Europa-Kolleg Hamburg
Institute for European Integration

**Study Paper**
**No 2/13**

# How the European Union assists SMEs in their access to finance: measures and evaluation

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**Please quote as follows:**
Europa-Kolleg Hamburg, Institute for European Integration, Study Paper No 2/13, http://www.europa-kolleg-hamburg.de

# How the European Union assists SMEs in their access to finance: measures and evaluation

Nicolas Kohlmann*

**Abstract**

*This paper seeks to find out, how the EU assists SMEs in their access to finance in the Community. A critical assessment of the taken measures at the level of the EU is conducted to evaluate the effectiveness of the applied instruments for the situation of SMEs and the European economy at large.*
*To start, the thesis will point out the reasons why SMEs are important for the economy, and why their access to finance deserves special attention. It has been pointed out that the EU addresses SMEs in three manners: in the European capital market, in its creation of exemption rules for State aid and in the way it grants Community aid to SMEs. In regard to the capital market, the EU endeavours to support SMEs by improving the regulatory framework for raising capital across the Community. Thereby, the EU achieved progress in financial market integration, but also imposed rules, which constitutes a disproportionately high burden for SMEs. The exemption rules allow Member States to grant State aids to SMEs under certain conditions. Furthermore, the EU grants direct or indirect subsidies to SMEs to compensate them for their insufficient access to finance, a phenomenon regarded as a market failure by the EU. The existence of a real market failure remains questionable, and the granting of subsidies by either the State or the Community clearly threatens to distort competition and is, therefore, an unconvincing instrument of improvement when it comes to facilitating access to finance for SMEs and the European economy at large.*

**key words: Access to Finance, SME, State aid, European capital market, competition**

* This paper was submitted in June 2012 as a thesis for the degree „Master of Arts (M.A.)“ of the University of Hamburg (supervisor: Dr. Konrad Lammers).

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# How the European Union assists SMEs in their access to finance:
measures and evaluation

Nicolas Kohlmann

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**List of abbreviations**

| | |
|---|---|
| CIP | Competitiveness and Innovation Framework Programme |
| Commission | European Commission |
| | |
| ECB | European Central Bank |
| EIB | European Investment Bank |
| EIF | European Investment Fund |
| EIP | Entrepreneurship and Innovation Programme |
| EPMF | The Progress Microfinance Facility |
| ERDF | European Regional Development Fund |
| ESF | European Social Fund |
| EU | European Union |
| | |
| FEMIP | Facility for Euro-Mediterranean Investment and Partnership |
| FP7 | Seventh Framework Programme for Research and Technological Development |
| FSAP | Financial Services Action Plan |
| | |
| GBER | General Block Exemption Regulation |
| GIF1 | High Growth and Innovative SME Facility 1 |
| GIF2 | High Growth and Innovative SME Facility 2 |
| | |
| ICT-PSP | Information Communication Technologies Policy Support Programme |
| IEE | Intelligent Energy Europe Programme |
| IPA | Instrument of Pre-Accession Assistance |
| | |
| JASMINE | Joint Action to Support Micro-finance Insitutions in Europe |
| JEREMIE | Joint European Resources for Micro to Medium Enterprises |
| | |
| SME | Small and medium-sized enterprises |
| SMEG | SME Guarantee Facility |

## 1. Introduction

The aim of this paper is to address the question: how does the European Union [EU] assists micro, small- and medium-sized enterprises [SME] in their access to financing. The analysis will be conducted by shining a light on the different measures, which have been taken at the EU-level, and by critically assessing the effectiveness of the taken measures in respect to SMEs and the economy at large.

The second chapter will introduce SMEs as they are defined by the European Commission [Commission], and will explain why a common definition at a Community level is important. A major part of this chapter will concern itself with the relevance of these firms for the European economy, whereas the following chapter will point out the importance of the access to financing for this group of enterprises; hereby, pointing out the preferred sources of financing for SMEs. Finally, differences in the access to financing across Europe will be described, a notion based on the argument that fragmented inner-European financial markets are largely responsible for the existing differences. The fragmentation is believed to cause certain inefficiencies and impede the optimal allocation of capital throughout the Community.

The following chapter will explain the underlying causes for the fragmentation of financial markets across the European Union, among them, information asymmetries between the suppliers and the seekers of financing, tax barriers, agency costs, regulatory differences and high communication- and transaction costs. The EU, having recognized the problem of fragmented financial markets, has undertaken several regulatory measures to overcome this problem. Among them are the Financial Service Action Plan, the Prospectus Directive, the Market Abuse Directive, the Transparency Directive and the Market in Financial Instruments Directive.

Further measures, which have been implemented by the EU to foster the access to financing for SMEs include certain exemptions that they can enjoy in terms of State aid from their national governments. Actually, State aid to firms runs contrary to European law, but with the granting of exemptions, SMEs are allowed to also make use of this kind of governmental support. Mainly, those exemptions are either directly addressed in the Treaties or in General Block Exemption Regulations, which allow Member States to grant aids to SMEs without having to notify the Commission.

The EU also provides direct and indirect financial support to SMEs through a number of structural funds connected to the EU Cohesion Policy and other funding opportunities. Among them are many thematic funding opportunities, which uphold the common interests and objectives of the Community, and are often only accessible via financial intermediaries. Further indirect financial support is provided to SMEs by granting guarantees for loans or other liabilities.

All these measures are intended to ensure an optimal allocation of capital in the area of the EU, a goal that aims to improve the access to finance for SMEs and to maximize their economic potential. Moreover, the EU wants to compensate this group of enterprises for the disadvantages they face due to their size, and the EU also seeks to classify SMEs’ weak access to appropriate sources of financing as a market failure, which should be corrected at Community level. The taken measures are therefore critically analyzed to assess their adequacy in improving the situation of both SMEs and the European economy.

## 2. Role of SME in the economy

### 2.1 Definition of SME

There is no single definition for SME that is applied world-wide, and the different definitions that are in use rely on different economic indicators, often including total revenue and the total number of employees.[1] In order to limit the proliferation of different definitions across EU countries, the Commission published a recommendation with a common definition to be used at Community level and in the Member States.[2] In accordance with the Commission, micro, small and medium-sized enterprises are defined as follows: Micro enterprises have fewer than 10 employees and their turnover or balance sheet total does not exceed 2 Million Euros. Small firms have less than 50 employees and their turnover or balance sheet total does not exceed 10 Million Euros. The Commission further regards an enterprise with fewer than 250 employees, a turnover not exceeding 50 Million Euro or a balance sheet total not exceeding 42 Million Euros as a medium-sized enterprise. However, the above mentioned ceilings have been designed for a single firm. If the firm in question is a member of a group of enterprises, the firm may have to include all linked enterprises in the calculation.[3]

### 2.2 Structure and size of the European SME sector

There are plenty of SMEs in the European economy that play a key role in many industrial sectors by employing the majority of workers in these business fields. Furthermore, they are generally considered as being beneficial for both economic and social cohesion.[4] The latest available results from Eurostat prove that the vast majority of European enterprises that are active in the non-financial business sectors are, in fact, SMEs. Approximately 20.9 million enterprises were grouped together in this size class, which equals 99.8% of all enterprises operating in the non-financial economy of the EU27. Only about 44.500 firms (0.2%) constitute large enterprises with more than 249 employees. However, the majority of SMEs are micro enterprises with less than 10 employees, and only 1.1% are medium-sized enterprises. Small firms made up 6.7% of all enterprises covered by the surveys from Eurostat.[5]

### 2.3 SMEs and Employment

#### 2.3.1 Contribution of SMEs to employment

Many publications refer to SMEs as the backbone of an economy and also as the main contributors to employment, especially among EU-countries.[6] The latest results from Eurostat show that SMEs account for 66.7% of total employment in the EU; in comparison, large firms only account for 33.3% of employment. The distribution of employment over the different size classes of SMEs shows that micro enterprises account for 29.0% of total employment and

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[1] World Business Council for Sustainable Development (2004), Promoting Small and Medium Enterprises for Sustainable Development, p.8.

