



The Green Paper 'Entrepreneurship in Europe'

Reaction from EIM Business & Policy Research

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Introduction

In January 2003 the European Commission presented the Green Paper 'Entrepreneurship in Europe'. This document presents the European entrepreneurial challenge, i.e. it identifies the key factors for building a climate in which entrepreneurial initiative and business activities can thrive. Policy measures should seek to boost the Union's levels of entrepreneurship, adopting the most appropriate approach for producing more entrepreneurs and for getting more firms to grow.

In order to meet this challenge, the Commission has formulated three pillars for action towards an entrepreneurial society:

- 1 Bringing down barriers to business development and growth
- 2 Balancing the risks and rewards of entrepreneurship
- 3 A society that values entrepreneurship

Based on these three pillars, ten questions were raised what could be done to move Europe towards an entrepreneurial society.

EIM Business & Policy Research is pleased to formulate a reaction on the questions raised in the Green Paper. We have assembled our main comments and policy suggestions in the present report. Our reaction is strongly based on the findings from research in this area, both the many investigations carried out by EIM Business & Policy Research itself and several other studies and reports that are publicly available. Sometimes, research leaves several options open to policy makers or cannot give due attention to all relevant aspects. In all cases, of course, policy makers in the Member States and at the level of the European Union will have to make their own (political) choices.

1 Question 1

What should be the key objectives for an agenda for entrepreneurship in the European Union and how should these relate to other political ambitions? How can we build a model for entrepreneurship in an enlarged Europe?

In recent years, economic research has provided the following two insights:

- *Entrepreneurship matters.*
Entrepreneurship affects the economy both directly and indirectly, and at various levels, through innovation, competition and restructuring (Wennekers and Thurik, 1999). Empirical research has shown that both a higher rate of new business start-ups and a higher rate of turbulence (the sum of start-ups and closures) enhance, after a certain time lag, economic growth and job creation (Carree and Thurik, 2003). More specifically, an increasing 'small firm presence' in sectors of manufacturing stimulates economic growth in those sectors (Carree, 2002). These findings from recent research bear out the economic importance of entrepreneurship within a wider perspective of growth theory at large, encompassing the role of education, scientific progress and scale economies.
- *Europe lags behind in entrepreneurship.*
Entrepreneurship in almost all member states of the European Union, as measured by harmonized rates of 'nascent entrepreneurship', is structurally lower than in a group of 'Anglo-Saxon' countries, including Canada, the USA, Australia and New Zealand (Global Entrepreneurship Monitor, 2002). The main reasons for Europe's arrears in entrepreneurship seem to be rooted in its culture and institutions (Audretsch et al., 2002; Bosma et al., 2002; Davidsson and Henrekson, 2002; Van Stel et al., 2003). Specifically, incentive structures in Europe are not conducive to entrepreneurship. Also, many European countries have relatively high legal and administrative barriers for business start-ups. Finally, cultural and regulatory impediments to labour mobility and to knowledge transfer from universities to new businesses hamper entrepreneurship and innovation.

If, as stated in the Green Paper 'Entrepreneurship in Europe', the European Union seriously and effectively wants to foster its entrepreneurial drive, it must face the challenges that are inherent to the abovementioned facts. Key objectives will have to be:

- Better incentives for entrepreneurship, including higher labour market flexibility and lower 'opportunity costs' of self-employment versus wage-employment;
- Lower legal and administrative barriers for new business start-ups and incumbent enterprises;
- Improved conditions for technology based enterprises, including easier knowledge transfer from universities and sufficient availability of venture capital.

The cultural and institutional impediments to entrepreneurship in Europe are deeply rooted and by no means negligible. The attainment of these key objectives therefore asks for a long-term policy of *structural reform*, a road some Member States have already begun to follow. Additionally, policies stimulating and promoting entrepreneurship through support schemes, publicity campaigns, entrepreneurship awards, and by appointing former business leaders as Industry Minister or as a European Commissioner, will help to enhance the structural level of entrepreneurship in Europe. The road to an entrepreneurial society, however, is a long one. The realisation of this goal will demand perseverance from policymakers and will involve political choices. However, once reform is underway, the process will tend to become self-reinforcing as learning processes and role models will create positive feedback effects (Wennekers and Thurik, 1999). Furthermore, the key objectives relate positively to other political ambitions such as enhanced competitiveness, the abatement of unemployment and higher rates of labour participation.

In stimulating entrepreneurship there are important tasks to be carried out both at the level of the European Union and that of the Member States. In many policy areas the Member States will have the prime responsibility to promote entrepreneurship in their own country (principle of subsidiarity), while in some specific areas such as improving labour mobility, the European Union might take the lead. Furthermore, the European Commission might concentrate on promoting the evaluation of support schemes, the dissemination of relevant research findings, the exchange of good practices and the co-ordination and harmonisation of national regulations.

