European Economic and Social Committee

ECO/433
Family and traditional businesses in regional development

OPINION

European Economic and Social Committee

The potential of small family and traditional businesses to boost development and economic growth in the regions
(own-initiative opinion)

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1. **Conclusions and recommendations**

1.1 In a number of opinions, the EESC has consistently expressed its positive attitude towards EU polices that aim to support small and medium size enterprises (SMEs)[1]. However, SMEs are an extremely heterogeneous category, meaning that a special effort is required to properly target the different subgroups and particularly small family and traditional businesses (SFTBs).

1.2 The importance of this subgroup lies in the fact that the vast majority of jobs in EU regions are provided by this type of business. While reaffirming its previous conclusions and recalling the recommendations made in in its previous opinions[2], the EESC aims to have a closer look at and provide an analysis of the challenges that SFTBs are facing. This is intended to provide an opportunity to influence policy-making constructively at EU, national and regional level.

1.3 The EESC encourages the European Commission (EC) to consider ways of supporting and promoting SFTBs, as these businesses are the key element in the creation of new activities and in income generation in resource-constrained areas. They are adding value in the process of regional development, particularly in less developed regions, since they are deeply rooted in the local economy, where they invest and maintain employment.

1.4 The Committee believes that there is a lot of potential for development in many regions which are still lagging and that this underutilised potential could be realised through local SFTBs. This challenge should concern not only the European Commission but also other players which should be intensively involved, including local governments and local intermediaries like business organisations and financial institutions.

1.5 The EESC calls on the Commission to pay attention to the fact that SFTBs have been negatively affected by recent economic and industrial developments and trends. They are losing competitiveness and are facing increasing difficulties in performing their operations.

1.6 The EESC is concerned that support policy instruments do not focus on SFTBs and it is unlikely that they will benefit significantly from them. In general support to SMEs is geared towards increasing research and innovation in SMEs and towards start-ups. Without calling the importance of these policies into question, the EESC wants to emphasise that a very small fraction of all SMEs will benefit from them and SFTBs are typically not among them. The EESC welcomes the EC's intention to revise the definition of an SME, which was initiated by DG Grow and has been provisionally scheduled for the beginning of 2019[3].

1.6.1 The current definition of an SME is already outdated, and for this reason the Committee believes that the planned revision could be helpful in providing a more adequate understanding of the

1 See EESC opinions: *Policy measures for SMEs*, OJ C 27 of 03.09.2009, p. 7; *International public procurement*, OJ C 224 of 30.08.2008, p. 32; *Small Business Act*, OJ C182 of 04.08.2009, p. 30; *OTC derivatives, central counterparties and trade repositories*, OJ C 54 of 19.02.2011, p. 44; and *Access to finance for SMEs* (EESC-2014-06006-00-00-RI-TRA).

2 See EESC opinions: *Family Business*, OJ C 13 of 15.01.2016, p. 8; *Review of the Small Business Act*, OJ C 376 of 22.12.2011 p. 51; *Diverse Forms of Enterprise*, OJ C 318, 23.12.2009, p. 22.

3 Inception Impact Assessment (2017)2868537 of 8 June 2017.

nature of SMEs and in designing better policies for them. The EESC invites the EC to include an assessment of how the current definition is applied when implementing SME policy measures at EU, national and regional level in the consultation process, with particular focus on SFTBs.

1.6.2 The EESC believes that as a minimum the revision of the definition should:

- cancel the "staff headcount criterion"[4] as the leading criterion and provide SMEs with the flexibility to choose which two out of the three criteria to meet, using the most up-to-date approach set out in Directive 2013/34/EU[5];
- carry out a thorough analysis of the thresholds set out in Article 2 of the Recommendation and update them whenever necessary, including by converging them with those set up in Directive 2013/34/EU;
- reassess and revise the restrictions in Article 3 of the Annex to the Recommendation.

