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NOTAS ECONÓMICAS 7

SMEs in Europe: there's no business like smal business

Carlos Tenreiro Assistente da Faculdade de Economia da Universidade de Coimbra Administrador da Comissão Europeia

resumo

Em Dezembro de 1992, a Comissão Europeia criou um Observatório europeu para as PME a fim de permitir a todos os responsáveis políticos dispor de uma avaliação detalhada da evolução e perspectivas de desenvolvimento das empresas na economia europeia. Desde então, a "European Network for SME Research" tem procedido à elaboração de um relatório anual independente sobre as pequenas e médias empresas.
O presente artigo tem como objectivo apresentar, sucinta e criticamente, alguns dos principais resultados desses relatórios, num número limitado de domínios. Em geral, considera que as pequenas e médias empresas são o veículo mais importante para gerar novas possibilidades de emprego e crescimento, assim como para reforçar a coesão económica e social e sustentar o desenvolvimento regional na União Europeia. Em particular, faz uso dos dados publicados pelo Observatório para rever o estado actual das PME na União Europeia, avaliar a sua contribuição para a criação de emprego, e apreciar, a título ilustrativo, o impacto de alguns desenvolvimentos relativos ao mercado interno sobre as PME. Finalmente, termina considerando que as medidas de polftica e mecanismos de apoio às pequenas e médias empresas não necessitam de tomar explicitamente em consideração a dimensão da empresa, devendo antes orientar-se para a criação e desenvolvimento de um quadro económico global coerente e transparente, no âmbito do qual todos os operadores possam competir livremente com base num tratamento não discriminatório.

résumé / abstract

En Décembre 1992, la Commission européenne a établi un Observatoire européen pour la PME afin de permettre à tous les décideurs politiques de disposer d'un instrument d'appréciation des développements et des perspectives des entreprises dans l'économie européenne. Depuis lors, le "European Network for SME Research" a éle chargé de rédiger un rapport annuel indépendant sur les petites et moyennes entreprises.
Cet article vise à présenter un résumé succinct et annoté des principaur resultats des rapports dans un nombre limité de domaines. En général, il considère que les petites et moyennes entreprises sont le secteur clé pour la relance de l'emploi et de la croissance, ainsi que pour renforcer la cohésion économique et sociale et soutenir le developpement régional dans l'Union européenne. Il utilise notamment les données statistiques et les estimations publiées par l'Observatoire pour rendre compte de l'état actuel des PME dans l'Union européenne, évaluer leur contribution à la création d'emplois, et apprécier, à titre préliminaire, l'impact de certains développements relatifs au marché intérieur sur les PME. Enfin, il se termine en considérant que les mesures politiques et les mécanismes ciblés de soutien aux PME ne nécessitent pas de prendre explicitement en considération la taille de l'entreprise, mais doivent plutôt être dirigés vers la création et le développement d'un environnement cohérent et transparent dans lequel tous les acteurs économiques puissent librement concurrencer sur la base d'un traitment non discriminatoire.

In December I992, the European Commission set up a European Observatory for SME.s in order to provide all relevant policy-makers with a comprehensive survey of enterprise developments and prospects in the European economy. Since then, the European Network for SME Research has been charged of drafting an annual, independent report on small and medium-sized enterprises.
The present paper aims to present a short, annotated summary of the reports' major findings in a limited number of domains. In general, it considers that small and medium-sized enterprises are the key issue for generating employment opportunities and growth, as well as for maintaining social and economic cohesion and assisting regional development in the European Union. In particular, it makes use of statistical data and estimates published by the Observatory to review the current state of SMEs in the European Union, evaluate their contribution towards employment creation, and tentatively assess the impact of some Internal Market related developments on SMEs. Finally, it ends up by considering that properly targeted policy measures and support mechanisms need not take explicitly into account the enterprise size, but have instead to be geared towards providing a coherent and transparent framework within which all economic operators can freely compete on the basis of non-discriminatory treatment.

Carlos Tenreiro

1. Introduction[1]

For decades, the key to economic success seemed to lie within the very foundations of the growth attitude adopted by the most developed countries. Not only were economic growth and economic development seen as two faces of the same coin, as growth by itself was generally believed to deliver ever-increasing levels of progress, prosperity, employment, opportunities and well-being. Appropriately as it then was, empirical evidence seemed to confirm that industrial growth alone would ensure increased efficiency in resource allocation, and allow for rational use of all production factors, technologies and methods, while continuously making room for additional reductions in unit costs.

The early seventies have nonetheless witnessed the dismissal of the common orthodoxy. On the one hand, a few oil crises added to the already recognisable dismal of the industrial "development poles" model by underlining the fundamental importance of flexibility and ability to adapt to new and unforeseen conditions, and dramatically reducing the scope for traditional economies of scale. On the other hand, the rapid emergence and diffusion of an array of new and pervasive technologies contributed to further reduce the comparative advantages of large firms, and paved the way to development of customisation, as opposed to mass production, of consumer goods.

The reported exhaustion of the traditional industrial development model has brought about some major changes in economic policy, propelled as they were by rapid expansion of the tertiary sector and considerable change in the pattern of industrial output. Not only have new concerns about structural shifts in the sectoral economic balance and the cohesion of the industrial fabric been added to long-standing commitment towards short-term market regulation, as enterprise policy has gradually replaced industrial policy as the most effective tool for addressing and reconciling such general objectives as growth, employment and competitiveness in a globalised economy.

By establishing a "Bureau de rapprochement des entreprises" (BRE) in 1973, launching a "European Year of Small Businesses and Crafts" in 1983, and creating a "SME Task-Force", which subsequently developed into an independent Directorate-General, in 1986, the European Commission proved to be one of the few institutions who paid early attention to the increasing economic importance of small firms. And, in the process, it eventually made clear (European Commission, 1990) that a suitable instrument was needed to assist it in pursuing its enterprise policy, particularly in finding out more about the situation and prospects of small and medium-sized enterprises by improving their statistical coverage and analysing the impact the Internal Market would have on them.

In December 1992, therefore, the Commission set up a European Observatory for SMEs, which then, for the first time, brought together twelve national organisations specialising in small and medium-sized enterprises (and which last year has been extended to cover also new European Union members and Norway), in order to provide all relevant policy-makers with an annual report on the latest enterprise developments and prospects in the European economy, quite often in areas where data is scarce but vital for any effective analysis. Considering that the neutrality and the scientific character of data-processing procedures that preside over the development of statistical data, and are ensured both by EUROSTAT and the National Statistical Offices should be matched by a comparable independence of the Observatory, the Commission deemed it best to restrict its role to that of a catalyst. The contents of the reports and the methodology used in this regard are the responsibility of the European Network for SME Research (ENSR), which prepares them, with the Commission merely setting out the guidelines and monitoring the network's activities.