[2] Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, C(2003) 1422, p.1.

[3] Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, C(2003) 1422, p.4-6.

[4] Commission (2005), Communication of 10 November 2005, Implementing the Community Lisbon Programme – Modern SME Policy for Growth and Employment, COM(2005) 551, p.3.

[5] Eurostat (2011), Key figures on European Business, p.11.

[6] *Schmiemann* (2009), SMEs were the main drivers of economic growth between 2004 and 2006, p.1.

small enterprises for 20.5%. Medium-sized enterprises are responsible for 17.2% of employment, and finally, 33.3% of total employment can be attributed to large enterprises with more than 249 employees.[7] By and large, this information is still in line with Eurostat results from 2003, where micro enterprises made up 29.9%, small enterprises 20.8% and medium-sized enterprises 16.5% of total employment in the EU. Large firms accounted for 32.8% of total employment in 2003.[8] Following this, it can be deduced that the distribution of employment over the different size classes in the EU constitutes a quite stable pattern.

### 2.3.2 SMEs and job creation

Eurostat identified SMEs as the main source of employment in the non-financial business sectors in the EU in the period 2004 to 2006. It was also discovered that in the majority of surveyed Member States employment in SMEs increased faster or decreased slower compared to large firms. In particular, employment rose by 5.5% in medium-sized enterprises, by 5.8% in small enterprises and by 4.2% in micro enterprises in the above-mentioned period. In contrast to this development, large firms only observed an increase in employment by 2.7%.[9]

A more recent study from 2012 conducted by a private research institute using data from the Commission covering the period 2002 to 2008 analyzed the contribution of size classes to employment growth in the EU. By and large, the latter study confirms the results from Eurostat, including the fact that SMEs create more jobs than large firms. In line with Eurostat, the survey also found out that large enterprises have the lowest job creation rate (a rate of only 1% for the period 2002 to 2008) in comparison to micro enterprises (3.1%), to small enterprises (1.6%) and to medium-sized enterprises (1.3%).[10] Thus, the apparent trend that European SMEs create more jobs than large enterprises is confirmed in both surveys.

Furthermore, the World Bank reported in 2011 that in a sample of 99 countries they found that in 81 economies firms with 20 to 49 employees claimed the largest portion of job creation. Detailed results for these countries showed that enterprises with less than 100 employees have a net job creation rate of 67.4% in upper-middle income countries.[11] These findings confirm the great importance of SMEs for the creation of jobs in an economy.

## 2.4 Value added and contribution of SMEs to productivity in the economy

In order to shed light on the role of SMEs in the economy, it is also important to measure their contribution to total value added and to generate information on apparent labour productivity.[12]

Eurostat provide evidence that the contribution of the SME sector to the total value added to the EU has been larger than that of large enterprises. The distribution of value added at factor costs over the different size classes show that micro, small and medium-sized enterprises hold quite equal portions of value added, ranging from 18% to 21%. All in all, SMEs have a share of 58% of total value added, in comparison to the 42% value added of large enterprises. Although the greatest portion of total value added can be attributed to SMEs, large enterprises benefit from a higher labour productivity (59,000 Euros per employee).

[7] Eurostat (2011), Key figures on European Business, p.11.
[8] Eurostat (2006), Key figures on European Business, p.42.
[9] *Schmiemann* (2009), SMEs were the main drivers of economic growth between 2004 and 2006, p. 2–4.
[10] *De Kok/De Wit* (2012), Determining the Contribution of Size Classes to Employment Growth, p.11-12.
[11] *Ayyagari/Demirguc-Kunt/Maksimovic* (2011), Small vs. Young Firms across the World, p.14.
[12] *Audretsch/van der Horst/Kwaak/Thurik* (2009), First Section of the Annual Report on EU Small and Medium-sized Enterprises, p.27.

According to the fact that SMEs create 58% of total value added with 67% of all employees, they are less efficient (39,000 Euros per occupied person) than large enterprises, which contribute 42% of total value added while having only a share of 33% of total employment in the EU.[13] Analyzing the period 2002 and 2007 reveal that this pattern is quite stable and has barely changed over time. The shares of total value added and labour productivity held by SMEs and its sub classes and large enterprises remain almost the same in both 2002 and 2007.[14] Furthermore, the same pattern holds true for the latest results, taken from 2008.[15]

### 2.5 SMEs and innovation

In order to assess the contribution of SMEs to innovation, the different kinds of innovations have to be taken into consideration. Examples include novelties in the fields of products, processes, technology, non-technology, organization and marketing. The impetus or ideas for innovation can be brought into the enterprise from outside or they can be developed internally. Hence, another role of SMEs could be to provide ideas to large enterprises, which then subsequently exploit the innovation.[16]

Innovation statistics from Eurostat for the EU, Iceland and Norway, covering the period 1998 to 2000 show that the inclination to innovate is higher in large enterprises in comparison to small and medium-sized enterprises. Overall, 39% of small enterprises and 60% of medium-sized enterprises conducted innovation activities in the monitored period. Over 77% of large enterprises have been involved in innovation activities, a statistic which could lead to the assumption that the likelihood of innovation increases as the size of the enterprise increases.[17] Furthermore, it can be observed that the smaller the enterprise, the more often firms achieve either product innovations or process innovations only. It appears that smaller enterprises have to economize their resources and therefore set a focus on a specific type of innovation. Of course, large enterprises have more resources at their disposal and are able to engage in both innovation activities. Additionally, findings showed that there's a larger likelihood that an enterprise, of any size, will realize a product innovation rather than a process innovation.[18]

All in all, the findings reveal that SMEs play a minor, but not unimportant, role in regard to innovation in the economy. The contributions made by SMEs are considerably lower than those from large enterprises.

## 3. The access to finance for SMEs

### 3.1 Importance of the access to finance for SMEs

Access to finance has a positive impact on firms´ growth; it assists enterprises in overcoming liquidity constraints, in exploiting growth potentials, and in capitalizing on investment opportunities. Furthermore, access to finance enhances firms´ performance, and helps enterprises to achieve a larger long-term equilibrium size.[19] It also affects the expansion and

[13] Ibid., p.28.
[14] Ibid., p.30.
[15] Eurostat (2011), Key figures on European Business, p.20.
[16] OECD (2010), SMEs, Entrepreneurship and Innovation, p.32.
[17] Eurostat (2004), Innovation in Europe: Results for the EU, Iceland and Norway, p.40.
[18] Eurostat (2004), Innovation in Europe: Results for the EU, Iceland and Norway, p.41.
[19] *Beck/Demirgüc-Kunt* (2008), Access to Finance: An Unfinished Agenda, p.387-388.

internationalization activities of SMEs, and it plays a role in their resource acquisitions and business operations.[20]