1.7 The EESC believes it is important that SFTBs be recognised as a specific subgroup since they typically suffer the most from market failures. Therefore the Committee recommends designing tailor-made support policies which target them. To address the most pressing problems such policies have to at least be geared to:

- assisting in attracting and training the labour force;
- training and retraining managers/owners;
- providing access to advisory and consultancy services;
- improving access to finance;
- ensuring more information and better training for staff in local employers' associations and local bank offices;
- providing one-window services;
- revising local and EU administrative burdens;
- ensuring access to more and better information on regulatory requirements, local business environments and market opportunities.

2. Small family and traditional businesses – background and importance

2.1 A number of topical industrial developments and trends – digitalisation, Industry 4.0, fast changing business models, globalisation, the sharing economy and more innovative sources of competitive advantages – are currently the focus of EU policy making. At the same time, it must be recognised that people should be able to live anywhere in the EU, including in many regions that Industry 4.0 is not likely to reach easily.

2.2 Without undermining the importance of these new trends and while supporting the political efforts aimed at promoting them, it is necessary to recall that the vast majority of jobs in EU regions are

4 Article 4 of the Annex, Commission Recommendation 2003/361/EC.

5 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013.

currently provided by very traditional SMEs[6] and small family businesses[7], most of them with a long history and their own traditions, experiences and many success stories from the past. This group of businesses typically includes the following subgroups:

- small, micro and mono-enterprises;
- very traditional SMEs, operating in historically and traditionally determined fields;
- SMEs in remote areas – like small towns, villages, mountain regions, islands, etc.;
- small family companies;
- craft-based companies;
- self-employed.

2.3 As stated earlier by the EESC, SFTBs are the backbone of many economies around the world and are growing at an impressive rate. They play a considerable role in regional and local development and play a distinctive, constructive role in local communities. Family businesses are better able to withstand difficult periods of recession and stagnation. These enterprises have unique stewardship characteristics since their owners care deeply about the long-term prospects of the business, largely because their family's fortune, reputation and future are at stake. Their stewardship typically manifests itself as an unusual devotion to the continuity of the company, and entails a more assiduous nurturing of their employee community, as well as seeking out closer connections with customers to sustain the business. The EESC previously called on the EC to implement an active strategy to promote best practices in family businesses among Member States[8].

2.4 In recent years, many SFTBs have faced increasing difficulties in performing their operations, because:

- they are not well equipped to anticipate and adapt to the fast-changing business environment;
- their traditional patterns of doing business are no longer as competitive as they used to be due to changing business models – i.e. digitalisation, more effective ways of running businesses, the development of new technologies;
- they have limited access to resources – e.g. financial, information, human capital, and market expansion potential, etc.;
- they face organisational constraints, such as a lack of time, quality and forward-looking ownership and management, and inertia when it comes to behavioural change;
- they have little ability to shape the external environment and less bargaining power, but are more dependent on it[9].

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6 Small traditional businesses are those which have maintained the same business model for long period of time serving relatively small communities – e.g. small restaurants and cafeterias, independent petrol stations, bakeries, family hotels, small companies in transportation and commerce, etc.

7 There is no one definition of a family enterprise, but rather there are several working definitions that have evolved over the years. They emphasise that family firms are those in which a family controls the business to a large extent through involvement in ownership and management positions. (Sciascia and Mazzola, *Family Business Review*, Vol. 21, Issue 4, 2008). Family-run businesses account in total for more than 85% of all firms in OECD countries. Some of them are very large companies, but the present opinion focuses on small family businesses.

8 See EESC opinion *Family Business*, OJ C 13 of 15.01.2016, p. 8.

9 Various studies (e.g. European Parliament, 2011; CSES, 2012; EC 2008; OECD, 1998).

2.5 There are just under 23 million SMEs in the EU, with a higher share of SMEs as a proportion of the total number of enterprises in the southern countries of the EU[10]. Not only do SMEs represent 99.8% of the total number of enterprises in the EU's non-financial business sector[11], but they also employ almost 67% of the total number of employees and generate almost 58% of the total value added in the non-financial business sector[12]. Micro-businesses, including one-person firms, are by far the most widely represented in terms of number of firms.