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2 Question 2

How can we improve the availability of finance (tax measures, public-private partnerships, stronger balance sheets, guarantees) and what alternatives to bank loans should be promoted (business angel finance, leasing, factoring and micro-loans from non-bank lenders)? How can entrepreneurs be supported in obtaining external finance?

Constraints

Stability is important to receive financial assets. Especially young SMEs (including seeders and start-ups) find themselves in a kind of growth process, which enlarges the risks for financiers. This holds even more specific for technological innovative firms. There is no track record and the agency costs for financiers such as banks are high. The demanded capital is relatively small, while transaction costs are high. There is also the problem of information-asymmetry, as financiers have difficulties in assessing the return of the investment or the innovation. Therefore this group is less interesting for financiers and for venture capitalists. Besides, the entrepreneur is reluctant to give away control of the business. This is known as the restricted pecking order (Holmes and Kent, 1991). The entrepreneur mostly receives the funds needed from his own family and by keeping profits in the business. Deduction of profits is a signal to financiers (Leland and Pyle, 1977).

Differences in fiscal treatment of equity and debts make financing with debts attractive for SMEs (Ang, 1992). As collateral is needed for long term debts, SMEs finance growth often with short debts (Van der Wijst, 1989; Verhoeven and Van Noort, 1999; Myers, 1977). The success of getting funds for investment projects depends on the question whether the interest payment is no problem rather than receiving the return on investments requested (Martin et al).

EIM investigated whether young SMEs and elder SMEs received the bank loans they asked for. About two third of the start-ups were successful in getting the amount asked for, while almost 90% of existing SMEs received the amount asked for.

Leasing and factoring are hardly used by SMEs (Van der Wijst and Verhoeven, 1996). Factoring companies have conditions for acceptance, by which entrepreneurs might be curtailed in their actions. Leasing is often only possible for object finance. The rate of interest is often higher and the right to receive tax deduction for the investments could disappear.

In practice it is hard to find informal investors for SMEs. Business angels are important for SMEs and these informal investors should be promoted. In the Netherlands there are about 500 business angels. They invest on average about € 70.000 - € 700.000. They are important because they not only invest capital, but also offer knowledge and networks (NEBIB, 2000) and have no need to 'sit on the chair of the entrepreneur'.

Trade credit is in a way a substitute for financing by financial intermediaries and is expected to be used more in countries with underdeveloped financial systems, but on the other hand it is complementary to short-term bank loans. The supply of trade credits may be greater if supplying firms have broader access to bank loans (Demirgüç-Kunt, Maksimovic, 2001). In the framework of the project The Observatory of European SMEs a survey was held in 2002 amongst almost 8,000 SMEs in 19 countries. One of the issues in that survey was the relation of SMEs with their banks. Of those SMEs that needed a loan in the last three years 84% obtained the loan. Almost 40% of SMEs did not have a need for a loan in the last three years. Around 12% of the SMEs reported that they did not get the loans needed; the banks refused to give loans to SMEs for the following reasons:

- The enterprise could not provide enough collateral; this holds in particular for the micro and small enterprises (23%);
- The bank was not satisfied with the performance of the business (7%);

- The bank was not satisfied with the information provided (5%).

In countries whose legal systems score high on an efficiency index, a greater proportion of firms use long-term external financing. Government subsidies to industry do not increase the proportion of firms relying on external financing (Demirgüç-Kunt, Maksimovic, 2001).

Young knowledge-intensive firms have difficulties in finding external financiers, because of the lack of collateral. If 'knowledge capital' (intangible assets) can be stated at a realistic value on the balance sheet this problem could be solved (EZ, 1999).

Solutions

From an EIM study in 1997 (Jonkheer et al, 1997) the following conclusions were drawn concerning the effectiveness of policy measures that still seem relevant today. A coherent and integrated policy offers best opportunities for an effective capital market for SMEs.

Information asymmetry appears to be the largest problem. When the capital market for SMEs is well developed guarantee loans are less effective while banks act more risk averse. Evaluation studies reveal that countries that have a well-developed capital market, like the UK (Small Business Guarantee Scheme) and the US (SBA-7), guarantee schemes are mainly used by traditional businesses. In general it holds that in developed financial markets for all policy measures the aim, the content, the selection criteria and financing conditions are described accurately and are executed strictly. Credit arrangements offer few opportunities to circumvent the information-asymmetry. The character of credit arrangement is often unique and probably offers no easier entry for capital in the private market.

Fiscal arrangements and subsidies do not reduce the information-asymmetry and are just meant to lower the financial costs. Policy measures in the field of risk bearing financing are most effective, as they actually subsidize the additional costs of selection and support of technological innovative firms. Mediation bureaus offer good opportunities to exchange information between business angels and firms. Measures in the field of advice might offer a contribution to diminishing the information problem. To solve the problems for technological innovative firms technology rating may be a solution (see also EZ, 2000). Practiced in the UK and the Netherlands.