A survey on the basis of firm level data gathered across 80 countries shows that access to finance is the most robust variable affecting firms' growth.[21] Further studies prove that small firms suffer more often from financial obstacles than larger and older enterprises.[22] Other findings reveal that larger obstacles to finance lead to lower growth in small firms.[23] It's been proven that SMEs suffer more from the obstacle of access to finance than large enterprises, and hence, they are more affected in their growth and business operations.[24] Due to the fact that small firms can provide fewer securities and require smaller loans, they pay higher interest rates and have higher transaction costs.[25]

Survey results from the ECB show that access to finance is the most pressing problem, after finding customers, for European SMEs. Between April and September 2011 access to finance has been the second most pressing problem for 16% of all European SMEs and for 11% of large enterprises. The results confirm that access to finance is a more serious concern for smaller firms. Criteria, like competition, costs for production and availability of skilled workers, has also been of concern for SMEs; however, it is still not as pressing a concern as the availability of financing.[26] For large enterprises, however, the latter mentioned criteria have been proven to be of more concern. Their most pressing problems have been competition and finding customers. Access to finance seems to be less important for large enterprises, which often finance projects by means of internal funds.[27] It can be followed from the aforementioned facts that the access to finance is a crucial issue for SMEs, and of considerable importance for their business operations. Only the availability of financing ensures SMEs can realize their full growth potentials.

### 3.2 Preferred sources of external financing for SMEs

The most relevant source of external financing for European SMEs is the banking sector. As discovered by a survey from the ECB, bank loans, in particular, have been the most important source of financing for SMEs in the EU. Moreover, overdrafts and credit lines provided by banks are highly relevant. Other alternative sources of financing include trade credits, leasing, hire-purchase and factoring.[28] The findings from Eurostat confirm the importance of bank loans for European SMEs. Loans in general have been found to be of great importance for this group of enterprises, and SMEs have been particularly successful in obtaining loans from banks.[29] It's also been discovered that the minority of SMEs use equity financing.[30]

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[20] *Smolarski/Kut/Wilner* (2005), Expansion and International Expansion of Small to Medium-sized Firms: The Role of Finance, p.1.
[21] *Beck/Demirgüc-Kunt* (2006), Small and Medium-size Enterprises: Access to Finance as a Growth Constraint, p.6.
[22] Ibid., p.8.
[23] Ibid., p.9.
[24] Ibid., p.7.
[25] Ibid., p.8.
[26] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.2.
[27] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.18.
[28] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.3.
[29] Eurostat, Data on Access to Finance for SME, available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics, (accessed on 5 April 2012).

### 3.3 Differences in the access to financing for SMEs among EU Member States and the impact of fragmented capital markets in the EU

It has become evident that access to financing varies substantially when analyzing the availability of external financing among the EU Member States. According to the results from the ECB, the success rates of loan applications from SMEs differ between countries, with a range of 65% in the EU. In 2011, the lowest success rates have been found in Greece (29%) and Ireland (27%), whereas the highest have been observed in Finland (91%) and Austria (84%).[31]

The number of loan applicants who were completely rejected amounted to 23% of all loan applications in Ireland and 22% in both Greece and the Netherlands. In contrast, no applications were completely rejected in Finland and Austria, and only 6% were rejected in Germany. The remaining applicants received part or most of the loan they applied for.[32] Differences in the success of large enterprises' loan application rates among EU Member States have also been discovered; however, their success rates were considerably higher, and in some Member States no large enterprises were rejected at all.[33] The results from Eurostat confirm the revealed differences in the access to financing among the EU Member States, and confirm that there is substantial variation from one country to the next, especially in case of SMEs.[34]

Although the internal market has made considerable progress in the last decade, the fragmentation of the European capital market is still among the main reasons for differences in the access to financing in the EU, and this fragmentation seriously limits the supply of capital to European SMEs. In particular, diverging national policy and regulation (there are 27 different operating environments) facilitates the aforementioned fragmentation that keeps the capital market from realizing its full potential and supply capital at the most efficient level.[35]

## 4. The fragmented capital market of the EU

### 4.1 The fragmented capital market and the problem of regulatory differences

The aim of the single market has been, among other things, to establish a common European capital market - an objective that has not yet been fully achieved. The full potential of the internal market cannot be realized due to the fact that obstacles to the free flow of capital still exist. Among the main reasons for the fragmentation of the European capital market are: differences in the regulatory frameworks, diverging taxation, market intransparency and high transactions costs.[36]

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[30] Eurostat, Data on Access to Finance for SME, available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Finance_types_sought_%281%29.png&filetimestamp=20110929085448, (accessed on 5 April 2012).

[31] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.12.

[32] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.12.

[33] ECB (2011), Survey on the Access to Finance of Small and Medium-sized Enterprises in the Euro Area, p.21.

[34] Eurostat, Data on Access to Finance for SME, available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics, (accessed on 6 April 2012).

[35] Commission (2007), Communication of 21 December 2007, Removing obstacles to cross-border investments by venture capital funds, COM(2007) 853 final, p.4.

[36] *Brasche* (2003), Europäische Integration, 2003, p.106.

Diverging national policies and regulations lead to differing financial environments for SMEs across the EU Member States, and thereby have a negative impact on their fundraising and investing activities. For example, venture capital funds, which are of particular importance for SMEs, have to comply with national requirements. This fact means that venture capital funds have difficulty expanding their activities to other Member States, as moving and operating across multiple borders requires satisfying separate, and often different, national requirements. This appears as a reasonable explanation for the fact that small venture capital funds tend to stay in their home jurisdictions, a point observed by the Commission.[37] Regulatory differences exist; for instance, the differences in consumer-protection and other supervision mechanisms in statutory requirements. The EU is comprised of about 40 national institutions, which are in charge of the supervision of their respective regulations.[38]

A common regulatory framework in the EU would have a great impact on the reduction of transaction costs for all market participants. The operational costs for SMEs and the lenders would decrease substantially. Furthermore, lenders would be encouraged to provide a higher amount of financing, as their return on investments would rise and their risk of business fall. Such a development would lead to a highly efficient capital market in the EU, since the capital would be allocated to its most efficient use. For instance, investors would provide the capital to the enterprises with the highest growth and the best performance.[39]

### 4.2 Tax barriers and the problem of double taxation

There is a high number of different tax regulations among the Member States of the EU, which affects the SMEs' access to financing. On the one side, a tax system influences the SMEs' access to financing through its impact on the self- and debt-financing activities of an enterprise, and on the other side, it affects access to financing through its influence on capital providers, which are either hindered or supported in their lending activities by a tax system.[40]

The problem of unrelieved double taxation enhances the fragmentation of the European capital market. The varying 27 tax systems across the EU lead to double taxation, uncertainties in tax treatment, and administrative obstacles. These points inevitably hinder the free flow of capital, and support the separation of national markets. The restriction of financial activities of capital funds and lenders to national territory is a considerable drawback for both the respective market participants and the EU at large. In general, the majority of Member States has recognized the problem of double taxation, and subsequently has agreed to double taxation conventions. However, those treaties do not always accommodate complex venture capital transactions in other Member States, which are very important to SME financing.[41]

In regard to venture capital markets, three different types of Member States can be observed. Some States accommodate national and foreign venture capital investors on a tax exempt basis. In this way, these States have a developed market for venture capital, which improves the access to finance for SMEs considerably. Additionally, some Member States have created