3. Policy lines and priorities at the EU level

3.1 A common rule is that support for SMEs is mainly streamlined to increase research and innovation in SMEs and SME development[13]. While the capacity to innovate and the capacity to go global are recognised as the two most important drivers of growth, SMEs generally exhibit weaknesses in relation to both[14]. Half of the identified typologies of instruments during the last financing period pursue objectives almost exclusively in terms of innovation. They are instruments that support technological and non-technological innovation, eco-innovation, the creation of innovative companies, support for R&D projects, knowledge and technology transfer.

3.2 During the period 2007-2013[15], "ERDF support to SMEs ... amounted to approximately EUR 47.5 billion (76.5% for business support and 16% of total ERDF allocation for the period)". Furthermore, "around 246 000 beneficiary SMEs were identified" out of 18.5 million enterprises. The comparison between the number of beneficiaries and the total number of enterprises clearly indicates that this amount is completely insufficient and proves that the EU has failed to support this very important category of enterprises. The EC does not touch upon this important issue due to a lack of resources and the great diversity in the characteristics of these companies.

3.3 During the same period a relatively large number of policy instruments were applied with a high degree of variability, ranging from 1 to 8000-9000 beneficiaries. Creating instruments that are applicable to a very small number of beneficiaries is clearly inefficient. That poses the question of whether it is worth designing so great number of instruments. Moreover, their effectiveness and efficiency must be questioned, by weighing up the human and financial resources involved

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10 Commission Recommendation 2003/361/EC defines SMEs, which are further classified into three categories: micro, small and medium-sized firms, depending on the number of people employed and turnover. The main statistical sources do not provide data on enterprises defined as SMEs, due to a strict application of the aforementioned SME definition. Available data are based on the employment size criterion. Accordingly, the statistics reported in this opinion are based on this definition. It must be noted that, while including the turnover and/or total assets criteria should not change the statistics very much, applying the rules concerning the autonomy of enterprises could have a substantial impact on the results; in a study conducted in Germany, the application of this rule reduced the total number of "SMEs" by 9% (CSES, 2012).

11 The non-financial business sector consists of all sectors of the economies of the EU28 or Member States, except for financial services, government services, education, health, arts and culture, agriculture, forestry, and fishing.

12 Annual Report on European SMEs 2014/2015, European Commission.

13 Final Report, Work Package 2, ex post evaluation of Cohesion Policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF), Contract: 2014CE16BAT002, http://ec.europa.eu/regional_policy/en/policy/evaluations/ec/2007-2013/.

14 Support to SMEs – Increasing Research and Innovation in SMEs and SME Development, Work Package 2, First Intermediate Report, Volume I: Synthesis Report, ex post evaluation of Cohesion Policy programmes, 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF), Contract: 2014CE16BAT002, July 2015.

15 Same source as for footnote 13.

in their design against the effects produced (if any). At the same time case studies highlighted a process of self-selection or "soft targeting", in which a specific set of beneficiaries (generally characterised by greater absorptive capacity) was targeted through the very design of a given policy instrument.

3.4 A comprehensive review[16] of a total of 670 policy instruments across the 50 Operational Programmes (OPs) implemented during the programming period reveals that the distribution between different policies is rather uneven. It shows that less than 30% of all policy instruments targeted the needs of traditional businesses. The EESC has already expressed its support for innovative and high-growth firms[17]. But at the same time the Committee regrets that the policy instruments are disproportionally and predominantly geared to SME innovation objectives, since the bulk of EU SMEs do not have – and will not have in the near future – any innovative potential, and their core business does not require them to have innovative potential. It is true that innovative products could be developed at extremely low cost and could have high growth potential, but this type of growth is clearly the exception and not the norm for traditional and family businesses, which work with a totally different philosophy. Some innovation is possible and advisable, and new generations are starting to innovate because they are open-minded. But in most cases innovation is only fragmented and is not part of the core business of these companies[18].

3.5 SFTBs are not the focus of support policy instruments, as is demonstrated by the fact that a minority of policy instruments (only 7% of the total public contribution) are geared towards SMEs operating in particular sectors, the most common of which is tourism. This is also illustrated by the fact that about 54% of beneficiary SMEs are from the manufacturing and ICT (10%) sectors, with only 16% from the wholesale and retail trade sectors and 6% in accommodation and food service activities – which are considered traditional sectors. This is aggravated by the fact that during the last programming period support for SMEs was structured in the light of the deep economic crisis, taking into account the need to shift resources away from innovation to more generic growth.