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3 Question 3

Which factors most hinder growth ((lack of) mutual recognition and EU-rules or their (non-)implementation at national level, national tax provisions or the situation on the labour markets)? What actions are best suited to supporting growth and internationalisation (trade missions, market analyses, clustering and networking, information and consultancy services)?

There are three ways to explain differences in the growth pace of growing enterprises. (The Economist, 1999):

- 1 Each firm should go through different growth phases. The transition of one phase to another is accompanied by a crisis, like the problem of the span of control or the decision to hire an employee or not.
- 2 All enterprises have an ideal size. Growth is a temporal phenomenon to make it possible to reach that size.
- 3 Growth is dependent of the competencies in the field of organization.

Each of these explanations is plausible but the points 1 and 3 create problems in real life of businesses. There are obstacles that hinder the development of the enterprise such as the increase of the complexity of the firm, the decision to go abroad (export), the expression of an innovation strategy, personnel management etc. Firms that do not succeed in solving these problems get stuck in a low growth pace or even exit (Kemp, Verhoeven and Kreijnen, 2002).

Some characteristics of fast growing firms are: innovative, niche-players, much attention for product development, a modern structure of their organization with attention for human resources, the level of productivity is relatively high. Exports and an offensive strategy are not necessarily conditions for growing fast (EZ, 1998; Van der Hoeven and Verhoeven, 1994).

In general firms are helped when policy promotes a healthy competition, lays down adequate rules and restricts administrative burdens and finally creates a productive climate in the field of taxation, financing, etc., by attuning (supra)national, regional and local policy and by supporting enterprises to develop new markets.

In the Netherlands policy helps fast growing firms in three ways:

- 1 by improving the reach of networks and education,
- 2 by improving the quality of education,
- 3 by improving the information facilities and learning from best practices (website and stimulating a platform for fast growing firms (Growth Plus).

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4 Question 4

To ensure high quality businesses, what training and support should be offered for a business start-up (basic training – compulsory or voluntary; incubators, mentoring) and business development (networks, courses, mentoring, distance learning, e.g. e-learning)? Should there be services tailored to the needs of specific groups (women, ethnic minorities, unemployed or socially disadvantaged people) or businesses (knowledge-based activities)? Should the quality of delivery of support services be improved (using ICT, professional standards)?

A vast majority of start-ups in the Netherlands make use of some kind of support service during the start-up phase. Starting entrepreneurs particularly apply to the Chambers of Commerce, the tax authority or their accountant to gather information concerning fiscal matters, setting up an administration, regulation and market information (Bais, 1998). Many start-ups indicate that they need a 'guide' that will show them what steps are necessary to take in order to start the business (Stigter and De Vree, 2002). A relatively high share of Dutch micro, small and sole proprietor's businesses indicate to be 'rather well' informed on the existence and availability of support services, but none of the enterprises feel 'very well' informed (Austrian Institute for Small Business Research, 2001). Entrepreneurs often complain that the information they receive is too general and not completely tailored to their own situation. Businesses that do not make use of support services either are not aware of the existence of external information and advice or are of the opinion that they do not need external help. A recent study from EIM reveals that growing firms are more likely to call for external help than firms that are not willing or not able to grow (Muizer and Stigter, 2003).

Based on research (Bruins et al., 2000) we can indicate at least two elements that are crucial for start-ups to survive during the first years of their existence, in which support organisations might have a role to play. In the first place the importance of writing a business plan can hardly be denied. Nowadays only 12% of all nascent entrepreneurs (i.e. people that are preparing to start a business) in the Netherlands write a business plan before the start (Bruins, 2001). A business plan is nonetheless a very useful instrument to check what is needed to start a business and to become aware of the obstacles they might be confronted with in the future. As a lot of nascent entrepreneurs do not write a business plan, some might be not well enough prepared for running their business. Support organisations can raise the awareness among nascents about the importance of writing a business plan and if necessary assist them in this process.

Another element that needs special attention is the importance of networking. Research has revealed that exchanging information and keeping up to date about trends and developments is a crucial element in the first years of the existence of the business (Bruins et al., 2000). Here support organisations, like the Chambers of Commerce, can set up and facilitate these networks of (starting) entrepreneurs. Although many entrepreneurs are already willing to learn from each other's successes and failures, maybe others should be made aware of the advantages of sharing experiences and exchanging information.

Entrepreneurial policy can be a stimulating factor in this respect. During the first half of the nineties the main focus of Dutch entrepreneurial policy was to stimulate people to become self-employed. This led to more public attention for entrepreneurship in general, the promotion of role models and the introduction of several training courses for nascent entrepreneurs. In these years particular attention has been paid to the possibilities for women and ethnic minorities to become self-employed (Bruins, 2001). Although it is rather difficult to judge to what extent this entrepreneurial policy has been effective, data reveal that entrepreneurial activity has increased during these years. The total amount of annual start-ups increased from 30.000 in 1990 to more than 41.000 in 1995 (EIM, 2003); relatively more women

started a business (from 25% to 33% nowadays) (Stigter, 1999) and more nascents wrote a business plan at that time (20%).