1 A shorter, colloquial version of this paper has been presented at the EBN (European Business and Innovation Centre Network) Symposium on "The financing of innovative SMEs in the European Union" (Brussels, 22-23 February 1996). The opinions expressed are those of the author and do not engage the European Commission.

This far, the European Observatory for SMEs has published three independent reports. Every one of them is meant to be part of an articulated and coherent series designed to allow the situation of SMEs to be monitored and their prospects in the Internal Market to be assessed, as well as to encourage increasingly serious thought and debate on enterprise policy guidelines as to the best way to assist SMEs overcome the problems attendant on their size and make better use of current opportunities. As the integration of the European economies has proceeded apace and further accelerated under the impulsion of the completion of the Internal Market, the task faced is immense and these reports can not be expected to cover all relevant aspects of SME development. They look at many aspects having regard to the essential role played by small and medium companies as vectors of European economic growth and agents in the speeding-up of the integration process, but certainly do not cover as many other issues in any detail.

The present paper has, by far, a much smaller ambition as it intends only to present a short, annotated summary of the reports' major findings in a very limited number of domains. Apart from this introduction, it thus comprises a brief description of the state of SMEs in the European Union (section 2), an outline of their contribution towards employment creation (section 3), a short consideration of some Internal Market-related developments affecting SMEs (section 4) and, inevitably, a few tentative concluding remarks (section 5). In spite of a new SME definition having recently being adopted by the Commission (European Commission, 1996) and for the sake of comparison, it follows the approach that has been used by the Observatory itself and considers the European SME sector to comprise non-primary private enterprises employing less than 500 persons. Whenever possible, further distinction is made between micro enterprises (0-9 employees), small enterprises (10-99 employees) and medium-sized enterprises (100-499 employees).

2. SMEs In The European Union

2.1 SMEs in 1990

Building on official data published for 1990 (European Commission, 1994a), the Observatory estimates that the European non-primary private sector then included about 16.3 million enterprises, of which more than 99.9% were SMEs. In particular, there were about 15.2 million micro firms, more than 7 millions of which had no salaried employees, 1 million small firms, 75,000 medium firms, and only 15,000 large enterprises (Table 1). When referring to intermediate size classes, it is estimated that there were about 605,000, 370,000, 70,000, 60,000 and 15,000 firms in the, respectively, 10-19, 20-49, 50-99, 100-249 and 250-499 employees range.

Table 1 — Main indicators by size class, 1990

	micro	small	medium	large	SMEs	total
Enterprises (1,000)	15,210	1,045	75	15	16,330	16,345
Enterprise share (%)	93	6.4	0.5	0.1	99.9	100
Employment (1,000)	31,450	25,450	15,500	28,900	72,400	101,300
Employment share (%)	31	25	15	29	71	100
Average size	2.1	24.3	206.6	1926.6	4.4	6.2
Turnover per enterprise	190	3,050	33,200	273,750	525	775
Value added per person	25	30	45	40	31	33

Source: ENSR (1995). The figures include some 130,000 Norwegian companies, but exclude the new German Länder. Employment is measured by the number of persons working at least 15 hours weekly. Turnover and value added are expressed in ECU 1,000.

As European enterprises had since to endure a severe economic downturn that did not allow the enterprise population to grow significantly, these figures are probably an accurate representation of the current state of SMEs. On the basis of the Observatory own estimated developments for the period 1988-1995, it can thus be reasonably assumed that there are at present in Europe some 17 million enterprises (including the new German Länder), of which some 93% are micro enterprises. The average enterprise in the European economy has about 6 persons employed (ranging from 3 in Greece to 13 persons employed in Sweden), while the average SME employs slightly more than 4 persons. As a result, SMEs now provide well over 70 million jobs, accounting for an impressive 71% of total employment in the European non-primary private sector.

With regard to firm size, it is significant to note that the average firm size roughly increases by a rather constant factor of ten between size classes, ranging from some 2 persons employed by micro firms to almost 2000 employees in large firms, and that a clear divide seems only to take place between micro enterprises, small and medium enterprises, and large enterprises (European Commission, 1994b). In fact, the data presented in the reports point to the existence of a remarkable stability in average firm size increases between every intermediate size class in the 10-499 employees range (the progression factor to be found here approximates 2.25), whilst large companies are more than five times bigger than the "250-499 employees" average firm, and the typical "10-19 employees" undertaking is about seven times as big as a micro firm. At first sight, this can be seen as evidence on the existence of fundamental different problems, attitudes and behaviour within the SME sector, thus seeming to justify the adoption of differentiated policy approaches aiming at micro enterprises on the one hand, and small and medium enterprises on the other hand.

Naturally, a more precise picture can be drawn at a lower level of aggregation. In this respect, the reports clearly show that the industrial sector has by far the largest average firm size (29 employees per enterprise in extraction and 16 in manufacturing), the trade and construction sectors being the realm of SMEs. Moreover, when the employment sectoral distribution by size class is considered, small and medium-sized enterprises appear to dominate in manufacturing, construction and wholesale trade, and are the second most important source of employment in every other sector (Table 2). On the other hand, micro enterprises excel in retail distribution and (even if their employment share has slightly decreased from 1988 onwards) personal services, whilst being of particular importance also in construction and wholesale trade. As regards large enterprises, they seem to dominate in extraction, transport and communication, and, to a lesser extent, in producer services, without having any major role in other sectors, apart from manufacturing.

Table 2 — Employment share (%) by sector and size class, 1990*

	micro	small	medium	large
Extraction	7	17	15	61
Manufacturing	15	28	21	36
Construction	44	34	12	10
Wholesale trade	34	35	22	9
Retail distribution	57	20	9	14
Transp. & communic.	19	16	9	56
Producer services	28	20	15	37
Personal services	49	23	13	15
Total	31	25	15	29

Source: ENSR (1994).

Some clear-cut differences are also to be found when SME presence is considered from a national point of view. Small and medium-sized enterprises seem to dominate in most Member States, with the exception of Greece, Italy and Spain where micro firms are dominant, whilst large firms seem to perform a relative major role as employment providers only in Austria, Finland, France, Germany and the United Kingdom. Moreover, the reports suggest that there is a strong positive correlation between the number of enterprises in the Member States and their population size, whilst a negative one is identified between the average firm size and entrepreneurship, as measured by the number of enterprises per 1,000 inhabitants. A particularly interesting finding is that the relative importance of the SME sector, measured in terms of both the overall average firm size and the share of SMEs in employment and turnover, seems to be higher on those Member States where population density, wage rates and, particularly, GDP per capita are lowest. Relative economic prosperity, national markets' size and, to a much lesser extent, differences in sectoral structure, all acting as driving forces of concentration processes and enabling a better exploitation of potential economies of scale are offered by the Observatory as possible explanations.