[37] Commission (2007), Communication of 21 December 2007, Removing obstacles to cross-border investments by venture capital funds, COM(2007) 853 final, p.4.
[38] *Brasche* (2003), Europäische Integration, 2003, p.106.
[39] Commission (2007), Communication of 21 December 2007, Removing obstacles to cross-border investments by venture capital funds, COM(2007) 853 final, p.7.
[40] *Heimer/Hölscher/Werner* (2008), Access to Finance and Venture Capital for Industrial SMEs, p.57.
[41] Commission (2010), Report of Expert Group on removing tax obstacles to cross-border venture capital investments, p.1.

very specific rules with the intention to accommodate foreign venture capital investors, which are usually not used by reason of complexity. The final type of Member State does not have any particular taxing rules applicable to venture capital activities from abroad. The Commission, however, found out that none of the available systems in the EU are able to deal with all types of foreign investors.[42]

### 4.3 Information asymmetries and agency costs

Especially in respect to credit markets, information asymmetries occur because borrowers have a more complete knowledge of the investment project as compared to the lender. More specifically, if the lender transfers capital to the borrower, the lender gives up control of the resource, and thus risks suffering from disadvantages if the borrower follows diverging interests.[43] For example, the borrower could hide information about revenue and the characteristics of the investment project, and could, as a consequence, breach the contract. Furthermore, the borrower could cheat the lender, and the lender would never know, as he´s neither privy to the borrower´s intentions nor does the lender have access to the same information. Finally, there is the risk of a debt repayment default, and the borrower could be subject to limited liability.[44]

The uncertainties attached to the lender's perspective is balanced out by the calculation of the probability of repayment. Following from this, the charged interest rate is adjusted for the provided capital.[45] This often results in a disadvantage for SMEs, as this group of enterprises can provide less security and is associated with higher risks, which often leads to higher interest rates.[46]

Another helpful instrument to overcome the market failure of information asymmetry between the borrower and the lender is the inclusion of financial intermediaries.[47] These entities help to solve the information problem by screening, monitoring and contracting with SMEs.[48] The use of financial intermediaries for cross border transactions leads to a further rise in the costs of external financing and the price of capital. This development results in an increase in agency costs.[49]Moreover, SMEs often lack audited financial statements that could prove the economic health of the enterprise to the providers of capital. Therefore, SMEs have difficulty proving the quality of their business, and therefore, may struggle to increase their allure in the eyes of lenders from outside. It remains a challenge for this group of enterprises to build a reputation and indicate reliability to lending institutions.[50] Capital providers often

[42] Commission (2007), Communication of 21 December 2007, Removing obstacles to cross-border investments by venture capital funds, COM(2007) 853 final, p.8.
[43] *Claus* (2010), The effects of asymmetric information between borrowers and lenders in an open economy, p.2.
[44] *Bebczuk* (2003), Asymmetric Information in Financial Markets, p.5.
[45] Ibid., p.3.
[46] *Beck/Demirgüc-Kunt* (2006), Small and Medium-size Enterprises: Access to Finance as a Growth Constraint, p.8.
[47] *Claus* (2010), The effects of asymmetric information between borrowers and lenders in an open economy, p.3.
[48] *Berger/Udell* (1998), The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle, p.4.
[49] *Claus* (2010), The effects of asymmetric information between borrowers and lenders in an open economy, p.17.
[50] *Berger/Udell* (1998), The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle, p.4.

perceive investments projects of smaller enterprises as being vague, a perception that leads to increased monitoring costs for smaller projects.[51]

### 4.4 Natural barriers to a common capital market

Besides the aforementioned obstacles, there are also natural barriers which hinder the creation of a common capital market; thereby, negatively impacting the access to financing for SMEs. Among the major natural barriers are the differences in language, culture and preferences. These obstacles are very difficult to address by national or European policymakers and often have to be taken as given.[52] Both the borrower and the lender of capital prefer to communicate with each other in their mother tongue. Thus, the language problem can only be overcome by the use of translators, which leads to an increase in the communication costs. The communication problem has an impact on trust and loyalty, two elements crucial in cementing a financial contract with another party.[53]

The problem of high communication costs due to language differences is exacerbated by the problem of distance. The desire for face-to-face, personal meetings results in high travel costs. Another barrier is the problem of high information costs that arise, especially, in financial cross border transactions. During the course of these transactions it can often be difficult and costly to obtain specific information. Furthermore, either the borrower or the lender is forced to adapt to foreign conditions, an inevitability that also leads to further adjustment costs. The aforementioned information and adjustment costs can only be regarded as natural as long as they are not augmented by national legislation that could generally be harmonized at European level.[54] A survey from the Bank of England revealed that natural barriers are seen as being far more difficult to overcome compared to regulatory or tax differences, which are considered as solvable in time.[55]

## 5. Measures taken by the EU to improve the access to financing for SMEs

### 5.1 Regulatory measures of the EU to overcome the fragmented capital market

The aim of establishing a common financial market in the EU is not a new objective, and is one that has already been pursued from the mid-1980s to 1992 in the context of the Single Market programme. However, further crucial steps have been taken from the late 1990s onwards.[56]

Under the British presidency, the European council, having recognized the benefits of a common financial market, invited the Commission to propose actions that could be taken to overcome the fragmented financial market and to, thereby, enable the realization of the economic potential of a common capital market. Subsequently, the Commission officially published a communication with the proposal for a common framework for action on financial services in 1998, and thus gave new impetus to financial integration in Europe.[57] At this stage, the Commission had pointed out the advantages created by a common, efficient and transparent financial market in regard to the financing situation of SMEs and the allocation of

[51] *Artola/Genre* (2011), Euro area SMEs under financial constraints: belief or reality, p.5.
[52] *Heinemann/Jopp* (2002), The Benefits of a Working European Retail Market for Financial Services, p.13.
[53] *Heinemann/Jopp* (2002), The Benefits of a Working European Retail Market for Financial Services, p.45.
[54] *Heinemann/Jopp* (2002), The Benefits of a Working European Retail Market for Financial Services, p.46.
[55] Bank of England (1994), The developing Single Market in financial services, p.343.
[56] *Quaglia* (2010), Governing Financial Services in the European Union, p.31.
[57] Ibid., p.34.

capital in the EU. Furthermore, it highlighted the resulting benefits in terms of the growth of SMEs, employment, consumers and the European economy at large.[58]

### 5.1.1 Financial Service Action Plan

After having identified the relevant areas of action, the Commission published a concrete five year action plan with 42 legislative measures on financial services that built upon the respective communication in 1999. The so-called Financial Service Action Plan [FSAP] contained three strategic objectives.[59] The first objective was the realization of a common market for wholesale financial services; a phenomenon that would enable enterprises to raise capital on competitive terms on an EU-wide level, and would provide EU-wide market access to investors and intermediaries without unnecessary hindrances or regulatory barriers.[60] The second strategic objective was the emergence of an open and secure retail market, where informed and legally safeguarded consumers would take part in the single financial market with harmonized consumer to business rules. Sophisticated payment systems and distribution channels would facilitate cross-border transactions with European consumers.[61] The third objective included the development of modern prudential rules and supervision that would allow the banking sector to manage upcoming competition, create appropriate and highly sophisticated supervisory and regulatory structures and eliminate any arising gaps in the legal framework.[62] Another more general objective was the adjustment of taxing rules, which was an effort to avoid differences in tax treatment among Member States. Furthermore, an efficient and transparent legal system would improve corporate governance within the EU.[63]

### 5.1.2 Lamfalussy architecture

In order to realize the aforementioned objectives of the FSAP, the ECOFIN appointed a Committee of Wise Men to find the best strategy to implement the measures of the FSAP. This committee is also responsible for figuring out how to adjust EU regulation to the changing financial framework. In particular, the committee focuses on the effective creation and implementation of rules and overall supervision across the EU. Alexandre Lamfalussy was appointed as head of the committee. Consequently, the legislative pieces proposed and realized by the Committee have been given the name Lamfalussy directives; these pieces of policy have changed the overall financial services architecture of the EU.[64] Those directives have been crucial pieces of legislation, and included important changes to the framework principles of the financial market as well as specific measures on how to put these principles into practice.[65] Important aspects of financial service regulation have been shifted to the supranational level at the expense of the sovereignty exercised by the Member States. The

[58] Commission, Financial Services: building a framework for action, p.1.

