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**NOTE**

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From:	Incoming Netherlands Presidency
To:	Delegations
Subject:	Commission Communication "Upgrading the Single Market: more opportunities for people and business"
	1. Start-ups and SMEs
	2. Services

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Delegations will find in Annex a Note by the incoming Netherlands Presidency for the meeting of the High Level Working Group on Competitiveness and Growth on 11 January 2016.

**HLG paper****The key areas of the Single Market Strategy:**

- 1. SMEs and start-ups**
- 2. Services**

In the Competitiveness Council (COMPET) of 30 November 2015, a first policy debate about the Single Market Strategy (SMS) took place and Ministers acknowledged the need to eliminate the remaining economic barriers from the Single Market in order to achieve tangible and quick results in terms of growth and job creation. Ministers supported the sector-specific approach of the Commission to improve the functioning of the Single Market for services and access to regulated professions. Given the COMPET discussion, the Presidency suggests to focus the debate of the HLG on two key areas: 1. SMEs and start-ups, and 2. services.

**1. Helping SMEs and start-ups to grow***1.1. Economic evidence*

According to the 2015 Report of the SME Envoy Network to the Competitiveness Council (presented at the COMPET Council of 30 November), EU SMEs are emerging from the economic crisis slowly but steadily. In 2014, their value-added increased by 3.3% (compared to 1.6% in 2013). Also, the number of SMEs increased to a total of 22.3 million which is 3.6% more than in 2008. Most importantly, employment in SMEs grew for the first time in six years (by 1.2%).

The positive trend in SME performance reflects the improvement in macroeconomic and business conditions. However, emergence from the crisis occurs at different speeds. The vast majority of Member States – 22 in total – saw their SMEs expanding their business in 2014. In a small group of Member States the SME revival has not yet set in. These are the countries which have been hardest hit by the crisis.

In terms of sectors, services are leading the way. Among the five key sectors, the ‘business services’ sector was the star performer for all indicators used, in particular with a value-added growth of more than 5% in 2014. Also other service sectors, including tourism-related services such as accommodation and food services, saw solid growth in terms of value-added and employment. SMEs in particular in construction sector but also in manufacturing were hardest hit by the economic crisis. They are also the slowest to recover.

Despite the extremely harsh economic environment since 2008, it is estimated that 1 in 5 of the EU’s 22.3 million SMEs managed to grow during that period. In essence, the more knowledge-intensive a services firm is, the higher the likelihood that it would have experienced net job growth. While there is more than one prototype of “job creating” SME, most of them share some common features:

- many are “young firms”, i.e. those of less than 5 years of age;
- most of these firms offer services which are knowledge-intensive in nature, ranging from legal services, marketing and advertising to scientific, education and health services;
- they include also firms in “traditional” sectors and not just the frequently cited internet-start-ups.

### *1.2 Five main priorities of the EU SME policy*

Start-ups, scale-ups and innovative businesses should be fully enabled to grow through cross-border trade. The Small Business Act (SBA) is the overarching framework for the EU policy on SMEs. The main priorities of the SBA are:

- Helping SMEs to access finance, including alternative sources of finance, and cross-border financing;
- Facilitating access to markets;

- Reducing the administrative burden and simplifying the business environment for SMEs;
- Promoting entrepreneurship; and
- Training and skills (based on a consultation among the Member States, the SME Envoys Network has made the suggestion to add this as a fifth priority to the EU SME policy).

Access to finance, including cross-border financing, is key. Financial markets are in the midst of a transition. A transition from a mostly bank-orientated to a more diverse landscape in which equity and venture capital financing are an important part. The Capital Markets Union Communication of 30 September 2015 acknowledged that venture capital has a key part to play in supporting growth and offering entrepreneurs an option to raise funding in Europe as well as from overseas. It states that venture capital is typically long-term (equity) capital, channelled through funds which pool investor interest and diversify risk. However, EU venture capital funds remain relatively small. At around EUR 60 million, the average European venture capital fund is only half the size of that in the US, and around 90% of EU venture capital investment is concentrated in 8 Member States. Most Unicorns (companies with a valuation of more than US\$1bn) are located in the US and China. Only around 10% are European. Nearly all of them have at least one US investor; the EU is lagging behind. Larger EU venture capital funds could increase the market share of European unicorns and their impact on economic growth.