If a distinction is made between those Member States that, together, account for at least 70% of all enterprises within every size class (France, Germany, Italy, Spain and the United Kingdom) and the remaining ones, a positive correlation between the average firm size of SMEs and GDP per country still is to be found within each group. However, the whole picture seems now to be somewhat distorted (European Commission, 1993), as the second group consistently outperforms the first as far as the average SME size is concerned, even if an allowance is made for the smaller relative importance of medium firms in the Mediterranean countries. This, together with the fact that SMEs tend to be bigger in the northern/central countries that in the southern/peripheral ones, could point to the presence of other factors, such as different cultural attitudes towards work organisation and different degrees of openness of national economies, influencing the relative position and development of small and medium-sized enterprises in the Union. Whether such factors could countervail or override the influence of sheer economic performance, as measured by GDP per capita, notably in the context of the development of the Internal Market can be a subject for future research.

Finally, it can also be noted that labour productivity in SMEs, as measured by value added per occupied person, seems to be below the national average in almost all countries (the only exceptions being Belgium, Denmark, Germany and Norway). Still, its size class pattern appears to follow an inverted "V-shape", reaching the highest value for medium-sized enterprises. Together with other findings relating to sectoral and national variations in SME relative labour productivity (ENSR, 1995), and assuming that there is a positive relation between average enterprise size and capital intensity, this would suggest that the relative distribution of SMEs and large enterprises across the economy is related to the very nature of the production process and partly governed by economic efficiency. In this sense, market forces alone would work towards an economic optimum, with SMEs and large firms tending to dominate those sectors and markets in which they generally can benefit from higher labour productivity. However, these results must be seen as provisional and still require further investigation.

2.2 Recent developments

The SME population is numerous, heterogeneous and unstable. The average annual growth in the stock of enterprises during the period 1989-1992 is estimated by the Observatory at 1.9%, or some 300,000 enterprises per year in absolute terms, although a downward trend is already identified in this period. This evolution is the result of both birth and death rates, which have been estimated at around 10% and 8% respectively. At a lower level of aggregation, it is nevertheless possible to note that both rates have been smaller for industrial sectors throughout the Union, which could be viewed as either an indicator of the ongoing process of "tertiarisation" of the European economy or evidence of faster renewal of the economic fabric in services[2], especially

2 These results should however be taken with extreme caution. In fact, no data is available for some Member

as this sector seems to account for about 80% of all new enterprise creation (European Commission, 1995c).

In particular, the number of micro and small firms is found to have increased during that period in most Member States, while a tendency for decrease is noted in the number of medium and large enterprises. A brief analysis of developments in some selected business indicators presented in the reports for the period 1986/88-1990/1 does also allow one to note that SMEs have maintained or increased their employment share in almost every Member State, with Ireland being the only exception to this general pattern. Nevertheless, whilst SMEs have gained in importance most noticeably in Belgium and Denmark, some concentration of employment in the upper size-classes seems also to have occurred in Spain (with large firms "crowding out" medium enterprises), and in Luxembourg and Portugal (where both micro and small firms appear to have loose some ground to medium enterprises).

As regards economic environment factors affecting entrepreneurship, the Observatory did not find any straightforward relationship between the number of new enterprises and the business cycle. As expected, the major reasons for starting an enterprise are self realisation, the presence of a business opportunity and the existence of a perceived income gain. Significantly, the average new entrepreneur is a young, well-educated male, with a sound previous professional status and possibly some entrepreneurial family background. However, women (possibly some 27% of all starters) and ethnic minorities appear to have raising rates of entrepreneurship, especially in the trade and services sectors.

When analysing new firm survival, the reports unsurprisingly find the major causes of failure to be managerial and organisational problems, coupled by financial and market difficulties. In general, only 54% of all new firms are still in business five years after being created, and survival rates appear to be higher in industrial sectors and positively correlated with the firm's starting size. Besides, birth and death rates tend to be distributed in the same way between sectors and Member States, and SME "turbulence" seem to have been somewhat bigger in northern/central countries relative to the rest of the Union. If, as other studies suggest, turbulence or rather "newness" is as important a factor as smallness in employment creation and regional development (Davidsson, 1995), this fact could point to different prospects facing SMEs throughout the Union.

But the Observatory has also considered useful to analyse estimated developments from 1988 to 1995 by distinguishing three sub-periods, as those years can be seen as encompassing a succession of three different phases of growth (1988-1990), stagnation (1990-1993) and recovery (1993-1995). The results presented in the reports are in tune with other findings (European Commission, 1995a) suggesting that SMEs have in general outperformed large enterprises during the first part of that period, at least if their respective performance is measured by average annual growth rates in real value added, real turnover and employment (Table 3). Notwithstanding the supposed counter-cyclical behaviour of the smaller firms' employment share, the general trend towards declining overall firm size, along with increasing business dynamics and flexible industrial specialisation, to which the Observatory refers as possible general explanations of observed superior SME performance, as well as the outstanding growth experienced in the services sector during the last two decades should have made a decisive contribution to this result. A reversal of this tendency, which could follow from a decline in the economic performance of micro enterprises, appears nevertheless to take form from 1990 onwards as the growth differential between SMEs on the one hand and large firms on the other is found to become gradually smaller

States, and differences in definitions reduce the scope for comparison between countries. Moreover, death rates were clearly underestimated for countries where no sanction is imposed on firms that do not cancel the registration when closing, and the methods used to measure new enterprise creation, based on the registration of new firms regardless of whether they start an activity or not, should also have lead to a general overestimation of births.

in all three dimensions, and is particularly evident in 1993-1995, when large firms grow even faster than SMEs.

Table 3 — Differentials in average annual growth rates between SMEs and large

	1988-1990	1990-1993	1993-1995	1988-1995
Real value added	1	-0.25	-0.25	0
Real turnover	1.25	-0.25	-0.75	0.25
Employment	1.75	0.75	-0.5	0.75

Source: ENSR (1995). All figures refer to percentage points.