[59] Commission (1999), Communication of 11 May 1999, Financial Services: Commission outlines Action Plan for single financial market, IP/99/327, p.1.

[60] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.21.

[61] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.26.

[62] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.28.

[63] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.31.

[64] *Quaglia* (2010), Governing Financial Services in the European Union, p.35.

[65] Commission, Transposition of the Lamfalussy Directives, available at: http://ec.europa.eu/internal_market/securities/transposition/index_en.htm, (accessed on 24 April 2012).

latter remain responsible for the direct implementation of the coordination and enforcement of rules, which come from the policy-makers of the EU.[66] Among the most important and famous legislative acts, in terms of financial integration, are the Prospectus Directive, Market Abuse Directive, Transparency Directive and the Directive on Markets on Financial Instruments.[67]

### 5.1.3 Prospectus Directive

The Prospectus Directive was enacted in November 2003 with the aim to ensure investor protection and market efficiency by providing a single passport to bond issuers and by enabling capital to be raised by means of a single document. The passport is valid in any Member State of the EU, and indicates the State of origin and where the issuer is regulated. The home Member State is responsible for the supervision of the entity, and also observes compliance with the directive.[68] The main idea of the directive has been to promote cross border competition and financial market integration.[69]

### 5.1.4 Market Abuse Directive

The idea of the Market Abuse Directive, enacted in January 2003, was to prevent both insider dealing and market manipulation in the common financial market of the EU; thereby, maintaining investor confidence and ensuring the integrity of the common financial market. The Commission recognized the advantages of combining the issues of insider dealing and market manipulation in a single directive. This directive allows for a clear allocation of responsibilities, enforcement and cooperation. By these means, full market transparency can be achieved, which is among the preconditions of a functioning financial market that facilitate trade between different economic actors. The Member States preserve the right to give the definition of inside information and market practices, which may constitute market manipulation.[70]

### 5.1.5 Transparency Directive

The Transparency Directive was enacted in December 2004 and is strongly related to investor protection throughout the community. Member States must impose periodical information requirements for issuers with registered offices in their territory. In order to reach a common high level of investor protection throughout the EU, Member States have to put the information and reporting requirements associated with foreign and domestic issuers on equal footing. Investors should be enabled to make a better assessment of the issuer's business situation by obliging the issuer to prepare annual and comprehensive half-yearly financial reports. However, those reports have to be published within a certain period after maturity; thus allowing investors to conduct appropriate comparisons between annual reports.[71]

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[66] *Posner* (2007), The Lamfalussy Process: Financial Rule-making with EU DNA, p.3.
[67] Commission, Transposition of the Lamfalussy Directives, available at: http://ec.europa.eu/internal_market/securities/transposition/index_en.htm, (accessed on 25 April 2012).
[68] Directive 2003/71/EC of 4 November 2003 on prospectus to be published when securities are offered to the public or admitted to trading, L345/64, p.2.
[69] *Quaglia* (2008), Completing the Single Market in Financial Services: An Advocacy Coalition Framework, p.9.
[70] Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation, L96/16, p.2.
[71] Directive 2004/109/EC of December 2005 on the harmonization of transparency requirements in relation to information about issuers, L390/38, p.2.

### 5.1.6 Directive on Markets in Financial Instruments

An essential element of the FSAP is the Markets in Financial Instruments Directive that was enacted in April 2004, replacing the Investment Services Directive. The latter directive only covered a limited range of financial instruments, and at a point was no longer an appropriate tool to deal with the rising complexity of financial services and instruments. In order to facilitate the full range of financial activities and ensure a high level of investor protection, the Investment Services Directive had to be replaced, thereby updating the existing rules. The overall aim of the Markets in Financial Instruments Directive was to facilitate all kinds of financial transactions, regardless of the trading methods used, and thus to take account of both new upcoming trading systems and technical progress.[72] Furthermore, the new directive delivered a set of rules that allowed investment firms to do business throughout the EU with a single set of documents. In particular, the directive contained an updated regulatory framework for securities and derivatives markets and it included more extensive reporting requirements. Although, the single set of documents enable investments firms to operate throughout the EU, firms are still regulated by their home Member State.[73]

Two years later, in April 2006, the Commission enacted an amending directive that changed the deadline of transposition of the directive on Markets in Financial Instruments, and ultimately repealed the Investment Services Directive from 1993. The Commission acknowledged that investment firms and other concerned entities would possibly need to change organizational structures, reporting procedures or information technology systems in order to comply with the new requirements. However, the firms could only do so as soon as the directive was implemented in national law. Once the new provisions were settled in the national frameworks, the firms would be able to adapt to the new framework. Therefore, the deadline was not only extended for the Member States, but also for the firms after the directive was implemented in the respective country.[74] After this, the focus of the Commission was on the implementation of the Financial Service Action Plan and ensuring its effectiveness. Therefore, the Commission has monitored the progress and implementation of the directives in the Member States. From this point in time, there was a regulatory pause.[75]

## 5.2 Evaluation of the regulatory measures of the EU

Among the 42 actions of the FSAP, only a few directly aim to improve raising capital on an EU-wide basis. These actions endeavour both to enable enterprises, especially SMEs, to raise financing throughout the Community and to disburden investors in their cross-border investing activities. Furthermore, the actions looked to create a sophisticated legal framework would provide legal certainty and abolish unnecessary barriers and risks for respective cross-border operations. In order to tackle these issues, the FSAP proposed to upgrade the directives on prospectuses and regular reporting. In particular, the update of the prospectuses directive was given the highest priority, meaning that the Commission suggested drawing immediate attention to this issue.[76] The question arises: did an updated directive on prospectuses directly improve the financing situation of SMEs?

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[72] Directive 2004/39/EC of 21 April 2004 on Markets in Financial Instruments, L145/1, p.1.
[73] *Quaglia* (2008), Completing the Single Market in Financial Services: An Advocacy Coalition Framework, p.12-13.
[74] Directive 2006/31/EC of 5 April 2006 on Markets in Financial Instruments, L114/60, p.1.
[75] *Quaglia* (2010), Governing Financial Services in the European Union, p.35.
[76] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.22.

