

Policy Paper

Entrepreneurship and SMEs

Essential issues

- Start-up policies should aim at ventures who have the potential to become high-growth firms.
- Barriers to obtain public funding for SMEs are to be removed.
- There is still potential for the reduction of the administrative burdens for establishing a firm.
- Corruption, which is a major problem in large parts of the Danube Region, needs to be pushed back.

Recommended target of start-up policies: high-growth ventures

Entrepreneurship and start-ups have the potential of playing a major role for increasing the competitiveness of the Danube Region. Entrepreneurs can be regarded as “agents of change” because they bring new methods, processes, products and services to the market thereby challenging existing firms and their business models. This can lead to a stream of innovations initiated not only by the new firms but also by existing firms in response to increased competition due to the entry of new firms. Furthermore, new firms can cause existing firms to exit. This can have positive effects on the competitiveness of the Danube Region if outdated processes and products disap-

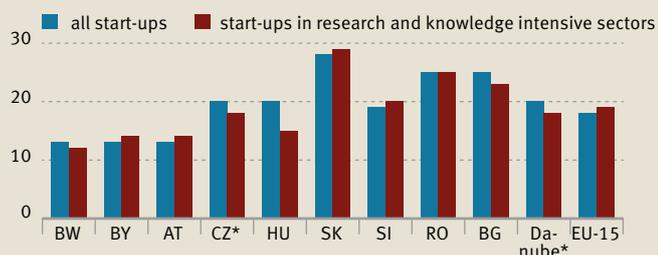
**Entrepreneurs as
agents of change**

About the project

Coordinator of Priority Area 8 (“To support the competitiveness of enterprises”) of the EU Strategy for the Danube Region (EUSDR), the Ministry of Finance and Economics Baden-Wuerttemberg, has commissioned a study on the socio-economic assessment of the Danube Region with financial support from the Directorate-General for Regional and Urban Policy of the European Commission. The aim of the study is to document the socio-economic development of the Danube Region with respect to the goals of the EUSDR and the overall objectives of the EU growth strategy “Europe 2020” and to identify strengths and weaknesses, to propose areas of activity and to provide recommendations for the future strategic orientation of the EUSDR. In a first step, extensive data has been collected on competitiveness, entrepreneurship and SMEs and cooperation in the Danube Region and a set of preliminary recommendations has been formulated. In the second part, these recommendations will be developed further with the help of expert interviews and focus groups in order to provide a strategic contribution of a programme strategy for the Danube Region. The study is conducted by the Centre for European Economic Research (ZEW), Mannheim in cooperation with the Institute for Applied Economic Research (IAW), Tübingen, and the Vienna Institute for International Economic Studies (wiiw)



Figure 1: Turbulence rate in the Danube Region 2008-2010 (in % of active firms)



Note: The turbulence rate is the sum of the start-up and the closure rate. The start-up (closure) rate is defined as the number of start-ups (firm closures) in percent of the number of active firms. Considered countries/regions of the Danube Region: BW, BY, HU, CZ, SK, SI, RO, and BG. *Considered time period: 2009-2010 because of implausible values for CZ in 2008.

Source: Structural Business Statistics (Eurostat), Mannheim Enterprise Panel (ZEW). Calculation and illustration: ZEW.

pear together with the closed firms. There is substantial amount of firm dynamics going on in the Danube Region reflected e.g. in the turbulence rate (sum of the start-up and closure rate, Figure 1). Overall, the turbulence rate of the Danube Region resembles that of the EU-15 countries but in some countries the turbulence rate lies clearly above the average. In most countries, this is associated with an increase in the number of active firms. (The exceptions are Romania where the stock of active firms decreased and Baden-Wuerttemberg, Bavaria, and Austria where start-up and closure rates are more or less equal.)

However, not all start-ups are the same. The average start-up

is not innovative at all, it employs nobody except the founder, does not create much jobs and has a high likelihood of closing in the first years after establishment. Therefore, it is more sensible to develop policies targeted towards start-ups which have the potential to become so called high-growth firms (HGFs). Although it is extremely difficult to identify HGFs there are some hints in the entrepreneurship literature on the characteristics of HGFs. 1) HGFs have strong ambitions to not only serve domestic markets but also to expand internationally; 2) The products of HGFs and improvements of them emerge in strong collaboration with costumers; 3) HGFs place a strong emphasis on sales and marketing, and 4) The managers of HGFs have strong leadership skills. Meaningful measures to support high-impact firms may therefore be those which are targeted at the needs of firms with these characteristics.