For the entire period of 1988-95 however, average yearly real turnover as well as employment growth in SMEs would have been in excess of that of large firms, and micro enterprises, although far from being recession-proof, would have been the only ones able to secure some significant net job creation. In particular, the employment growth differential was found to be positive in all countries but Ireland, Spain and Norway, and quite substantial in such sectors as wholesale trade, retail distribution, transport and communications, and producer services. Some related results from recent research (Thurick, 1995) indicate that the growth performance of SMEs has a more than proportional impact on overall economic growth, and suggest that small firm policy can be deemed as an instrument for reduction of unemployment or as a mean of furthering economic growth. Whilst it is certainly conceivable that there are alternative routes to achieve the same rate of economic growth, the research evidence would thus imply that policies that put more emphasis on the small firm sector would have better chances to, at the same time, secure higher levels of employment. Thus being, it would be worth examining whether that apparent reversal in the relative performance of SMEs and large firms is significant and pervasive or, as some indications in the reports and referring to productivity and profitability development patterns seem to point to, merely the transitory result of distinctive size class behaviour and temporal adjustment paths to the economic cycle.

2.3 Export behaviour and technological orientation

Would some additional evidence on the outstanding importance of small and medium-sized enterprises still be needed, there is no shortage of it in the reports. Export behaviour and technological orientation are just two amongst various domains from which relevant indications can be obtained.

The fact that international trade and direct investment abroad have, over the past years, grown faster than production, suggests that enterprises have become more and more internationalised. Nevertheless, one could also claim that globalisation of economic activities, although causing several "national champions" to disappear, has not really led to the emergence of enterprises without a national base. On the contrary, the need to simplify and reconcile aspects of business that are often seen as contradictory, such as price and quality, and to redirect production activities, has led to a search for closer and closer co-operation between enterprises, or to a change in globalisation strategies, aimed more at developing "relationship enterprises" than "global companies". Moreover, given the fact that the share of inter-Member States' sales in the turnover of European companies is still much greater than the weight of the European economy in the world, one could also pretend that European enterprises are not yet sufficiently internationalised. In fact, for European enterprises and in particular for small and medium-sized enterprises, internationalisation first of all means Europeanisation (the rate of growth of internal trade among Member States being higher than that of external trade), even though the effects of international competition are fully felt in their traditional markets (the rate of growth of imports from outside the Union seems to be even higher).

Judging from the limited information available on this subject, the reports argue that micro and small enterprises, as probably also stable or declining and older firms, more frequently serve final consumers and make little use of distribution channels. Furthermore, a large part of SMEs seems to be operating relatively more on segmented markets and to depend on a smaller number of clients, thus being more vulnerable to shifts in the demand structure although facing less competition pressure. Besides, as the share of exports in total sales tends to increase with firm size, and the industrial sector is relatively more oriented towards exportation, the Observatory found SMEs to be less prone to directly meet external demand.

Yet, and on the one hand, SMEs account for more than two thirds of turnover and sales of the non-primary private sector in the Union, the sales of the construction and trade sectors being the most highly concentrated in micro and small firms, whilst sales of large enterprises come mainly from the industrial sector. On the other hand, exports do account for an average of 10% of SME turnover, and correspond to a bigger share of sales for all size classes in small Member States, which can be seen as indicating that the relatively small dimension of local and domestic markets is a factor for earlier internationalisation of SMEs.

Finally, as regards SME technological orientation and in spite of only partial data on formal R&D activities being available for a limited number of countries, the Observatory broadly confirms that small and medium-sized enterprises play a key role in both product and process innovation, especially as they tend to be more involved in incremental as opposed to radical innovations. Thus being, some four out of five domestic innovations could take place in SMEs, even if the percentage of innovating enterprises in manufacturing industry is found to rise with firm's size. This is mainly due to the fact that technology oriented businesses are typically micro and small enterprises that usually do not perform fundamental research and concentrate on having a quick response to market needs.

Only a minority of new technology based firms will expand into export oriented large scale businesses. Nevertheless, this minority is likely to provide the European Union with new world-wide leaderships that will undoubtedly be crucial to its overall competitiveness. In this respect, it is worth noting that the reports consider expansion of high tech enterprises to be still hindered by some major obstacles, particularly fiscal ones, and suffering from the absence of a dynamic European capital market for such small and medium-sized enterprises, which are thus forced to turn to options such as start-up and venture capital that are not easily available to them. In particular, the withdrawal of venture capitalists from the segment of business creation since the end of the eighties is seen as probably meaning that a large number of viable projects do not see the light of day in Europe because insufficient adequate financing is available, although this type of projects represents in the long-term a potential source of high-growth enterprises.

3. Employment in SMEs

3.1 Employment creation

Long-term unemployment has increased over the past years in the majority of Member States and the situation in the Union is now marked by high rates of unemployment that are detrimental to both the competitiveness and the social fabric of the European economy. Moreover, international competition, the globalisation of economic flows and company strategies are having a considerable impact on enterprises' choice of locations and attitudes regarding employment. The search for productivity gains, the concern to deploy new technology to automate production to an increasing extent, and the pressure from newly industrialised countries, whose wage costs are extremely low but who have proved capable of coping with the most modern techniques, may all induce European enterprises to shed even more jobs and to seek a competitive edge in a human resource policy based on increased selectivity.

On the whole, micro enterprises play the most important role in employment in Europe (31% against 29% for large enterprises), and are, in several Member States, the main single provider of

jobs in the non-primary private sector. Furthermore, although the data available on employment creation by SMEs is scarce and job generation studies are difficult to compare and interpret, small and medium-sized enterprises are considered to have the greatest job creation potential throughout the business cycle. In particular, and considering that fast growers are more likely to be identified in the "50-249" employees range (Kirchhoff, 1994), firms with the greatest propensity to create a large number of new jobs on a continuing basis are believed to be those smaller firms who have already demonstrated an ability to expand their operations successfully, but whose markets have yet to reach maturity. Therefore, the two collective objectives of conserving the social fabric and the competitive edge of enterprises can only be reconciled by taking advantage of SME strengths, particularly their presence in spearhead markets and activities that are less susceptible to international competition (and especially their predominance in personal services and in high-performance market niches), their links with the local environment, their ability to adapt and the flexibility of their internal organisation, while helping them to negotiate the administrative and legislative hurdles, overcome their problems and devise suitable strategies.

Whilst noting that policy making requires knowing not merely where new jobs are created but also how and why they are created, the Observatory carefully assesses the current debate on job creation by enterprise size (Davis et al., 1993) and produces some new evidence to conclude that the methodological criticisms raised by other studies on SME job creation (namely the seminal work done by Birch, 1987) do not invalidate its analysis, and the statement that SMEs generally create more jobs than large enterprises remains valid in Europe (Table 4). Moreover, it suggests that net job creation rates decline with the enterprise starting size, which would make this conclusion applicable regardless of the relative position of the firm along its life cycle.

Table 4 — Average annual growth rates (%) in employment by size class

	1988-1990	1990-1993	1993-1995	1988-1995
Micro firms	3.75	-0.5	-0.25	0.75
Small firms	1.75	-1	-0.25	negligible
Medium firms	1.25	-1.75	0	-0.5
SMEs	2.5	-1	-0.25	0.25
Large firms	0.75	-1.75	0.25	-0.5

Source: ENSR (1995).