The prospectus directive brought advantages as well as disadvantages to the players involved in the European capital market. First, it considerably improved the protection of investors by obliging issuers of shares to file a prospectus with the competent authority and make the document available to the public. The directive includes information in clear language about the issuer, all guarantors and the securities, thereby offering all information necessary to make a well-founded assessment of the offer to potential investors. Secondly, the prospectus provides security to the investor by enabling him to hold the relevant authorities liability for wrong information included in the document.[77]

In terms of raising capital, the prospectus directive only affects SMEs searching for equity financing and acting as issuers on capital markets. Therefore, the relevance of this action to the access to financing for SMEs in the EU is already limited. Furthermore, studies revealed that equity is not a popular source of financing for SMEs, and falls far below the importance of loans.[78] Thus the directive only applies to a rather small group of SMEs intending to finance their businesses with equity. This group benefits from increased investor confidence in inner-European capital transactions. In addition, the harmonization of the prospectus rules in the EU and the single passport has a positive impact on the access to capital markets for issuing enterprises.

In contrast, the administrative burden for the issuers is high and they have to comply with a high number of rules.[79] For example, the enterprises have to provide information on the distribution of the voting rights within the company. Annual reports have to be prepared, and further reporting requirements have to be fulfilled.[80] Those regulatory requirements constitute a disproportionate high burden for smaller enterprises. Having recognized this problem and being provided with new impetus from the Small Business Act, which underlined the importance of decreasing the administrative burden for small businesses within the Community, the Commission amended the prospectus directive in 2010 to simplify its application and to disburden SMEs. Although, certain amendments have been taken to reduce the administrative work for smaller enterprises (for example the updated exemption rules which relieve more small issuers from the obligation to publish a prospectus) there still remain a high number of rules SMEs have to comply with.[81] Furthermore, the disadvantage resulting from not having a prospectus can be quite large for small enterprises, especially if they have to compete for investors with larger enterprises. Instead of exempting them from the obligation to publish a prospectus, the directive should rather be modified and tailored to the characteristics of SMEs to make compliance for them cheaper and easier. However, the directive itself does not constitute an appropriate instrument to tackle the problem of access to financing for SMEs at large. As mentioned before, the group of SMEs financing their projects by means of equity is rather small in the EU, and even though some enterprises benefit from

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[77] Bundesanstalt für Finanzdienstleistungsaufsicht (2011), Der Wertpapierprospekt – Türöffner zum deutschen und europäischen Kapitalmarkt, p.5.

[78] Eurostat, Data on Access to Finance for SME, available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Access_to_finance_statistics, (accessed on 18 April 2012).

[79] HM Treasury (2010), Financing business growth: The Government´s Response to Financing a private sector recovery, p.19.

[80] Bundesanstalt für Finanzdienstleistungsaufsicht (2011), Der Wertpapierprospekt – Türöffner zum deutschen und europäischen Kapitalmarkt, p.20.

[81] Directive 2010/73/EU of 24 November 2010 on prospectus to be published when securities are offered to the public or admitted to trading, L327/1, p.1.

the common framework in the Community, they still have to spend a lot of time, money and effort for raising capital via equity on an EU-wide basis.

The same holds true for the transparency directive, by which issuers are obliged to provide regular information in the form of annual and half-yearly reports on their business, if they act on regulated markets. This is supposed to enhance trust in investment projects, and is also supposed to ensure the smooth operation of functioning capital markets throughout the Community. Again, the focus of the directive is centered on investor protection as a means of financial integration and improved investor confidence.[82] In fact, transparency has been proven to be an efficient instrument to strengthen the investor faith in investment projects.[83] However, it is doubtful if the associated burden motivates SMEs to raise capital via equity in the EU.

Another legislative act developed under the umbrella of the FSAP to pursue financial market integration was the directive on markets in financial instruments. The rules set out in this directive aim to improve the European trading environment and its competiveness without jeopardizing the securities market system or the interests of investors and issuers. Thereby, the regulatory structure mainly consists of investor protection, market access for investment firms and transparency.[84] Equity searching SMEs may benefit from more activity among investment firms and enhanced investor confidence. Although, this regulatory measure of the EU endeavours to promote cross-border trade on financial markets and reduce their transaction costs, it does not take special account of the characteristics of SMEs. Similar objectives and benefits are achieved with the directive on market manipulation.

In regard to the barriers mainly responsible for the existing fragmentation of the European capital market, it can be summarized that the regulatory measures which have been taken until today primarily touch upon the problems of information asymmetries, agency costs and regulatory differences in investor protection and supervision standards. The directives attempt to harmonize rules and set a common framework in the Community for the benefit of all market participants. Having achieved progress in these fields, little has been done in the field of taxation, the problem of double taxation and uncertainty in tax treatment. Market participants depend on the bilateral tax conventions, which are usually applicable between Member States. In cases of complex cross-border venture capital transactions for SMEs, these conventions are not able to cover all possible scenarios; they constitute a more general instrument incapable of taking account of specific needs of a special group of enterprises.[85] Further regulatory measures should be taken in this field to reduce existing tax barriers between Member States and to assuage the special requirements of SMEs searching for finance EU-wide.

The natural barriers to a common financial market are very difficult to address by European lawmakers, and there is little that can be done on a regulatory basis.[86] Notably, it is also not desired to reduce the differences in language, culture and preferences, as this would be contrary to the common interests of the EU and the society of pluralism, which is mentioned

[82] Directive 2004/109/EC of December 2005 on the harmonization of transparency requirements in relation to information about issuers, L390/38, p.4.
[83] *Wasserer* (2008), Die Neuordnung des Kapitalmarktrechtlichen Wohlverhaltens durch die MFid, p.8.
[84] *Ferrarini/Wymeersch* (2006), Investor Protection in Europe, p.188-189.
[85] Commission (2011), Communication of 7 December 2011, Action plan to improve access to finance for SMEs, COM(2011) 870 final, p.4.
[86] *Heinemann/Jopp* (2002), The Benefits of a Working European Retail Market for Financial Services, p.13.

in Article 2 of the TEU.[87] In regard to these issues, the Community should rather provide assistance to SMEs to overcome these natural obstacles, rather than trying to approach these barriers with regulatory measures.

The aforementioned directives are regarded as the latest and most important milestones of financial integration in the Community. The improvement of raising capital throughout the EU on competitive terms and the abolition of the existing fragmentation in financial markets are among the main objectives of the FSAP.[88] Even though considerable progress has been made since the adoption of the FSAP, the pace of financial market integration is rather slow. The financial environment is changing rapidly due to technical and economic progress, and as soon as the directives have been implemented, they have almost been out-of-date.[89] Nonetheless, the regulatory measures of the EU are beneficial for the economy and financial integration at large. However, the extent to which these benefits also improve the access to financing for SMEs is rather small. As mentioned before, the measures mainly affect SMEs searching for equity, which constitutes a small group of enterprises as compared to SMEs searching for loan or other sources of financing. The remaining fragmentation of the financial market and the strong differences in the access to financing for SMEs in the different Member States of the EU prove that there is still much to be done to reduce existing barriers and to improve cross-border market access at low transaction costs.

### 5.3 Special rules on State aid for SMEs in the EU

As already mentioned in a previous chapter of this thesis, access to appropriate financing is crucial to the success of SMEs, and yet at the same time, securing financing remains one of their greatest challenges. The financing of small and, especially, young firms is connected with high risk for investors, but also leads to greater benefits for the economy at large.