Easier access to public funding programmes required

Special challenges for SMES with respect to financing

Financing is often an issue when it comes to the realisation of business ideas. SMEs face different challenges with respect to financing than large businesses. While large companies have access to equity capital markets, these markets are not accessible to the vast majority of SMEs. The lack of equity capital for SMEs makes them more reliant on other sources such as bank lending, entrepreneur's own savings, retained earnings or funds resulting from the sale of assets.

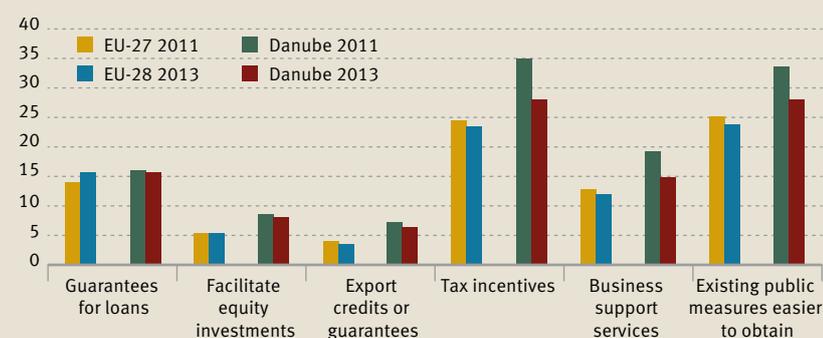
The severe crisis of 2008/2009 has brought additional challenges for SME as the credit supply conditions significantly tightened arising from the reduced ability and willingness of banks to provide financing. However, in the last 2-3 years the financing conditions stabilised. Indicators as willingness of banks to provide a loan or access to public finance are still among the major challenges facing SMEs' managers, nevertheless, these indicators showed a gradual improve-

ment in the last 3 years.

Further challenges arise from the limiting factors to get external financing in order to realise firm growth. According to SME managers, insufficient collaterals and high interest rates are the two largest obstacles to external funding.

The challenge for SMEs is often not primarily the lack of financial sources but the barriers to apply for funding. According to SME managers, especially the application for EU funding comprises high bureaucrat-

Figure 2: Most important factors for future companies' financing 2011 and 2013



Source: SMEs' Access to Finance-Survey 2013. Calculation and illustration: ZEW.

ic barriers and time consuming procedures. In 2013, managers across the EU rated “making existing public measures easier to obtain” (for example through the reduction of administrative burdens) and “tax incentives” as the two most important measures, when asked to rate the importance of a number of different mechanisms to help their company’s financing in the future (Figure 4). They were followed by “guarantees for loans” and “business support services”. Although there is a reduction in the level of importance of all factors since 2009, SMEs’ managers of the Danube Region rate all the factors (except for “guarantees for loans”) at above EU levels for both years.

Furthermore, evaluation reports also highlight the need for more technical assistance through the application process. Also more information tools for potential applicants are needed. According to SMEs’ managers, knowledge about funding opportunities, key dates of calls for proposals and application processes need to be spread to the business community.