Additional use of available detailed data for a limited number of Member States also allows the Observatory to underline the decisive role of micro and small enterprises in job creation in recent years, whilst noting that the direct effect of, respectively, expansions and contractions of established enterprises on job creation and job losses seems to be about twice as big as that of enterprise births and deaths. Though valuable in illustrating the complexity of the job generation process throughout the Union these findings are only a first step towards an analysis of differences between firms, which would be relatively more important than the sectoral structure to understand the reasons for their success or failure, and still require further clarification. Nevertheless, on the basis of employment data for 1990 and the Observatory's own estimates for average annual growth rates in employment by size class, it can in fact be noticed (Tenreiro, 1996) that job creation in SMEs has more than compensated job losses in large enterprises during the whole period 1988-1995 (Table 5).

Table 5 — Employment creation (annual average) by class size, 1988-1995

	micro	small	medium	large	SMEs	total
Employment creation	235,875	22,625	-77,500	-144,500	181,000	36,500

Source: ENSR (1995).

In spite of these encouraging signs, it remains clear that employment creation in the business sector in Europe is far from impressive and still a long way from contributing significantly to curb unemployment. Moreover, the evidence presented in the reports clearly indicate that SMEs may also have been loosing jobs in the most recent years. In general terms, and on a medium-term perspective, increased attention should therefore be paid to such issues as improving employment opportunities for the labour force by promoting investment in vocational training and raising the quality of human capital, increasing the employment intensity of growth by encouraging changes in work organisation and working time, reducing non-wage labour costs, especially at the lower end of the wage and productivity scale, and improving the effectiveness of labour market policies and measures designed to fight against social exclusion, namely by enhancing flexibility in the field of professional and geographical mobility and considering incentives to create and take over new jobs.

Finally, in the light of the undergoing, and much expected general economic recovery, some of the reports' findings can also be disturbing. To name just a few examples, there are signs that, in spite of large amounts of labour available and in many parts of Europe, employers are facing difficulties in finding people with the skills they require and that this may still inhibit output growth and job creation. Or that increasing use of numerical and functional flexibility, important as it may be for economic efficiency, can lead to a sub optimal utilisation of human resources and contribute to the emergence of some kind of "dual" labour market, characterised by an increased polarisation of work qualifications.

Moreover, the reports clearly show that similar constraints are being dealt with in very different ways by different countries. Both the level (measured as a percentage of GDP) and the structure of public expenditure on labour market policies can be noticed to vary markedly across Europe. In particular, Denmark, Germany, Luxembourg, Norway and Sweden have a relative high level of expenditure (particularly as opposed to Greece, Italy, Spain and the United Kingdom), and spending on training and youth measures dominates in France, Italy, Ireland and Portugal, while job subsidies are more important in Belgium, Denmark and Spain. Certainly, the complex nature of labour markets, and their central role in fulfilling social as well as economic objectives, means that national systems need to be understood in the context of distinctive national features in the business environment as well as in institutional and legislative arrangements that are in place. While fully respecting national choices or preferences it would thus seem useful to consider combining different experiences in order to improve overall performance, and fostering co-operation in policy development in order to minimise its costs and ensure compatibility between different national systems whenever they need to interact across the Union.

3.2 Self employment

An analysis of self employment in the EU (which includes the owner-managers of more than 7 million enterprises without salaried employees) clearly shows that, notwithstanding its growing importance from 1986 to 1991, differences in national legal and fiscal frameworks as well as in cultural and organisational attitudes towards work still reflect heavily on the structural characteristics and development of the self employment sector. In fact, the importance of self employment varies considerably amongst Member States, ranging from around 30% in Greece and Italy to a remarkable low of 10-12% of total employment in the private enterprise sector in Denmark, France and the Netherlands. Likewise, the likelihood of a self employed having

employees, which averages 30% at the Union level, varies dramatically from 4% in Italy to 60% in Germany and is, in general, substantially lower for women than for men.

Some problems with the definitions and data used in the reports make it difficult to interpret results on self employment, especially when contrasting them with those derived for the stock of enterprises and new entrepreneurship. It can be noted, however, that self employment, while seeming to appeal relatively more to male and older persons, is particularly important in the southern/peripheral Member States, where it provides around 20% of total employment in the enterprise sector. In general, it also appears that wage-earners are the single main source of inflows into self employment, although a large part of the remainder comes from out the labour force and unemployment (especially in Ireland and Spain), the main outflows being to wage employment and out of the labour force. In this case, it can probably be presumed that either most of the newly self employed are near the end of their professional careers or re-entering the labour market after some period of inactivity (European Commission, 1993). Nevertheless, as the relative importance of identified exit routes from self employment can be also interpreted as an indication for the presence of a considerable number of "unemployable" or discouraged workers that engage into their own activity for mainly negative reasons, further analysis of the characteristics of the self employed seems to be needed before operational conclusions can be drawn. Amongst others, an assessment of the economic importance and characteristics of family businesses (which, incidentally and mainly for demographic reasons, could be facing their biggest shake-up in two generations as they need to cope with difficulties related to the transfer of enterprises), namely if paying special attention to the role performed by assisting spouses, could be of particular interest in this field.

3.3 Job quality

It is generally acknowledged that SMEs are not an independent engine of employment growth and that special attention has to be paid to industrial interactions between enterprises of all sizes. At the same time, there is little doubt about the crucial importance of a well educated and trained workforce for SMEs. Thus, the role played by small and medium-sized enterprises as regards flexible production, and its implications on job quality are also considered in the reports.

Although clearly recognising SMEs to be instrumental in absorbing the less sought-after categories of the workforce, as they recruit more than their fair share of young people, women and unskilled workers, the Observatory suggests that flexible production, as a by-product of large enterprises' reaction to an uncertain, ever-changing economic environment, has a considerable negative impact on SME job quality. In particular, the Observatory builds on some well known, extensively documented and interacting trends (increase in the female participation rate and employment share, sectoral shift in employment from manufacturing to services, and increase in the number of part-time and temporary jobs, amongst others) to conclude that SMEs are, in general, more likely to have a significant proportion of their workforce covered by part-time or temporary contracts than large enterprises. At the same time, SMEs are also found to make relatively more use of a less educated, and therefore less productive, workforce, to be relatively less inclined to engage in vocational training, and to offer poorer working conditions, at least in terms of wages and fringe benefits. Moreover, when reviewing some international comparative studies on relatively low technology SME-dominated industries in both manufacturing and services, the reports clearly support the view that differences in employees skills and qualifications are a key factor in explaining observed differences in labour productivity and the workers' capacities of adaptation to technological change.