Against this background and following the request of most of the European SME Envoys, the Commission established a working group on Venture Capital nominated by the SME Envoys. Based on a questionnaire completed by national experts, the working group identified three main areas of interest which became the topics of discussion in the final working group meeting among Member States' representatives in October 2015 with the aim of sharing good practices among Member States. The three main areas of interest are:

- Tax incentives policies by Member States;
- Member States' interventions to develop larger venture capital markets; and
- Financial literacy programmes developed by Member States.

Facilitating SMEs' and start-ups' access to markets is another key area. The SME Performance Review of the European Commission (2015) states that the propensity of an enterprise to export is largely determined by the characteristics of its sector (the type of product or services it sells). It should be noted that the vast majority of SMEs are active in industries that are only to a very limited extent driven by exports (for example, consumer services such as barber shops or local bars and restaurants). Still, with roughly a third of EU exports, SMEs play an important role in EU exports. Extra-EU exports account for roughly a third of SMEs' total exports. The Flash Eurobarometer study of 28 October 2015 on internationalisation of SMEs showed that relatively few young SMEs – younger than 7 years – export or expand cross-border: 23% exported within the EU and 15% outside EU.

Reducing the administrative burden and issues related to better regulation continue to be of great importance for simplifying the business environment for SMEs. The SBA includes the 'Think Small First' principle; SMEs' interests are taken into account at a very early stage of policy making. This helps the EU develop SME-friendly legislation. A number of the initiatives discussed both in the Capital Markets Union Action Plan and the Single Market Strategy have an impact on SMEs. The SME Envoy Network report states that proper enforcement of the existing rules to allow SMEs to fully benefit from the Single Market is particularly important.

The final key issues helping SMEs and start-ups are the promoting of entrepreneurship and training and skills, including digital skills. The ICT revolution together with globalisation and the increase in differentiation in consumer demands both lead to opportunities and challenges. The Commission Staff Working Document on the Single Market Strategy (October 2015) states that compared to the USA, fewer innovative start-ups are created in the EU and that those that see the light of day are reluctant to expand cross-border, which is seen as a major missed opportunity. Their problem is the lack of knowledge, which leads them to fear entering other EU Member States because they do not know which rules apply. On the other hand, young SMEs are more likely to enter into technological cooperation with foreign firms, compared to older SMEs.

A survey by the SME envoy network shows that several Member States complement their entrepreneurship education with policies to support entrepreneurial schools, teacher training and good practice exchange. This ‘ecosystem’ approach could be an innovation model.

Not included in the 2015 Report of the SME Envoy Network, but nonetheless cited as a significant, or the most significant, barrier to cross-border activity by over 75% of SMEs and start-ups in a 2015 NESTA survey, is the complexity of the VAT regime. The SME Envoy Network Report states that, based on research, it appears that the ex-ante perception of barriers to cross-border expansion is often much greater than the actual assessment of those barriers once a firm has attempted to scale up. This shows that small firms without international experience lack confidence and sufficient information to enter foreign markets and to deal with foreign regulations. Both the Digital Single Market Strategy and the Single Market Strategy pay attention to the issue of VAT.

### *1.3 The way forward: actions on EU level and the Single Market Strategy*

The Strategy highlights the difficulties for SMEs and start-ups to begin trading cross-border and scale up across the single market. According to the Strategy, few SMEs, start-ups and young entrepreneurs consider the EU their home market or set out with pan-European ambition, which limits innovation and job creation.<sup>1</sup> The Strategy sets out a range of actions to help young businesses with the difficulties they face in all phases of their lifecycle, including:

- setting up a Start-up Initiative;
- a legislative proposal on business insolvency;
- easing access to finance (inter alia through the Capital Markets Union Action Plan);
- simplifying VAT rules<sup>2</sup>;
- development of innovative regulatory approaches;

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<sup>1</sup> COM 2015(550), p. 4.

<sup>2</sup> In the Digital Single Market Strategy, the Commission announced a legislative VAT simplification measure to help small e-commerce businesses in particular to operate cross-border. In addition, the Single Market Strategy states that the Commission will bring forward, as part of its Action Plan for a fraud-proof VAT system, a comprehensive simplification package for SMEs, with the intention of reducing the administrative burdens experienced by such businesses.

- examination and removal of barriers to innovation through the REFIT platform; and
- development of specific features in the Single Digital Gateway to facilitate cross-border operations.