In the second half of the nineties, entrepreneurial policy has changed towards creating opportunities for entrepreneurship and removing all kinds of impediments for entrepreneurs. Attention has shifted to economically relevant entrepreneurs like technology based firms¹ and high growth companies. Probably due to the economic situation at the moment (2003), there are nowadays discussions whether to introduce special arrangements for disabled people or for older people that become unemployed in order to help them start their own business.

Several studies reveal that starting entrepreneurs often lack full insight in the availability of information offered by public support organisations (Stigter and De Vree, 2002; Muizer and Stigter, 2003). As a consequence entrepreneurs spend extra time in finding the information they need. Bringing the information together by introducing a one stop shop for (starting) entrepreneurs is in progress, but needs to be further stimulated. The use of information technology is undoubtedly very useful in this respect, although one should not consider this the cure for all problems; the intentions and willingness to cooperate among public (and maybe also private) support organisations is even more important to assist entrepreneurs and create a stimulating entrepreneurial climate.

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¹ Syntens e.g. is a public support organisation in the Netherlands that assist small innovative firms to overcome the obstacles in bringing their new product or service to the market.

5 Question 5

Are the obstacles and incentives for business development and growth in the European Union similar for entrepreneurs in the Candidate Countries, and does the forthcoming enlargement call for specific measures in the Candidate Countries?

In May 2004 the EU will – formally - be enlarged by 10 new member states and the accession of additional countries is foreseen a few years later. However, the forthcoming enlargement cannot be understood as a single event happening at a particular moment in time. What is more, enlargement (and the accession of future member states respectively) is a long-lasting process of (economic) integration, comprising a multitude of different integration steps and stages in various fields. This process of economic integration has changed and will further change the economic framework conditions under which (small and medium-sized) enterprises in current as well as future member states are operating, e.g. by altering the governance and rules of economic interaction. Surveys have shown that there is still considerable scepticism regarding enlargement among parts of the population and also among entrepreneurs in current and future member states.

Within the context of the 8th Observatory of European SMEs a report will be published about SMEs and the Enlargement of the EU¹. This report will provide an *overview* of the diverse effects, including opportunities and threats, of the accession of new member states on *SMEs* in particular².

The basic research question and starting point of the report is: What is the economic impact of EU enlargement on European SMEs? Economic impact mainly refers to economic performance and any kind of economic opportunity and risk (threat):

- Impact on sales, turnover, exports, or market shares
- Impact on the cost situation for and access to inputs (material, services, labour, and transport costs)
- Impact on the competitive position (opportunities, risks)
- Impact on survival, enterprise formation
- At aggregate level: Impact on the structure - size, regional, sectoral - of the business sector (e.g. concentration effects, specialisation effects)

However, actions on the side of businesses are required for some potential effects to materialise. In this sense, some characteristics regarding the behaviour of enterprises will be taken into account as well. Behavioural characteristics may pertain to:

- *Business interactions/contacts (e.g. co-operation)*
- *Business strategies pursued*

An important basic distinction that will be made is between businesses in current and future member states.

Apart from the basic research question related to the impact of enlargement the report will also discuss the question, which relevant policy strategies and measures are applied at European (e.g. transition periods, pre-accession strategy), national or regional level, including candidate countries: Is there a

¹ The publication of this report is scheduled for December 2003.

² Only few studies concentrated on this issue before, for example: RWI Essen, *Impact of the Enlargement of the European Union on Small and Medium-sized Enterprises in the Union*, Report to European Commission, DG Enterprise, Essen and Glasgow, 2000.

general policy strategy existing? If yes, what are the aims and approaches? What are the most important specific measures? Can different policy patterns be identified? The policies applied shall then be put into perspective with reference to the results of the impact analysis.

As in Western Europe, most of the enterprises in Candidate Countries are micro-sized. The size-class structure of employment is on average slightly more geared towards small enterprises: SMEs make up 72 % of total employment in the Candidate Countries, while the corresponding figure is 66% for the EU. This difference is concentrated in micro enterprises, as they provide 40 % of total employment in the Candidate Countries, and only 34 % in the EU.

Also general indicators (e.g. the average number of occupied persons per enterprise) point at an enterprise sector that is on average smaller scaled in the Candidate Countries compared with Western Europe.

Large differences between the average sizes of enterprises in the Candidate Countries exist. In the Central and Eastern Economic Countries (CEEC's) - especially the Baltic countries (Latvia: 15!) - average enterprise size tends to be well above the average for the Candidate Countries (5) and the European Union (6). The group of Candidate Countries consisting of three Mediterranean countries: Cyprus (4), Malta (4) and Turkey (4), which are not former plan economies, show great resemblance to southern European countries in the EU (Greece (2), Italy (3), Spain (5) and Portugal (5)), as both groups of countries are characterised by a large presence of micro enterprises.