In general terms, wages appear to increase with the size of enterprises, labour costs in industry being on average between 30 and 50% higher in large enterprises than in smaller ones. However, both labour productivity and its growth rate seem also to be generally higher in large enterprises. Although some estimates suggest they have been able to close the gap in recent years (Table 6), SMEs, and particularly micro and small enterprises, would thus have to bear higher unit labour costs that have a potential adverse effect on their degree of competitiveness and, by stimulating

increased reliance on less labour-intensive production technologies, might reduce their potential for creating jobs.

Table 6 — Average annual growth rates (%) in labour productivity and labour costs

	1988-1990	1990-1993	1993-1995	1988-1995
Real labour costs				
SMEs	1.5	1	1	1.25
Large firms	3.75	2	1.5	2.5
Labour productivity				
SMEs	1	1.5	3.25	1.75
Large firms	1.75	2.5	3	2.5
Real unit labour costs				
SMEs	0.5	-0.5	-2.25	-0.5
Large firms	2	-0.5	-1.5	0

Source: ENSR (1995). Labour productivity is measured by value added (in constant prices) per occupied person.

As expected, wage differentials can nevertheless be found to vary across sectors and Member States and viewed as a first indication of the degree of flexibility of labour markets, since the more flexible a given labour market the more changes in relative demand and supply of different types of labour are supposed to show up in relative wages rather than in unemployment, even if an alternative explanation for (growing) wage inequality could be provided by de-industrialisation and replacement of "high quality" jobs in industry by "low quality" jobs in services. Moreover, and in spite of some mixed evidence, several studies (European Commission, 1993) seem to suggest that labour costs are smaller in Member States with lower employer's perceptions of employment-protection regulations, and higher rates of participation and part-time jobs.

In general, it is also to be noticed that the data presented in the reports does not allow to assess the relative importance of sectoral characteristics, as opposed to enterprise dimension, on labour productivity, and evidence presented to support the view that SME job quality is somehow "the dark side of flexible production" seems far from conclusive. Alongside with considerable differences observed between Member States, that can be due to a combination of developmental and cultural factors[3], the involuntary dimension of part-time and temporary work is largely overlooked by the Observatory, and there are reasons to assume that sectoral aspects are at least as important as size class differences in explaining job tenure and job quality. Furthermore, while average job quality is usually referred to as being lower in SMEs than in large firms, there is also some additional evidence that new jobs, whether provided by small or large companies, are quite similar (Pyke, 1995). As they stand, the reports' findings can thus only but stress the need for further analysis on these issues.

In the mean time, and even if considering that inferior job conditions in SMEs, as long as they lead to lower costs of production might provide a compensation for size-related cost disadvantages (Wagner, 1995), it is important to stress that SMEs do have their own specific

3 For instance, part-time work is almost insignificant in southern/peripheral countries (Greece, Italy, Ireland, Portugal and Spain), which rank amongst those having longer working weeks (the United Kingdom replacing Italy in the top five), whilst temporary contracts are, by far, particularly important in Spain.

problems that must be addressed if they are to develop, namely by means of new targeted innovative initiatives aimed at resolving problems of scale, knowledge, complementarity and co-ordination. Yet, the issue is not primarily whether SMEs or large firms are better locations of employment but whether the social and economic performance of all firms can be improved. At a time when labour, which some already refer to as the "software side of competitiveness", is increasingly seen as a resource rather than simply a cost, appropriate instruments should thus be sought to directly link improvement of working standards to improvement of competitiveness.

4. SMEs in the internal market

4.1 Theoretical effects

The Internal Market programme has been billed as a stepping-stone towards a dynamic and thriving marketplace in the European Union. All in all, it can be seen as an "enabling programme" that opens up new possibilities for companies previously confined to one Member State by offering them an opportunity for growth. It can therefore be expected to deliver proportionately greater benefits to SMEs, especially in those sectors and regions that were artificially divided by trade barriers as well as to those enterprises operating as intensive input-users in highly fragmented markets or being relatively more affected by changes in performance of downstream industrial users.

In its first annual report (ENSR, 1993), the Observatory discusses the impact of the Internal Market upon SMEs in general terms, by distinguishing between first-order, second-order and long-term effects as they result directly from Community legislative measures becoming effective, relate to changes in market size and competitive conditions, or stem from long-term changes in the economic structure and income effects. At a theoretical level, it thus considers the completion of the Internal Market as able to improve the state of SMEs mainly in five domains:

- reduction of administrative procedures and costs related to international trade, and hence better exploitation of economies of scale;
- improved efficiency, induced by more competitive markets;
- industrial adjustments on the basis of a fuller play of comparative advantages;
- increased dynamism and improved flow of innovations, processes and products;
- higher economic growth in the long run, leading to new market opportunities.

Whilst noting that those elements will not be equally relevant to all kinds of enterprises or economic activities, the report nevertheless argues that the costs of adjusting to the Internal Market could, by and large, more than compensate any benefits for SMEs in the short run. Therefore, the Observatory broadly considers that the effects of the Internal Market upon SMEs would in general be "U-shaped", leading to an improvement of their position in the medium and long run only, particularly as some concentration is expected to occur in markets and sales (namely in the southern/peripheral countries), as the removal of external barriers to trade is seen as favouring large firms first, and the beneficial effects of increased financial competition are supposed to be subdued by some concentration of financial centres in the northern/central countries.

Obviously, some distinctive features are still to be found across sectors and Member States. In manufacturing sectors where hardly any economies of scale can be obtained in the short run SMEs are expected to be able to maintain their market share, whilst in less mature industries, and particularly in the least industrialised Member States, smaller firms could be subject to severe competitive pressure and forced to reorganise and restructure. In the construction sector, the opening-up of public procurement would induce better opportunities for SMEs but also lead to increased competition especially at the main contractor level. In distributive trades, the bulk of the

short term impact of the Internal Market is expected to be felt mainly by small retailers in the Mediterranean Member States which could be especially affected by concentration processes. In the service sector, the general tendency would be for SMEs to benefit from the development of niche-markets and tailor-made personal services, even if it can be expected that enterprises incapable of adapting to the new business environment will be forced out of the market. Craft-like activities would probably be less severely affected by the Internal Market due to the predominance of customised provision of goods and services and less scope for economies of scale that, together, characterise this sector, but increased competition would still occur especially in border regions.

