) comparing obstacles to finance between the EU-15 and the EU-13 found that the ease with which SMEs can obtain external funds depends heavily on the macroeconomic context and the state and structure of the banking sector. Access to external funds tends to be easier for SMEs located in Member States with higher levels of development of financial intermediaries, more advanced stock markets, more efficient legal systems or higher GDP per capita levels. The study underlines that today's macroeconomic context, GDP per capita and structure of the banking sector still vary significantly between the EU-15 and the EU-13. Considering that banks in the EU-13 still lag behind those in the EU-15, the report argues that SMEs in the EU-15 are less likely to

face big obstacles if they are located in more rapidly growing economies or in countries with a healthier banking sector. Furthermore, the level of financial intermediation is still lower in the EU-13 relative to the EU-15: the private sector lending to GDP ratio stood (apart from Cyprus and Malta) at 64% in the EU-13, as opposed to 148% in the EU-15. Non-performing loans were at 11% in the EU-13 compared to 7% in the EU-15.

In the EU-13, around 18% of SMEs applied for bank loans, and 14% applied for [trade credits](#), while in the EU-15, around 23% of SMEs applied for bank loans and 20% applied for trade credits. Furthermore, the results show that a previous positive bank loan history is conducive to a successful bank loan application, but this is only valid for the EU-15, thus indicating that SMEs in the EU-13 have more difficulties building trust and reputation with banks that tend to disregard previous (even positive) experiences in their decisions to grant loans. Another [research paper](#) concluded that in the EU-15, the presence of a large number of foreign-owned banks is associated with improved perceptions concerning access to bank loans, but this is not so in the 10 countries which joined the EU in 2004.

Administrative burden

The Small Business [Act](#) mentions that the most burdensome restriction reported by SMEs is compliance with administrative regulations. Regulatory burden can be broadly [defined](#) as 'all costs that result from mandatory obligations placed on businesses by public authorities on the basis of a law, decree or similar act'. Administrative burdens can vary, and [include](#) those related to (i) EU law and domestic legal acts required to transpose it into national laws, (ii) accounting and taxation requirements, as well as (iii) sector/industry-specific laws and reporting/compliance obligations. For example, a 2015 [study](#) covering 25 Member States indicated that in all of them SMEs, such as cooperatives and associations, perceived certain areas of accounting as creating administrative burdens. The report also found that in most countries the smaller the size of an entity, the higher the perceived administrative burden. [Research](#) carried out on the total costs of the administrative burden as a percentage of GDP shows that Italy, Spain, Poland, Greece and Hungary recorded the highest levels (between 4.6% and 6.8%), while Finland, Sweden, the UK, Denmark, and Ireland had the lowest (between 1.5% and 2.4%). In a 2011 [report](#), the Commission recognised that small firms face the greatest compliance costs, regardless of whether regulation stems from the regional, national or EU level. The High-Level Group on Administrative Burdens recommended in its final [report](#) that SMEs and micro-businesses be exempted from EU obligations as far as possible, provided the aim of the legislation is not jeopardised. Furthermore, in its Entrepreneurship 2020 [action plan](#) the Commission stressed that 'support measures for SMEs remain unbalanced, with a substantial number of EU Member States still neglecting to take into account the characteristics of small businesses, in particular micro-businesses, when designing

What do SMEs say?

A 2014 [consultation](#) on 'New SME Policy' showed that SMEs strongly support actions which reduce the administrative burden and simplify the business environment, indicating that a lot remains to be done in this field. Actions on reducing the administrative burden received the highest average support compared to actions proposed in other priority areas such as access to finance. Improving the consultation of SMEs and their stakeholders at an early stage, encouraging Member States to simplify tax procedures for new companies, identifying and addressing bottlenecks in national legislation that hamper SME growth, as well as launching an EU-wide campaign to cut red tape for SMEs, were the measures supported by at least 95% of respondents.

legislation'. Laws and regulations in the destination country as well as [administrative procedures](#) are also important [barriers](#) to SMEs' internationalisation.

It is also a well-recognised fact that SMEs bear a disproportionate regulatory and administrative burden in comparison to larger businesses. Experts estimate that where a large company disburses €1 per employee because of a regulatory duty, a small business might have to spend up to €10. Studies [indicate](#) that a business with fewer than ten employees has to face a regulatory burden (measured per employee) that is roughly double the burden of a business with more than 10 but fewer than 20 employees, and about three times as high as the burden of businesses with more than 20 but fewer than 50 employees. For larger companies, the burden per employee is only one fifth or less of that of small enterprises. Disproportionate regulatory burden exists because (i) compliance with regulation has the characteristics of a fixed cost (information duties may be the same for small and large companies), (ii) SMEs are less efficient in dealing with regulations (for instance, they invest less in compliance-specific computerisation), and (iii) it is often entrepreneurs themselves that have to deal with regulations.