3.6 At the same time, the data show that for the five years after the beginning of the crisis in 2008 the number of SMEs increased while value added and the number of employees declined[19]. Such statistics suggest that during this period "necessity entrepreneurship" prevailed over "opportunity entrepreneurship". Obviously people were trying to find a way through the crisis and companies were trying to survive, but support has not been sufficient or adequate[20].

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16 Same source as for footnote 14.

17 See EESC own-initiative opinion *Promoting innovative and high growth firms*, OJ C 75 of 10.03.2017, p. 6.

18 A good example is rural tourism, which nowadays relies a lot on digital platforms for marketing.

19 European Commission, SME Performance Review Dataset (2014 edition).

20 A "necessity entrepreneur" is a person who had to become an entrepreneur because they had no better option. An "opportunity entrepreneur" is a person who has actively chosen to start a new enterprise based on the perception that an unexploited or underexploited business opportunity exists. There is evidence to suggest that the effect on economic growth and development varies greatly between necessity and opportunity entrepreneurship. Generally necessity entrepreneurship has no effect on economic development while opportunity entrepreneurship has a positive and significant effect.

3.7 Many recent studies have provided clear evidence that there are significant differences between the needs of SMEs in northern and southern Europe, with significant differences at national level. This view is also fully endorsed in the European Commission's Annual Report on European SMEs 2014/2015, according to which the group of countries with the lowest scores are mainly from southern Europe. These countries report extremely low success rates for projects, including the SME component of Horizon 2020.

3.8 An additional serious challenge to the provision of effective support for SFTBs is the fact that promotion policies are mostly formulated based on the size of the companies to be supported and not on more relevant characteristics that have a greater impact on their activities. This approach might be outdated and too broadly targeted, and it fails to consider the different needs of different groups like SFTBs. In its opinions, the EESC has therefore constantly stressed the need for better targeted and more precisely defined SME promotion policies in Europe, as well as the need to update the definition of SMEs so as to better reflect their variety[21].

3.9 The EESC is concerned by the fact that only a small share of ERDF support has to date generated documented effects[22] proving that it has a real effect on the economy. This calls into question the real impact of the funds invested to support SMEs, and the EESC insists that a real impact assessment be performed, including an analysis of the support granted to SFTBs.

3.10 The ERDF is not the only source of support for SFTBs. Other sources like the European Maritime and Fisheries Fund (EMFF)[23], the European Agricultural Fund for Rural Development (EAFRD)[24] or the European Social Fund (ESF)[25], which can be used separately or through the Territorial Instruments (Community-Led Local Development (CLLD) and Integrated Territorial Investments (ITI)), also provide support for SMEs. But they are not targeted at SFTBs, and a very small fraction of funding goes to these enterprises. According to representatives of SFTBs, their needs are not well understood or properly met.

3.10.1 This could be explained by the fact that when designing the policy support instruments, EU, national and local policy-makers and administrations are too rigid in some ways and have failed to take on board the viewpoints of businesses and the social partners, with a view to understanding the real needs of small and very small companies.

3.10.2 Of course, the blame should not be put only on the administration, but also on intermediary organisations for having failed to effectively communicate the real needs of SMEs. A good example of this is that SMEs seem to show a distinct preference for grants to enterprises, in contrast with the growing emphasis in the policy debate on equity finance, repayable support and indirect support.

21 OJ C 383, 17.11.2015, p. 64.

22 According to the information available from the monitoring system and additional sources (e.g. ad hoc evaluation), only 12% of all policy instruments provide robust evidence of their positive achievements. Policy instruments which can be assessed as ineffective represent up to 5% of the total.

23 https://ec.europa.eu/fisheries/cfp/emff_en

24 https://ec.europa.eu/agriculture/cap-funding_en

25 http://ec.europa.eu/esf/home.jsp

3.10.3 Partnerships between enterprises and research centres and recourse to intermediary actors to provide assistance to SMEs also appear to be less developed than anticipated, despite the great attention these topics attract. It is argued that this mismatch could in part be explained by the crisis, but during an economic recession policy makers could have opted for more "traditional" policy instruments to sustain local economies at a critical time.