Market entry conditions are still to be improved

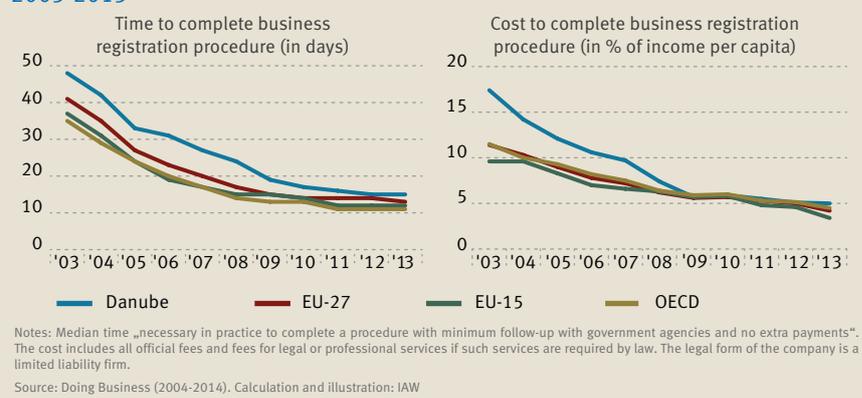
A further avenue of making better use of the positive effects of entrepreneurship is to reduce the administrative burdens for market entry. With this respect, there is still room for improvement in the Danube Region. According to the Doing Business Reports of the World Bank, the Danube Region ranks 89 of 188 countries in the category “Starting a business” in 2013. This is well behind the OECD (rank: 49), the EU-15 (rank: 63), the EU-27 (rank: 70) and the USA (rank: 20).

However, there have been major advancements in some respects in the Danube Region since 2003. The number of days to complete business registration procedures has decreased substantially. In 2003 it took on average 48 days to open up a firm in the Danube Region countries. In

2013, it was only 15 days, which is well below the target of the Europe 2020 plan to reduce the time required for the entire registration process to 30 days by 2015. Likewise, the cost of starting a business has decreased. In 2003, firm starters had to spend on average 17% of income per capita to set up a firm. In 2013 it was only 5%. The countries of the Danube Region have caught up with the OECD countries (4.5%) and the EU-15 (4.2%) countries in this respect and are currently performing in the highest quarter worldwide.

Ease of starting a Business below EU average

Figure 3: Development of time and cost to start a business in the Danube Region 2003-2013



Corruption serious concern for business activity of many SMEs

Corruption is “one of the most widespread and insidious evils” (United Nations Manual on Anti-Corruption Policy (2001)). According to the European Council, around € 120bn each year are lost due to corruption in the EU. While the Danube Region includes countries that are least affected by corruption worldwide, corruption poses a very serious concern for a large part of the region. The percentile ranks of the Danube countries vary from just 15 to over 90. The Danube average is far below the OECD and EU-27 averages. The low overall performance is due to the weak position of the Accession (RS, BA, ME) and Neighbouring Countries (UA,MD) and the countries of

More Eastern countries suffer from corruption

Figure 4: Control of Corruption in the subregions of the Danube Region 2012 (percentile world rank)



Notes: Values are given as percentile ranks. A percentile rank of 100 means that the country is the top performer worldwide while a percentile rank of 50 means that the country is at the median position (50% of countries are at least as good and 50% are below). Change in comparison with 2002 in brackets. (+) positive development, (-) negative development, (±) no change. Member States Area 1: BW, BY, AT; Member States Area 2: CZ, HU, SK, SI, Member States Area 3: HR, RO, BG, Accession Countries: HR, BA, ME; Neighbouring Countries: UA, MD.

Source: World Governance Indicators (2013 and 2003, referring to the years 2012 and 2002). Calculation and illustration: IAW.

Member States Area 3 (HR,RO, BG). These countries have levels of corruption which are comparable to that of countries like Kuwait, Tunisia or South Africa and are just above the values for Colombia and China.

While corruption is a business constraint for firms of all sizes, it poses particular problems for SMEs. Indeed, the smaller the size of the firm, the more likely is it affected by corruption. Small companies tend to be asked more often for a bribe, spend a larger share of their annual revenues for bribes and consequently view corruption more frequently as a “major business obstacle”.

The extent of corruption varies greatly between the different subregions of the Danube Region. Bribery ranges from 4% of SMEs affected in the countries of Member States Area 2 (CZ, HU, SK, SI) to 28% in the Neighbouring Countries (UA, MD),

with the Accession Countries (RS, BA, ME) and the countries of Member States Area 3 (HR, RO, BG) in between. A similar ranking is obtained with respect to bribing public officials. All in all, half of the SMEs from the Neighbouring Countries identify corruption as a major constraint, which is more than double the percentage obtained in countries of Member States Area 2 and the Accession Countries. It is noteworthy that the countries of Member States Area 3 are lagging well behind not only the countries of Member States Area 2, but also behind the Accession Countries with respect to all corruption measures.

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