Therefore, the Commission made use of the power delegated to it by the council to create special rules for SMEs and to make regulations exempting certain types of State aid. Cases falling under these exemptions are declared compatible with the common market, and are subsequently not subject to the notification requirement.[90] Special State aid rules in favour of SMEs are regarded as horizontal exemptions, which are usually justified by a policy framework efficiently correcting market failures in the economy.[91] The Commission considers any measure by a State endowing a public or private firm with a financial advantage as State aid.[92]

The exemption rules enable Member States and bodies appointed by the State to provide financial assistance to SMEs. In particular, the Commission encourages Member States to grant the appropriate type of aid, a means of support which should improve the competiveness and lead to long-term beneficial effects for SMEs. Among desired objectives of granting aid to SMEs are the promotion of innovative activities, research, training, energy-efficiency and high quality employment.[93]

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[87] *Foster* (2011), EU Treaties & Legislation 2011-2012, p.2.
[88] Commission (1999), Communication of the 11 May 1999, Financial Services: Implementing the framework for financial markets: Action plan, COM(1999) 232, p.3.
[89] *Ferrarini/Wymeersch* (2006), Investor Protection in Europe, p.192.
[90] *Craig/de Burca* (2011), EU Law, p.1086.
[91] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.64.
[92] *Craig/de Burca* (2011), EU Law, p.1088.
[93] Commission (2009), Handbook on Community State Aid Rules for SMEs, p.3.

### 5.3.1 General Block Exemption Regulation

The General Block Exemption Regulation [GBER] contains a number of stipulations under which certain types of aid are declared compatible with the common market and thus do not need to be made known to the Commission.[94] The idea of the GBER was to simplify State aid rules and to make them more appropriate and easier to apply. This modernization has reduced the administrative burden carried by Member States, and has provided for a new variety of exemptions for SMEs. As the Commission does need to be made aware of types of aid exempted under the GBER, it enables Member States to grant the aid immediately without the delay of a notification procedure. Nevertheless, the Member States have to inform the Commission afterwards. When the requirements in the regulation are met, the aid can be granted as long as it is transparent and can be precisely calculated afterwards.[95] In general, European SMEs are entitled to any kind of aid falling under EU State aid rules, including all aid categories which large enterprises can also make use. In such a case, however, SMEs benefit from higher ceilings and higher levels of aid. This is due to the fact that the access to appropriate financing constitutes a larger problem for SMEs than for large enterprises.[96]

The Commission has particularly emphasized the importance of transparency, equal treatment and effective monitoring, and has made clear that aid can only fall under the GBER if the aid meets the transparency requirements of the regulation.[97]

### 5.3.2 De minimis regulation

In 2006 the Commission enacted the de minimis regulation that allowed Member States to grant financial aid in the amount of up to 200,000 Euros without any administrative approval needed from the Commission beforehand. This financial ceiling of 200,000 Euros cannot be exceeded by one enterprise within a period of three fiscal years.[98] The same holds true for State guarantees, though, these guarantees can amount to 1.5 million Euros without being considered as exceeding the financial ceiling. Additionally, de minimis aid can be granted without having to add up this type of aid with other types of aid falling under other State aid schemes. Export aid has been excluded from the de minimis regulation. Apart from that, the aforementioned ceiling applies to all types of aid, regardless of the objective that is pursued by the State or the enterprise. The Commission assumes that aid of such a small amount does not affect trade and competition between Member States, but has considerable advantages for the access to financing for SMEs. As de minimis aid does not levy any administrative burden at the Community level, it is supposed to act as an instrument to provide immediate assistance to enterprises.[99] The de minimis regulation does not really constitute a set of exemption rules because the amount of financial assistance awarded by this regulation is not regarded as aid by the Commission.[100]

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[94] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.66.
[95] Commission, Handbook on Community State Aid Rules for SMEs, p.5.
[96] Commission, Handbook on Community State Aid Rules for SMEs, p.4.
[97] Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market, L214/3, p.4.
[98] Commission Regulation (EC) No 1998/2006 of 15 December 2006 on de minimis aid, L379/5, p.2.
[99] Commission, Handbook on Community State Aid Rules for SMEs, p.8.
[100] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.66.

### 5.3.3 State guarantees

The Commission set up certain rules on State guarantees in order to assist enterprises in their access to financing. In particular, new rules for SMEs have been designed to support this group of enterprises in finding appropriate sources of financing. In this respect, the Commission published a notice in June 2008 with the intent to bolster the confidence of SMEs and the Member States. This notice re-affirmed that State guarantees are exempt from the prohibition of State aid as long as certain minimum margins are being charged. On the other hand, if State guarantees are provided for lower margins than determined by the Commission, the guarantees fall under the State aid prohibition. Usually, State guarantees are provided for loans or other financial contracts that are enacted between a borrower and a lender.[101]

The Commission states that if the State acts as a guarantor, thus taking over a substantial part of the risk, it has to be remunerated with a margin as usual in the economy. Those borrowing capital in accord with a State guarantee benefit because it means a decrease in the securities that have to be provided to the lender, and it also means a lower rate can be paid for the borrowed capital. A State guarantee also is meant to enable a borrower to get access to a loan, which would have normally been denied. Therefore, the Commission emphasizes that State guarantees are important for the expansion of SMEs and the creation of new businesses.[102]

Basically, the main instruments that are at the disposal of the Member States are individual guarantees and guarantee schemes. The Commission defines an individual guarantee scheme as an instrument that provides a certain type of guarantee to a certain category of enterprise. The duration and amount of the guarantee, as well as the transaction and the enterprise, have to fulfill the conditions required by the respective authority. The Commission considers any guarantee that has not been granted on the basis of a guarantee scheme as an individual guarantee.[103] Alongside this point, an appropriate rating result from a professional rating agency is a prerequisite for applying a so-called safe-harbour premium; though, SMEs benefit from an exemption that allows them to be granted a rather low premium in the absence of a respective rating result.[104]

### 5.3.4 Risk capital aid

The Commission published guidelines on State aid in conjunction with risk capital to promote risk capital investments in SMEs. The underlying assumption of the Commission is that there is a strong correlation between risk capital (in conjunction with equity financing) and high growth rates of small and young enterprises. Furthermore, the Commission observed that enquiries for risk capital often come from enterprises with growth potential, but insufficient access to capital markets.[105]

The Commission is of the opinion that a considerable portion of the existing demand for risk capital cannot be served by the existing supply at reasonable costs. The Commission considers this development a market failure that is supposed to be solved at Community level.

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[101] EU (2008), Notice 2008/C155/02 of 20 June 2008 on State aid in the form of guarantees, C155/02, p.2.
[102] EU (2008), Notice 2008/C155/02 of 20 June 2008 on State aid in the form of guarantees, C155/02, p.3.
[103] EU (2008), Notice 2008/C155/02 of 20 June 2008 on State aid in the form of guarantees, C155/02, p.2.
[104] Commission, Handbook on Community State Aid Rules for SMEs, p.10-11.
[105] EU (2006), Guidelines 2006/C194/02 of 18 August 2006 on state aid to promote risk capital investments in SMEs, C194/02, p.2.