The 10 most burdensome EU laws for SMEs

In 2013, the Commission launched a [consultation](#) which identified the 10 most burdensome EU laws for SMEs: (i) the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) Regulation; (ii) the value added tax (VAT) legislation; (iii) the General Product Safety and Market Surveillance package; (iv) the recognition of professional qualifications; (v) shipments of waste; the waste framework legislation; the list of waste and hazardous waste; (vi) labour market-related legislation; (vii) data protection; (viii) working time; recording equipment in road transport (for driving and rest periods); (ix) procedures for the award of public contracts (public works, supply and service contracts); and (x) the modernised customs code. Parliament's [resolution](#) on the top 10 barriers underlined that almost one third of the administrative burden related to EU legislation stems from disproportionate and inefficient national implementation, which means that as much as €40 billion could be saved if Member States transposed EU legislation more effectively.

Taxation

Many SMEs in the EU [consider](#) taxation to be the most burdensome policy area affecting them. A Commission [report](#) stressed that European SMEs have a total tax compliance cost to all taxes paid ratio of more than 30%, while large companies have the same ratio of only 1.9%. The main reasons behind these high costs are frequent changes of laws as well as their complexity, the existence of different tax administrations, the complicated forms and language of tax laws, the strict deadlines for payment, the cost of tax consultants (which are often used by SMEs), and registration procedures. A 2015 [study](#) on SME taxation in Europe concluded that the corporate tax burden varies significantly across the EU, with the highest fiscal burden being in EU-15 countries like France, Italy, Germany, Finland and Belgium, and the lowest being mostly in the post-2004 Member States. Only five EU countries favour SMEs over larger firms through tax advantages (France, Greece, Bulgaria, the UK and the Netherlands). The study also analysed the effort needed to comply with taxes across the EU. The highest amount of time spent (EU average is 176 hours) was recorded in the majority of the eastern and southern European countries and in Portugal, Italy and Germany. On the other side of the spectrum are the northern EU countries. Considering the number of

tax payments, Cyprus, Luxembourg, Slovakia are above 19 (EU average is 12), and Sweden, Estonia, Latvia and Malta are below 8.

A 2015 [study](#) on SME taxation in OECD and G20 countries identified varying levels of SME exemption from VAT thresholds across the EU. In general, the report noted disproportionately high VAT compliance costs in relation to the turnover of SMEs as compared to larger firms. The study also examined various aspects of tax simplification measures for SMEs such as income tax simplifications, exemption thresholds and VAT simplifications including the related accounting, payment and filing. Countries with most measures in place included Hungary, Italy, Poland and the UK (seven categories) while Estonia, Finland, and the Netherlands had measures in only two.

Main references

Eurofound, [Job Creation in SMEs, ERM Annual Report 2015](#), 2016.

European Commission, [Survey on Access to Finance of Enterprises. Analytical Report](#), 2015.

OECD Scoreboard, [Financing SMEs and Entrepreneurs 2015](#), 2015.

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Endnotes

- ¹ According to the [Commission](#), SMEs represent 99% of all businesses in the EU. Furthermore, in the past five years, they have created around 85% of new jobs. Two thirds of total private sector employment is in SMEs.
- ² In particular Cyprus, Sweden, Croatia, Greece, Italy and the Czech Republic.
- ³ Recovery from the crises has not been completed in Greece, Spain, Croatia, Hungary, Ireland, Italy, Poland, Portugal and Romania. Meanwhile Austria, Belgium, Denmark, Malta, Luxembourg, Sweden and the UK have fully recovered in terms of the number of SMEs, value added and employment.
- ⁴ Namely Lithuania, Italy, Croatia, Latvia, Cyprus, Portugal, Spain and Greece. However, other countries showed SME employment growth, namely Austria, Belgium, France, Germany, Luxembourg, Malta, Sweden, and the UK.
- ⁵ The Commission [report](#) on cyclicalities of SME finance states that during a downswing or recession, bank lending criteria are tightened, while the change in demand for bank loans is not dramatically reduced. 'The supply of venture capital funding also has strong cyclical elements. During the expansionary phase of the cycle funds flow into venture capital firms, which then pursue deals aggressively, pushing valuations up. In the contraction phase equity prices fall, no new money enters into the sector, and valuations decline'. As a result, according to a Deutsche Bundesbank [study](#), 'Too many (too few) firms may obtain credit in a boom (recession)'.
- ⁶ Namely Denmark, Estonia, Hungary, Italy, Portugal, Slovakia, Spain and Sweden.
- ⁷ [In detail](#): 'Overall, the effects of the three crises identified can be summarised as follows: weakness in the real economy is shown to affect both the supply of and demand for credit; a weak sovereign or banking sector affects loan rejection and interest rates, but does not impact on demand; an over-indebted private sector appears to have some effect on loan rejection and also influences credit terms and conditions through increased interest rates.'

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