Moreover, it is significant to note that a preliminary analysis of several base-line indicators for 1988, as presented in the report for the then twelve Union members, does also reveal some striking differences between Member States. Taking SME-presence and degree of entrepreneurship as proxies for current predominance of small and medium-sized enterprises, and considering business dynamics and export orientation to be indicators of future prospects for SMEs, a definite picture seems to emerge. Small and medium-sized firms consistently predominate and seem to have bleaker prospects in a group of peripheral countries (Greece, Ireland, Italy, Portugal and Spain), while the opposite seems to apply to a group of small/central Member States (Denmark, Luxembourg and the Netherlands).

Whether or not, and how these tendencies can be affected by convergence originating from completion of the Internal Market is one of the major issues the Observatory tries to deal with since. In particular, as the first-order effects of the Internal Market are the first and most crucial link in the causal chain referred to by the Observatory, and only complete success in abolishing cost-increasing and market entry barriers will ensure that anticipated knock-on and macroeconomic effects of the Internal Market will follow, the need to provide for a careful monitoring of its functioning and proper isolation of its effects has been clearly recognised in the reports.

4.2 Perceived effects

When adopting the Internal Market programme in 1985, the Community chose to play a leading role in reshaping the international economy, and carried out at least one fundamental innovation. By setting both an aim and a timetable, it enabled the various economic and social operators, whose adherence to the objectives of the Internal Market was essential to ensure its success, to gradually adapt and acquire a European stance.

Anticipating on the 1st January 1993, a large number of companies has thus made proper use of the fixed time schedule to implement adequate response strategies to the progressive globalisation of their markets. Nevertheless, among these companies having a vocation, or a potential, to Europeanise there was probably still an insufficient proportion of SMEs, which traditionally account for a lower share in transnational trade flows. Therefore, even a "phased" implementation of the Internal Market was reflected in certain cases by an unbalanced perception of its effects. A gap that was still accentuated by a severe deterioration of short-term economic prospects, was sometimes felt to exist between the binding need for immediate adaptation to a new environment and the random character of potential benefits arising from the Internal Market.

To consider the perceived impact of the Internal Market on manufacturing industry, construction and services, the Observatory's second annual report (ENSR, 1994) grouped the then twelve Member States in two categories, according to their relative share of micro enterprise employment in 1988[4], thus aiming to take into consideration their specific economic structures and patterns of trade. Additionally, a distinction was made among five categories of possible

4 These are referred to as, respectively, Member States with a low (Belgium, Denmark, France, Germany, Luxembourg, Netherlands, United Kingdom) and a high (Greece, Ireland, Italy, Portugal, Spain) proportion of SMEs.

Internal Market effects as they referred mainly to the business environment, demand-related factors, resource availability, competition and costs, and expected developments up to 1997.

On the basis of results obtained from a specially designed questionnaire enquiry addressed to SME experts, the Internal Market is seen as having a positive effect on the business environment, as well as on demand factors, resources and business development, especially on those Member States with a lower proportion of SMEs. Yet, with the single exception of increased possibilities for economies of scale induced by sheer market expansion (which are viewed as being relatively more important in Member States with a high proportion of SMEs), the completion of the Internal Market is also felt to have an initial, less favourable impact on competition, costs and prices.

On the whole, the questionnaire findings provide some useful information on the direction and intensity of the Internal Market's effects on the business sector, and allow one to recognise that short run effects of the restructuring process under way, although not equally felt in all Member States, are potentially far more reaching for SMEs than for large scale enterprises. The impact is perceived to be weaker for small and medium-sized companies in SME-intensive countries, but the first-order effects are felt to be stronger than the second-order effects in both groups of countries. At a sectoral level, a similar pattern is to be found as to the assessment of the impact of the Internal Market on SMEs, but its intensity could be the strongest in manufacturing, followed by services and construction.

However, the complexity and intricacy of factors determining both the situation of, and the prospects for SMEs still prevent any interpretation of the responses to go much beyond these tentative remarks, especially since national SME tendencies are widely believed to increasingly interact with Union-wide enterprise and macroeconomic developments within the context of the functioning of the Internal Market. And indeed the report shows that significant convergence in the SME business environment and in SME performance was already under way during 1988-1993, in the run up to the Internal Market, even if observed differences in a number of indicators were still found to be large enough to lead to SMEs exhibiting distinctive behaviour in different Member States in the foreseeable future.

4.3 Estimated effects

By extending the analysis carried out earlier, the Observatory's third annual report (ENSR, 1995) has focused on the threefold interrelationship between SME performance, SME dynamics and the business environment in the light of completion of the Internal Market. Moreover, as actual and estimated developments in those variables were considered for the period 1988-1994, the Observatory has deemed useful to distinguish between two different groups of countries, according to whether or not they were Union members during that period.

On the whole, the information included in the report clearly shows that recent improvements in the overall economic situation and progress made in real and nominal convergence at the macroeconomic level do have an equivalent at the enterprise level. In fact, not only did SMEs perform fairly well in the then Member States (EUR-12) as their business environment doubtless evolved towards a higher degree of coherence[5]. At an aggregate level, convergence is particularly noticeable in such general domains as fiscal and monetary policies, technology and innovation, capital and finance, labour market conditions, and macroeconomic strength and presence in global markets. At an indicator level only three of the individual variables taken into consideration by the Observatory to capture specific features within each domain have shown some significant divergence over that period. Moreover, the business environment in new Member States and Norway (EUR-4) also appears to have become increasingly similar to that prevailing in the Union in most of those domains, the only exception being capital and finance where some relatively unfavourable developments in fixed capital formation and availability of venture capital appear to have taken place.

5 As in the report, the concept of convergence (or divergence) has here a dynamic nature and corresponds to a movement towards increased (or decreased) coherence, which is understood as its static counterpart.

Notwithstanding this general tendency, some divergence is reported to have occurred, however, in labour market policies (coupled by some diversion of EUR-4 from EUR-12, in spite of identified convergence tendencies in unemployment benefits, as measured by wage replacement rates, and start-up support policies), burdens on businesses (especially regulatory burdens) and industrial relations (especially labour regulations, which, incidentally, were not found to significantly affect SME performance). Although it should be noticed that these domains are exactly the three that were found to be the most coherent in 1988, in this sense also allowing for a higher degree of liberty in national policies, closer inspection of various indicators considered by the Observatory most of the times reveals some striking similarities and differences between different groups of countries (European Commission, 1995a), especially with regard to burdens on businesses, where four distinct patterns clearly emerge[6]. Considering that divergence in labour market policies was largely found to be the result of a general movement towards higher levels of public expenditure on active labour market policies, the report's findings thus seem to provide further evidence as to the importance of paying specific attention to the distinctive features of different Member States' employment, legal and administrative systems whenever an assessment of the business environment impact on SME performance is to be made.