On the other hand, enterprises in Candidate Countries seem to catch up with western enterprises.

table 1 Average *annual* employment growth in the period 1995-1999 by size class of enterprises was as follows:

	<i>Europe-19*</i>	<i>Candidate countries</i>
Micro	1.3	2.8
Small	1.0	3.6
Medium	0.7	7.8
SMEs	1.1	4.0
Large	0.7	-12.5

* *EEA plus Switzerland*

So, for the time being most Candidate Countries will suffer from the small-scale size class structure of their economies. This could be a hindrance to innovation and internationalisation, as well as a bottleneck to international co-operation (e.g. as subcontractors of larger Western European businesses). Short-term support measures should therefore be concentrated on eliminating the disadvantages of very small enterprises (weak management, poor access to finance, difficulties to get the right information, etc.) and/or helping them to grow. Structural improvements could include:

- Creating a healthy business environment: legislation, taxation, etc.
- Simple regulations and administrative procedures (in fact Candidate Countries are in an advantageous position: not many rules and regulations for the private sector have been implemented yet. It is easier to implement simple regulations (taking into account lessons learned in western countries) than changing already existing regulations).
- Creating a flexible labour market.
- Creating a supporting financial environment.

Additionally, and particularly in the former plan economies, there should be attention for creating a more entrepreneurial culture.

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6 Question 6

What can EU Member States do to make the balance between risk and reward more favourable to promoting entrepreneurship (reducing the negative effects of bankruptcy, making more social benefits available for entrepreneurs, reducing the tax burden either in term of administration or rates)?

Part I - reducing the negative effects of bankruptcy

Entrepreneurship involves success and failure

"The fastest way to succeed is to double your failure rate" (Thomas Watson, IBM). ¹ Making mistakes is inherent to entrepreneurship. Stimulating entrepreneurship therefore implies accepting that business founders make such mistakes and could end up filing for bankruptcy. Research results however indicate that business founders – despite these failures – overall contribute to economic well-being (see answer to Q.1).

Negative attitude towards failure in EU

Figure 1 demonstrates a negative attitude towards failure in many Member States. Anglo-Saxon countries appear to be more positive towards failure. For the EU, therefore, establishing a more positive attitude in this respect will be fruitful as it would lead to more people considering entrepreneurship as a career option (see also our answer to Q.1).

What can be done?

Acknowledging that negative effects of bankruptcy will always remain, possible actions reducing the effects pertain to relaxing existing barriers to entrepreneurship via

- 1 Modifications in juridical systems (Bankruptcy Acts);
- 2 Changing the attitudes towards failed entrepreneurs.

1. Bankruptcy Acts

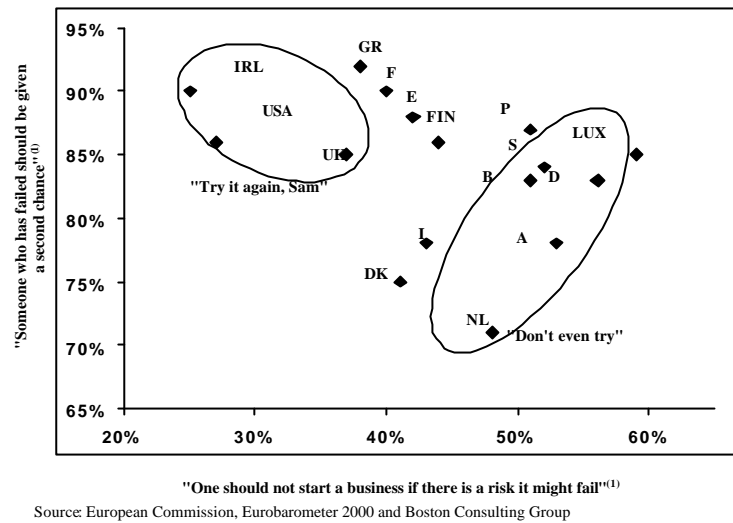
Important features already present (or currently in study) in many European countries' juridical systems is enabling an early debt-settlement in order to circumvent bankruptcy and minimize losses. Another key issue is the *balance* between debtor and creditor rights in case of bankruptcy. From the work of Laporta et al. (1997, 1998) it can be derived that creditor rights are somewhat higher in most European countries, as compared to the U.S.A., for example. Development towards less secured creditors will, due to decreasing (perceived) financial risks involved with setting up a venture, lead to more entrepreneurship. On the other hand, it might also hinder entrepreneurship as financial institutions could become less inclined to provide capital for start-ups.