3.10.4 The possibility of using various specific financial instruments is practically out of reach for SFTBs because of the difficulties in implementing them and the lack of experience and knowledge.

4. The heterogeneity of SMEs needs to be addressed

4.1 Small enterprises typically have lower exports as a percentage of turnover than medium and large enterprises, which suggests a relationship between firm size and exporting capabilities.

4.2 Access to financing is a serious problem for SMEs and start-ups. In an information report the EESC drew attention to the fact that inadequate supply of financing has been constraining SMEs' activities since 2008[26]. While the situation has been improving recently, progress has been slower the smaller the firm is, suggesting once again the importance of size in shaping firms' needs and performance. Furthermore SMEs rely mostly on bank loans for their financing, but the banking system is not well tailored for SMEs, particularly SFTBs.

4.3 Recently, financial support has focused mainly on start-ups – which represent a very small portion of the SMEs in the EU – but the pressing need for capital to finance scale-ups has still not been addressed adequately, nor has the need for the vast majority of traditional enterprises just to finance their regular operations, which have suffered from the recent crisis. There are reports of banking failures putting some small enterprises out of business because of simple cash flow problems.

4.4 Another very serious difficulty that SMEs experience – in contrast to large companies – relates to accessing information and new markets. It is also more difficult for them to hire and keep a highly skilled labour force and to comply with increasing regulatory and bureaucratic requirements. This disadvantageous situation is aggravated even further for SMEs in less developed EU regions, which face a lack of opportunities to cooperate with larger firms as part of their value chain, fewer opportunities to be part of competitive clusters, an under-provision of public goods, access to fewer facilities and supporting institutions, and often a declining population of customers. All of these factors may also result in greater costs in getting their goods to market.

4.5 Therefore, for traditional SMEs and those located in less developed EU areas, it is not policy instruments focused on promoting innovation, access to new markets, internalisation, access to capital markets, etc. which are of vital importance, but rather those which help SMEs improve and perform better at their core operations – such as those which facilitate better access to

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26 See EESC Information report *Access to finance for SMEs and midcaps in the period 2014-2020: opportunities and challenges*

common bank financing, information, a skilled labour force and immediate business opportunities (improvement of daily operations). For these businesses, initiating behavioural change also does not make sense in the short term, because it is first necessary to change the overall context in which they operate.

4.6 While in some countries business incubators work smoothly, in others their positive effects are quite limited. The key success factor is a culture of sharing organisational resources and support networks, which in principle are not well developed in the less developed EU regions.

4.7 The increasing importance of knowledge content production as a competitive advantage further increases the heterogeneity of SMEs, discriminating between high growth SMEs and other SMEs whose development is hampered by obstacles traditionally linked to their small size, their location and customer base.

4.8 The EESC calls on the EC to endorse the "Act Small First" approach and to pay special attention to SFTBs when designing policy instruments.

4.9 There were many lagging regions in Europe 30 or 40 years ago, regions removed geographically or functionally from the engines of economic growth. Some of these are now prosperous due to open, responsible and uncorrupt local governments, to the efficient work of the business organisations and to the establishment of local well-operating business networks.

5. Challenges and ways to tackle them, with a view to better promoting the development of small family and traditional businesses

5.1 *Access to financing is a notorious problem.* Compared to larger firms, SFTBs exhibit greater variance in profitability, survival and growth – which accounts for the particular problems they face in relation to financing. SMEs generally tend to be confronted with higher interest rates, as well as credit rationing due to a shortage of collateral. The difficulties in financing differ considerably between those companies which grow slowly and those that grow rapidly.

5.2 The expansion in venture funds, private equity markets – including informal markets and business angels – crowdfunding and development of the Capital Markets Union in general have improved access to venture capital for particular categories of SMEs, but SFTBs are unlikely to be able to benefit much from these developments and remain heavily dependent on traditional bank loans. Even for innovative companies, start-ups and mid-size companies these instruments are not always easy to use, and considerable differences remain between countries due to the level of development of local capital markets and the lack of proper legislation.