As regards SME performance, and apart from having found a certain degree of divergence that seems to result from a few, individual deviant cases, the report suggests that recent improvements in profitability and generation of value added were only to a limited extent matched by employment growth. Whilst a general increase in the enterprises' self-financing capabilities is certainly to be welcomed, especially since it can surely act as an enhancing factor for future investment, other studies also suggest that the business propensity to invest is still being negatively affected by inflationary expectations, interest rates differentials and exchange rate instability. Thus being, promoting the development of a stable macroeconomic environment by means of sound macroeconomic policy would indeed seem to be one of the most important single factors in stimulating business development and entrepreneurship, as well as employment growth and the international competitiveness of SMEs. Again, policies that put more emphasis on the small firm sector would be particularly well suited to achieve these objectives, as the Observatory has found that the structure, rather than the level of public expenditure tends to be associated with stimulating, or depressing factors of SME performance.

Finally, not only the general business environment was found to have improved during the last six years (meaning that specific developments in, for instance, monetary policies and capital markets' conditions have stimulated SME performance) as convergence in the business environment is also said to have contributed towards enhanced SME performance. Moreover, and most of all, completion of the Internal Market appears as having a positive effect on both the situation of, and the prospects for European small and medium-sized enterprises, at least when considered as one of the exogenous factors that directly influence interacting developments in SME performance, SME dynamics and the business environment.

Naturally, the report's conclusions have to be taken with some precaution, as it is still too early to fully evaluate the impact of the Internal Market on SMEs. First of all, macroeconomic developments will always act, along with the completion of the Internal Market, as an independent force on SME performance, even if relative synchronisation of business cycles, as well as relative convergence of the business environment is to be expected in the coming years. Secondly, different SME indicators will inevitably capture a different mix of Internal Market related aspects and refer either to its first-order or longer term effects, whose relative importance through time also needs to be assessed. As longer time series become gradually available and the time elapsed since its official coming into force allows more of its effects to be visible, the Observatory

6 Meaning higher than average financial and regulatory burdens in Austria, Belgium and Germany, higher regulatory and lower financial burdens in France, Denmark, Luxembourg and the Netherlands, higher financial and lower regulatory burdens in Greece, Italy, Ireland, Portugal and Spain, and, finally, lower regulatory and financial burdens in Finland, Norway, Sweden and the United Kingdom.

will certainly be called to further pursue and refine its analysis, namely by considering new causal relationships and adjusting its scope.

5. Conclusion

SMEs already make a significant contribution to employment generation and sustainable growth. Yet, taking into account the high unemployment levels registered throughout Europe, small and medium firms will certainly be called to play an even more vital role in the near future, and enterprise policy is set to become an increasingly important tool for the creation of new employment opportunities.

Quite unsurprisingly, the Observatory's reports suggest that enterprise policy should attempt to reinforce the strengths and countervail the weaknesses of the SME sector. Nonetheless, they also recognise that, in most cases, those strengths and weaknesses, as well as opportunities and threats faced by SMEs, are just two sides of the same coin. Whilst some of the reports' qualitative findings certainly require closer examination on the basis of the new SME definition recently adopted by the Commission (Bénassi, 1995), their main conclusions will surely remain mostly untouched, since considering micro enterprises, small enterprises and medium-sized enterprises to be those which employ, respectively, less than 10, 50 and 250 persons has only a marginal effect on basic SME indicators (Table 7).

Table 7 — Revised main indicators by size class, 1990

	micro	small	medium	large	SMEs	total
Enterprises (1,000)	15,210	975	130	30	16,315	16,345
Enterprise share (%)	93	6	0.8	0.2	98.8	100
Employment (1,000)	31,450	20,500	15,350	34,000	67,300	101,300
Employment share (%)	31	20	15	34	66	100
Average size	2.1	21	118.1	1133.3	4.1	6.2

Source: ENSR (1995).

The available evidence therefore suggests that growth and job creation in SMEs is still being inhibited by basic market and policy imperfections, and indicates that nowhere in Europe is SME contribution to employment and growth near its full potential (European Commission, 1995b). Compared to the 1988-1993 period, in which smaller companies more than compensated for job-losses in larger enterprises, the SME job-machine is now stagnating, as slow recovery follows a period marked by a general slowdown in the growth of enterprise population, due to a slight decline in new enterprise creation and an increase in closures.

Central to the process of long-term job creation and economic renewal is the continual, if unpredictable, process of creation and growth of new firms and industries. SMEs contribute more than proportionally to net job creation, but much of this creation can be attributed to a relative small cohort of fast growing firms in "new" industries. Therefore, the question often arises of knowing as whether societal goals can be best served by policies that address to the entire business population or try to focus on a small group of fast growing, innovative companies (Storey, 1994). As regards the related debate over whether to support the creation of new businesses or the development of existing ones, the Observatory generally considers that it is not possible to rule out either of these objectives, even if it recognises that consideration of the matter is, eventually, essential for defining the priority measures which budgetary constraint imposes in the Member States.

While it is true that new businesses have a relatively high death rate and few of them have much potential for job creation, the establishment of new companies is nevertheless essential for renewing the industrial structure. It is the only way ahead for the development of certain regions, and it doubtless constitutes the best guarantee as to the existence of an adequate industrial core from which high growth, innovative firms can safely spring and develop.

Enterprise policy in the eighties and early nineties has tried both to increase inputs to the entrepreneurial engine and its efficiency[7]. Although improvements in the efficiency of the entrepreneurial engine are more likely to have immediate effects (Hall, 1995), if only due to shorter time lags inherent to their operation, trying to pick up winners does not make much sense, because predicting which kind of start-ups will be high growth, or even growth oriented is a fairly futile exercise. This notwithstanding, it is equally senseless not to target programmes at where they will have the most effect.

At the turn of the century further development of enterprise policy will certainly be required. Different intervention levels, both on a quantitative as well as on a qualitative basis, are to be secured if different types of companies are to be effectively affected by policy measures. In this regard, there is still a clear need for improved knowledge about differences identified within the SME sector itself, as well as about micro processes underlying SME activities. But size "per se" need not matter and should only be taken in consideration as one amongst various elements in devising an appropriate typology of firms. Most of all, policy needs to be restructured on a functional, as opposed to an administrative basis, and to be pursued by reconciling political and budgetary priorities.

In reality, market developments require enterprises of all sizes to continuously adjust their activities and resources, regardless of sector or location. The initiative of entrepreneurs, their decisions on hiring and investing are paramount to growth. The aim of any public policy must then be to provide a coherent and transparent framework within which economic operators can freely compete on the basis of equal treatment, and therefore to induce a virtuous circle of initiative, employment and growth.

7 In practice, the distinction is mostly one of emphasis, and policies often have a combined effect on both increasing inputs (enhancing entrepreneurship) and efficiency (improving the companies' abilities to survive and prosper).

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