2. Bending the attitude towards failed entrepreneurs

Negative attitudes towards failed entrepreneurs are deeply rooted in the Member States. Bending these attitudes is therefore a matter of structural, consistent promotion of entrepreneurship in this particular respect, e.g. by highlighting best practices of successful restarts. It also appears that a considerable share of firms apply additional conditions towards entrepreneurs who experienced bankruptcy earlier. Examples of additional conditions relate to loans and supply conditions etc. Such practices should, wherever possible, be discouraged.

¹ See for example The Innovative Enterprise, *Harvard Business Review*, August 2002.

figure 1 attitude towards failure in the EU



Part II – reducing the gap in social benefits available for entrepreneurs and employees

Being an entrepreneur involves taking risks and dealing with uncertainty. Typically the income of self-employed persons is more irregular than that of employees. Furthermore, both employees and entrepreneurs are liable to risks causing a reduction or loss of income. Common risks, causing loss of income are:

- Sickness
- Disability
- Unemployment

Social security systems provide benefits in order to compensate the loss of income in those cases. Generally, the social security systems make a distinction between entrepreneurs and employees¹. Differences between entrepreneurs and employees concern the entitlement to social benefits in itself, as well as the level of contributions and benefits that apply.

In order to assess the impact of social security on entrepreneurship it is important to understand the role of social security in the decision-making process of a person deciding to earn an income as an employee or as an entrepreneur. According to Verheul et al. (2001), individuals assess and compare the risks and rewards in the process of deciding between different types of employment. This involves a weighing of alternatives, based on opportunities, resources, ability, personality traits and preferences.

¹ A notable exception is Finland, where one can change status from employee to self-employed (and back), while keeping all entitlements to social benefits.

In most countries the social security system is built and developed around businesses and their employees. This has resulted in a host of general schemes for employees, for which their employers usually contribute significantly to premiums. For self-employed persons comparable schemes often don't exist, or are much more expensive, since the entrepreneur has to bear 100% of the premiums. In other words the level of social security for entrepreneurs is lower than for employees. Another way of looking at it is that the costs for entrepreneurs to reach the same level of social security (e.g. through private insurance) is (much) higher than for employees. For entrepreneurs this implies a higher risk of losing income (or higher costs to be entitled to social benefits). At the level of society these higher 'opportunity costs' of entrepreneurship may hamper new business start-ups.

Research has focussed mainly on the role of social benefits in the decision-making process at the micro-level. See for example Bosch and Westhof (1997) or Visee and Zwinkels (1999). In studies at macroeconomic level indicators on social security are rarely considered. A recent study using the Global Entrepreneurship Monitor database, including nascent entrepreneurship rates for 36 countries, indicates a negative effect of social security expenditures (as % of GDP) on nascent entrepreneurship¹. Currently a study is being carried out, specifically aimed at analysing the influences of differences in social security between employees and entrepreneurs on the level of entrepreneurship within countries².

Hence, available research at both micro- and macro-level indicates that higher levels of social security have a negative influence on the level of entrepreneurship. These findings are mainly due to the fact the social security systems are primarily focussed on employees. Entrepreneurship can thus be promoted by decreasing the differences in social security between entrepreneurs and employees. A social security system that provides entrepreneurs with more entitlements to social benefits could help stimulate entrepreneurship. However, introducing mandatory social security schemes for entrepreneurs might not be an appropriate policy measure for promoting entrepreneurship, since most entrepreneurs prefer freedom of choice. A policy measure, already established in several EU countries, concerns a trial period for employee-starters, during which a certain security is provided in case of business failure. Alternatively, countries may reconsider the generosity of the social security systems in place with respect to employees.

Ultimately, it remains of course a political choice, which way is chosen to decrease the differences in social security between employees and entrepreneurs, in order to stimulate entrepreneurship.

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¹ Van Stel et al. (2003).

² Brouwer et al. (forthcoming).

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7 Question 7

How might more prospective entrepreneurs be encouraged to consider taking over rather than starting a new firm (buyers and sellers databases or market places, special training for family-owned businesses, management or employee buy-outs)?

The market for buying and selling small businesses is imperfect, to say the least.

On the supply side (business transfer), many small business owners do not think about selling their business, not even when they are aging. And if they do, they typically seek succession within their family and they may only (reluctantly) sell their business (when they can't find such a family successor). The most frequent non-family transfer occurs through mergers and acquisitions to other firms (Diephuis et al., 2003). Finding a new independent entrepreneur is often considered to be a long shot, unless an employee steps up to take the baton.

On the demand side, most entry into small business ownership occurs through new business startups. Prospective entrepreneurs typically do not even consider the option to take over an existing firm (including its employees). Most entrepreneurs simply think about starting a new firm, realizing in part that taking over an existing firm is a complex and time-consuming affair, not to mention costly. Usually existing businesses are larger than startups, therefore taking over may be more expensive than starting a new firm. In many cases, though, it may well be worthwhile. New customer and supplier relations are hard to build. If succession can take place smoothly, the entrepreneur can have a flying start (Morris et al., 1997). The problems are how to find an appropriate business to have such a start, and, how to overcome the barriers to a smooth transfer?