5.3 The EC policy to facilitate access to financing by providing guarantees is welcomed. However, the chosen scheme appears to create distortions on the guarantee market and ultimately unintended consequences for the activity of guarantee institutions. Empirical evidence is available (Spain being a case in point) that commercial banks are explicitly suggesting that their existing borrowers ask for a guarantee – to be directly issued to them from the EU in the form of a direct guarantee – so that the bank is able to cover current risks through the guarantee with no need to increase their risk class. "Disadvantaged SMEs" (i.e. those struggling to obtain credit) are being left out. Greater deployment of public money, channelled through counter-guarantees, will increase efficiency in the use of public money and will generate a greater leverage effect in the market and the wider economy.

5.4 European and local regulatory burdens remain a major obstacle for SFTBs, which tend to be poorly equipped to deal with the problems arising from excessive regulation. This requires access to information on regulations to be made easily available to them and better provision of information on technical and environmental standards. Policy-makers must ensure that compliance procedures are not unnecessarily costly, complex or lengthy. Also, there should be systematic and careful scrutiny of new regulations and their implementation by the relevant local business associations.

5.5 Access to better information is needed, and not only in relation to regulatory requirements. Information on the local business environment and on market opportunities at regional level is also of vital importance to traditional and family businesses. Modern technologies have great potential to narrow the information gap if they are designed in a user-friendly way. It would be very helpful to set up a one-stop shop where all the necessary information which affects firm strategies and decisions is made available in one place, as exists already in some countries. Measures to encourage information networks must seek to customise databases and avoid information overload.

5.6 Recent measures to ease access to markets have been focused primarily on international markets. Policy in this area seeks to tackle the disadvantages experienced by SMEs due to their lack of access to human resources, to external markets and to technology. But, as discussed above, for small traditional and family businesses this is often of little relevance. Therefore efforts should be geared towards better coordination between organisers of trade missions at regional level and towards providing better assistance in finding reliable business partners. Another possibility in the same area is to boost efforts to increase the "share" which small firms obtain of government contracts in public procurement.

5.7 A very specific problem that small traditional and family businesses have faced recently is access to qualified labour. The demographic picture is deteriorating in remote areas and in many regions which are lagging in their development, and as a result in many places there is a significant lack of skilled labour. Therefore these enterprises need assistance in identifying and attracting human resources as well as in training them. Training programmes should be off-season and tailor-made. There should also be a system for offering these programmes regularly, since small companies may face high quit ratios.

5.8 In family businesses, it is common that children from the same family or not work for the company. This is traditional and is good for the business because it facilitates the smooth transition of the company from one generation to the next or to be familiar with the future work. In such cases owners/managers should always bear in mind that the labour conditions must be according to ILO Convention no. 182 and ILO Convention no. 138 on Child Labour.

5.9 Training is needed, but not only for the employees of SFTBs. In rural and remote areas bank employees and employers associations often do not have any knowledge of the different programmes and possibilities provided by the EC and the documents and procedures involved. This network of intermediaries is extremely important in terms of the efficiency of support to SFTBs. Information programmes and the exchange of best practices between these intermediaries should be promoted. A single point of contact for all types of financing and programmes should also be organised.

5.10 An important policy measure should be to enhance the "quality" of owner/managers of SFTBs, since everything in these companies is directly related to this factor. This could be done either by encouraging training and/or by providing easy access to advisory and consultancy services. Lifelong learning should be promoted – online educational tools relating to areas like business planning, production standards, consumer legislation or other regulations could be a step in the right direction.

5.11 Another measure is to encourage SFTBs to reinvest their earnings. If they are incentivised to do so these enterprises will become more stable, less dependent on bank loans and less vulnerable to crises.

5.12 It would be very useful to summarise best practices from different countries in SFTB-intensive sectors like tourism, agriculture, fisheries etc. and to present these to the Member States.

Brussels, 18 October 2017

Georges DASSIS
The president of the European Economic and Social Committee