#### 1.4 Questions for discussion

Building on the policy debate at COMPET in November, the discussions in the SME Envoys Network and the Strategy itself, the Presidency invites the HLG Members to answer the following questions:

1. *Compared to the USA, fewer innovative start-ups, scale-ups and unicorns are created in the EU while those that see the light of day are reluctant to expand cross-border.<sup>3</sup> Which actions (within the Single Market Strategy or other initiatives) are in your view essential in accelerating growth cross-border? And how should these actions be designed so as to ensure that this objective is reached?*
2. *Access to finance is key in enabling growth. Which barriers on a European level hinder the growth of the venture capital market? How can the Capital Markets Union and the Single Market Strategy initiatives help to better develop financial markets and more diversified markets, including stimulating non-bank lending alternatives such as crowd lending? How can we utilise the European Fund for Strategic Investments more towards the needs of start-ups and scale-ups?*
3. *To what extent are entrepreneurial culture and skills relevant for SMEs and start-ups to expand cross-border? How can Member States share best practice (concrete measures) in a creative and efficient way, and how can your experiences help the Commission's work to take the announced initiatives forward?*

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<sup>3</sup> As stated in the Commission Staff Working Document, p. 9.

## **2. Releasing the untapped potential in services**

### *2.1 Context<sup>4</sup>*

In order to tackle remaining barriers for services as outlined in the Strategy as well as the draft paper for the Informal Ministerial Meeting, the Commission will introduce a proposal for a services passport to make it easier for businesses to provide services in other Member States through use of a harmonised notification form and a common electronic repository. This should reduce administrative burdens and improve legal certainty and compliance by clarifying which requirements apply. Additionally, legislative action will be proposed to address regulatory barriers, including legal form, shareholding and multidisciplinary restrictions in key business services and, if appropriate, organisational requirements in construction companies. This legislative action may be part of the services passport initiative.

In the Strategy, the Commission also indicated that it will give periodic guidance to improve access to regulated professions at national level and across the EU, identifying specific reform needs for Member States, to address divergent and disproportionate professional regulation. As discussed in the HLG of 13 October 2015, the mutual evaluation exercise – where several professions were reflected on in smaller groups of Member States during the past 18 months – showed that justification for the proportionality of regulating a profession differs among Member States. It remains challenging to reach a common approach between Member States on how to regulate professions in a proportionate way while serving the public interest, which today results in over 5000 regulated professions in the EU.

The Commission will also set out an analytical framework for Member States to use when reviewing existing professional regulations or proposing new ones. The framework will include a methodology for comprehensive proportionality assessments, with Member States needing to demonstrate that public interest objectives cannot be achieved through less restrictive means in order to justify limiting access to, or conduct in, the professional activities concerned.

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<sup>4</sup> For the more in depth context and the economic data on services, please refer to the draft paper for the Informal Meeting of Ministers Responsible for Competitiveness.



As provided for in the amended Directive on the Recognition of Professional Qualifications<sup>5</sup>, Member States are required to submit their draft National Action Plans to the Commission by 18 January 2016, outlining their evaluations of regulated professions at national level. A group of Member States gave a presentation to the Competitiveness Council in March 2015 on an assessment framework for undertaking National Action Plans.<sup>6</sup> This framework may be of assistance to the Commission in developing the analytical framework envisaged in the Single Market Strategy, particularly in the focus on examining the regulatory environment as a whole, and the cumulative effect of different rules with which the professional has to comply.

## 2.2 Questions for discussion

The Netherlands Presidency would like to use the debate in the Informal Meeting of Ministers Responsible for Competitiveness to provide a political steer on the development of the services passport and the analytical framework for regulated professions. To this aim, the Presidency invites the HLG Members to answer the following questions in order to deepen our understanding of these initiatives so as to better prepare our Ministers for their political discussion on services in the Informal Meeting of 28 January. The outcome of the HLG discussion will be taken into account when drafting the questions for discussion for the Informal Ministerial Meeting.

1. *How could the services passport initiative be developed and which items should it include to help businesses going cross-border, particularly focusing on the priority sectors (professional services and construction)? In addition to administrative simplification, could the services passport be a useful tool to tackle these kinds of barriers and advance mutual recognition, and if so, how?*
2. *How should the analytical framework proposed in the Strategy be designed in order to strengthen the single market in services, particularly focusing on priority sectors, and to facilitate the elimination of disproportionate barriers? How should better regulation principles be integrated within this framework?*

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<sup>5</sup> OJ L 354, 28.12.2013, p. 132–170.

<sup>6</sup> Doc.6198/1/15 REV1. The document was presented by the following countries: CZ, DK, DE, EE, LT, LV, MT, NL, NO, SE and UK. The following European countries participated in developing the framework: DK, EE, LT, NL, NO, PT, SE, and UK. Further details of the assessment framework are provided in Annex 2.