Additionally, the market for business ownership is characterized by incomplete and asymmetric information, with the typical problems of adverse selection (demand) and moral hazard (supply). Only employees and nascent entrepreneurs in the direct proximity of the existing firm may be able to reliably determine the value of a business. We may assume that in business succession typically 'satisficing' instead of 'best solutions' occur. The best-suited successor typically does not beat a path to the door of the predecessor, and does not take ample time to take over business relationships smoothly.

In order to improve the market mechanism for business ownership many measures are worthwhile. We would like to highlight three major areas.

Facilitating planning / training / smooth transfer

- 1 Stimulating transfer planning in general.
- 2 Building awareness and actual support to allow prospective successors to gradually grow into businesses.
- 3 Particularly for the larger SMEs: facilitating the transfer of businesses to employees or second parties by encouraging the internal training and development of successors.
- 4 Providing special training for family-owned businesses, management or employee buy-outs (European Commission, 2002).

Making the market / brokering

- 1 Setting-up a system of databases and marketplaces for buyers and sellers of small businesses. Improvements at the national level have priority (coupling various databases).

- 2 Creating national and European standards for the information provided in such databases, including financial performance and network ratings.
- 3 Offering due diligence by neutral/central party.
- 4 Building awareness regarding the costs and benefits of business transfer (Dyck et al., 2002), for instance compared to startups, and the need to post interest in transferring the business.

Improving capital conditions

- 1 Stimulating banks to provide new entrepreneurs with the capital needed for business transfers.
- 2 Alleviating emotional barriers to seek venture capital.
- 3 Enabling shared risk bearing.

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8 Question 8

How can spin-offs be made more attractive (management buy-outs, showcasing, specialised advice, tax or other provisions for employees and their employers whilst starting a business)?

A spin-off is an individual or a group of individuals leaving a 'parent' firm to start up a new, independent business. The start-up occurs on the basis of specific knowledge and competences built up within the parent firm. In many cases, the spin-off process can be a mutually beneficial and socially desirable process. On average, both spin-offs and parents perform relatively well (Meijaard, 2003), particularly if the spin-off operates its business in the technological proximity, but not in direct competition with the parent firm.

Organizations that have abundant, under exploited knowledge are fertile grounds for spin-off formation (Agarwal et al., 2003). Particularly organizations that have an imbalance in their value creation and value appropriation create unused opportunities, which in turn are incentives for employees to venture into entrepreneurial activity themselves.

In general, spin-offs see knowledge transfer as the most critical support received from the parent (Bernardt et al., 2002). A frequent motive to spin-off is to utilize opportunities that would otherwise remain unused (within the parent firm). Furthermore, creating new and improved opportunities for products and people is a critical motive, next to the 'regular' independence motive.

Established, publicly listed technology-based firms are an important source of start-up activity (Gompers et al., 2002). In addition to being a valuable new partner in the network of the parent as a spin-off (Bernardt et al., 2002), ex-employees may have many other advantages to their ex-employer as well (Sertoglu and Berkowitch, 2002). Many large firms have made the spin-off 'career path' an explicit part of their HRM strategies to promote corporate entrepreneurship.

In order to reap the benefits of spin-off venture creation, measures are worthwhile to trigger the spin-off process and to improve the related capital conditions.

Triggering the entrepreneurial process

- 1 Employees often feel a considerable barrier to exit the firm and to start a business of their own. Inducing knowledge intensive firms to foster an entrepreneurial spirit and to introduce an enlightened exit process (long term benefits) is worthwhile.
- 2 Showcasing of success stories, e.g. through competitions for new business development and/or spin-off initiatives. This provides examples for both the parent firms and the spin-off start-ups.
- 3 Tax or other provisions for employees and their employers whilst employees are starting a business may help both the employees and employers 'venture' into the uncertainty.
- 4 The public availability of standard contracts to secure trust between spin-off and parent can help wavering SMEs to actually allow employees to spin-off whilst taking along some of the knowledge and/or other assets at the parent firm.

Improving capital conditions

- 1 Access to capital can be much easier for spin-offs if the parent firm explicitly supports the initiative. In this case as well, tax incentives could provide the much-needed leg up for the spin-off and the parent.
- 2 Banks and venture capitalists are to be encouraged to explicitly take the experience of the ex-employee and the support by the ex-employer into account. The parent firm may be held accountable, although prolonged influence by the parent does not help spin-off success (Bernardt et al., 2002).

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9 Question 9

How can education support the development of the awareness and skills necessary for developing an entrepreneurial mindset and skills (entrepreneurship training as part of a school's curriculum, getting entrepreneurs into the classroom, apprenticeships for students to work with experienced entrepreneurs, more entrepreneurial training in universities, more MBA programmes, matching entrepreneurial training with public research programmes)?

Most authors share the contention that enterprise can be taught, and that it should be taught early. In Europe, few enterprise programmes exist in initial education. A review of literature regarding enterprise qualities results in the following list (Van der Kuip, 1998):

- Need for achievement
- Need for autonomy
- Creativity
- Initiative
- Risk taking
- Opportunity seeking
- Goal setting
- Self confidence
- Internal locus of control
- Persistence

Apart from these rather personal characteristics, entrepreneurial qualities also include having the right skills to run the business. The extent to which education has contributed to the current success of incumbent entrepreneurs is very limited. In the Netherlands two entrepreneurs out of three are of the opinion that their education did not in any respect prepare them for becoming an entrepreneur (Ministry of Economic Affairs, 2002). Several entrepreneurs state that their education has not paid any attention to entrepreneurship as a choice of career. The current educational system is too much focussed on theoretical concepts and transferring knowledge, instead of giving more practical relevance to the theory and training communicational and business skills.

In the Netherlands policy makers have picked up this notion and are dedicating time and money to promoting an independent attitude and facilitating schools to spend more time on educating entrepreneurial skills. In different levels of the educational system (from primary schools up to universities) we can find good practices of projects and initiatives to pay more attention to entrepreneurship in general or to educate entrepreneurial skills.

There are, however, some important obstacles, that need to be removed, in order to really incorporate an entrepreneurial attitude and entrepreneurial activity within the educational system (Bosma, et al., 2002). At first schools and universities should be stimulated to invest in entrepreneurial elements within the curriculum. This should not be hindered by all kinds of bureaucratic procedures and the management of schools and universities need to be open minded for change and innovation.

Secondly, the mismatch between traditional teacher training and the use of an entrepreneurial learning method needs to be removed. In many cases teachers are not equipped to teach entrepreneurial skills, as they have learnt to be the expert, instead of being a facilitator in the learning process of pupils and students. Moreover, teachers often lack an entrepreneurial attitude themselves.

It is obvious that the introduction of new programs for teacher training will take many years. In between, however, a lot can be done; e.g. organising regional meetings where teachers, management

and students come together to exchange information about entrepreneurial programmes. This is a means of creating awareness and stimulating each other. At the same time (starting) entrepreneurs could be invited to schools more often to share their experiences with running a business, and pupils and students could be stimulated to train in a small company for a few months.

Thirdly, both at the country and the European level, good practices related to raising entrepreneurial awareness or educating entrepreneurial skills should be exchanged and should become part of the educational system itself. This means quite often a structural reform of the educational system. The public initiative in the Netherlands to set up a commission to gather good practices, to stimulate schools to apply for a subsidy, and promote cooperation between schools and business, has been a valuable first step in this process. However, it is essential that this initiative will be taken further. As many countries experience the same problems in this respect, it is important to exchange information and learn from good practices across Europe.

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10 Question 10

What could business organisations, the media and public authorities do to promote entrepreneurship (role models, media campaigns, open door days of firms, award schemes for entrepreneurs) and at what level (European, national, regional or local)?

There are several stages in promoting entrepreneurship. We identify three steps:

- 1 Raising awareness
- 2 Stimulating and training entrepreneurial qualities and skills
- 3 Creating an entrepreneurial society

Promoting entrepreneurship first of all means enhancing general awareness about the importance of and the contribution by entrepreneurship to society and economic welfare. Raising awareness can be done in several ways. An important instrument is to create awareness among children and students in schools and universities and stimulate their entrepreneurial qualities. Not only the school system has a role to play here, parents can also encourage their children to consider the opportunities for becoming self-employed. Media attention is another instrument to raise awareness. Advertising campaigns both of government agencies and of private organisations, like banks, to financially support (starting) businesses, can be helpful to draw attention to self-employment as a career option. At the same time these campaigns contribute to the general notion that being an entrepreneur is an everyday profession.

Secondly, it is important to stimulate an entrepreneurial attitude through the educational system (see question 9) and through several support organisations (see question 4). Role models and media attention (TV programs, commercials, etc) are important instruments in this respect. Award schemes can also contribute to enhancing the attitude towards entrepreneurship. One must be aware that the attitude towards entrepreneurship is very much culturally determined. It is related to e.g. the perception of opportunities, social values assigned to independence, the social security system, risk taking etc. As long as people are sceptical about failing entrepreneurs (and Bankruptcy laws reflect the same attitude), changing the attitude to an entrepreneurial society will be a long road.

Finally, promoting entrepreneurship means creating an entrepreneurial society. This can be realised at different levels. At local level cities can play an important role in facilitating entrepreneurship by offering enough business locations and creating a favourable local tax system for businesses. Regionally issues like the physical infrastructure can be an important element for people to set up or move their business. At the (inter)national level, entrepreneurship can be stimulated by removing barriers. Entrepreneurs do not have to be pampered, but should be given enough room to make optimal use of their creativity, commercial attitude and their drive for success.

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