The latter situation is also regarded as an equity gap that exists much to the detriment of SMEs, in particular. Having realized the need for action, the Commission adjusted existing State aid rules and conditions in their guidelines in order to assist SMEs in overcoming the said equity gap. In this respect, the Commission regards State aid as an appropriate instrument to correct the existing market failure and to improve the allocation of capital, as long as certain conditions are fulfilled and State aid is applied properly.[106]

### 5.3.5 Thematic exemptions from State aid rules in favour of SMEs

#### 5.3.5.1 Aid for Research and Development and Innovation

Research, development and innovation are regarded as desirable activities within the EU, as they lead to scientific and technological progress. Furthermore, they enhance the international competiveness of the Community. Thus, they are considered objectives of common interest, and should be supported by the EU. So, when respective categories of aid are assumed to lead to additional activities in the aforementioned fields, the Commission exempts them from the prohibition of State aid. The granted aid has to promote economic efficiency, development and employment.[107] Among the allowed kinds of aid, which are also partly covered by the GBER, are subsidies for research and development projects, industrial property rights costs, highly qualified personnel, technical feasibility studies, young innovative enterprises and process as well as organizational innovation in services.[108]

#### 5.3.5.2 Aid for environmental protection

Environmental protection is a declared objective of the EU that should be upheld at both Member State and Community level.[109] The Commission considers State aid as an appropriate instrument to provide enterprises with incentives to invest more in environmental protection than they actually have to. Thereby, State aid measures should help to reach a higher level of environmental protection compared to the level that would have been reached if enterprises had only to comply with the minimum standards.[110] In addition, it has been acknowledged that environmental protection constitutes a more costly exercise for SMEs than for large enterprises. Therefore, it is considered as justified that SMEs are granted higher amounts of aid for investing in environmental protection.[111] The guidelines on State aid for environmental protection from 2008 and the GBER contain all relevant rules on State aid for environmental friendly projects for SMEs and large enterprises.[112]

#### 5.3.5.3 Regional aid

The GBER and the guidelines on regional aid from 2007 include rules addressing State aid granted to enterprises in economically disadvantaged regions. The Commission considers certain types of aid for disadvantaged regions as an instrument compatible with the common

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[106] EU (2006), Guidelines 2006/C194/02 of 18 August 2006 on state aid to promote risk capital investments in SMEs, C194/2, p.3.
[107] EU (2006), Information 2006/C323/01 of 30 December 2006, Community Framework for Research, Development and Innovation, C323/1, p.4.
[108] Commission, Handbook on Community State Aid Rules for SMEs, p.14-15.
[109] EU (2008), Notices 2008/C82/01 of 1 April 2008, Community guidelines on State aid for environmental protection, C82/1, p.4.
[110] EU (2008), Notices 2008/C82/01 of 1 April 2008, Community guidelines on State aid for environmental protection, C82/1, p.7.
[111] EU (2008), Notices 2008/C82/01 of 1 April 2008, Community guidelines on State aid for environmental protection, C82/1, p.8.
[112] Commission, Handbook on Community State Aid Rules for SMEs, p.17-18.

market, if the aids pursue the objectives of economic and social cohesion between Member States and the Community at large. Basically, there are three types of aid, allowed to be granted by a Member State to enterprises in order to eliminate regional disparities: investment aid, operating aid and aid for newly created small enterprises. Investment aids provided to SMEs in disadvantaged regions have higher financial ceilings than the investment aids granted to large firms in order to give particular support to the aforementioned group of enterprises.[113]

The regional investment aid can be granted for investments in material and immaterial assets for reasons of the extension or creation of new establishments. Regional operating aid should only be provided for enterprises in extremely disadvantaged areas that are sparsely populated and that are facing structural problems. The aid for newly created small enterprises is supposed to assist small businesses in their early stages of existence.[114]

#### 5.3.5.4 Investment and employment aid

Rules on investment and employment aid are addressed in the GBER and are applied in both non-assisted and assisted regions. However, cases in assisted areas should follow the rules set out in the guidelines on regional aid. The aid should aim to assist enterprises in mitigating costs for tangible and intangible assets or any costs of employment arising directly through the investment project. In this respect, in the case of small firms Member States are allowed to provide up to 20% of the total investment costs, and in the case of medium-sized enterprises the Members States are allowed to provide 10% of the total investment costs without having to notify the Commission. The Commission only has to be notified in the case that aid exceeds the ceiling of 7.5 million Euros for an individual case of aid.[115]

#### 5.3.5.5 Training aid

The GBER includes rules on State aid for training purposes in enterprises. Member States are allowed to provide aid to SMEs for specific or general training measures, if the requirements from the Commission are fulfilled and the aid does not exceed certain limits. Member States are allowed to grant a variety of training aids to the enterprises, among them the personnel costs for trainers, costs of travel and accommodation for trainers and participants, costs for training consultancy and material costs.[116]

#### 5.3.5.6 Aid for consultancy and aid for participation in fairs

In accordance with the GBER, Member States are allowed to provide aid for consultancy and participation in fairs; the aid must not exceed the limit of 2 million Euros per enterprise. The costs of external consultancy, as long as the enterprise does not make use of this service regularly, is eligible to be covered by consultancy aid. Tax or law advisory, as well as advertising, are not regarded as eligible costs to be covered by this aid as they constitute ongoing firm operational costs. Member States are also allowed to grant aid to SMEs for the participation in fairs, this means that costs for rent, build-up and running of a stand are considered eligible. However, the aid intensity for both kinds of aids should not exceed 50% of the eligible costs.[117]

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[113] EU (2006), Guidelines 2006/C54/08 of 3 March 2006 on national regional aid, C54/08, p.1.
[114] Commission, Handbook on Community State Aid Rules for SMEs, p.20-22.
[115] Commission, Handbook on Community State Aid Rules for SMEs, p.23.
[116] Commission, Handbook on Community State Aid Rules for SMEs, p.24.
[117] Commission, Handbook on Community State Aid Rules for SMEs, p.25.

5.3.5.7 Aid for female entrepreneurship

The GBER also contains rules addressing aid for female entrepreneurship. The Commission allows that aid is granted by a Member State to small enterprises which have been founded and are managed by women. Aid up to 1 million Euros per small enterprise can be granted, as long as the overall aid intensity does not exceed 15% of the eligible costs. Among the activities that are eligible for this aid are the expenditures for law and tax advisory, and also the costs for child and parent care. Furthermore, aid can be granted for any kind of consulting or administrative tasks, which are directly related to the foundation of the enterprise.[118]

5.3.5.8 Aid for disadvantaged and disabled workers

By allowing for aid to be granted to disadvantaged and disabled workers the Commission intends to improve the workers' chances on the labour market. The GBER covers this type of aid in order to allow Member States to support enterprises, which are thereby able to create additional jobs for disadvantaged and disabled persons. If an enterprise employs a disadvantaged person, it can be granted a wage subsidy, which should neither exceed 50% of the eligible costs nor 5 million Euros per enterprise. In the case of disabled workers, however, the aid can include wage subsidies of up to 75% of the eligible costs and a maximum amount of 10 million Euros per enterprise. Furthermore, any additional costs, other than wage costs, which occur solely because the enterprise has employed a disabled person, can be supported 100% by a Member State; examples include the costs for adapting the workplace and the equipment. However, the maximum amount of 10 million Euros should not be exceeded.[119]

5.3.5.9 Aid for rescue and restructuring of firms in difficulty

The Commission introduced guidelines on State aid for the rescue and restructuring of firms in difficulties, an area not covered by the GBER. According to these rules, Member States can provide aid to enterprises, which are not able to prevent insolvency with their financial resources, for conducting urgent restructuring processes. However, the aid should only be granted for the period necessary to prepare a restructuring or liquidation plan.[120] The rescue aid should give the opportunity to prepare a recovery plan by granting loan guarantees or loans at interest rates customary in the market for up to 6 months. In contrast, the restructuring aid should be limited to the minimum amount necessary to implement a recovery plan and should only be granted if significant own contributions are made by the enterprise. The rules are applied with much more leniency in case of SMEs.[121]

## 5.4 Evaluation of the State aid rules in favour of SMEs

5.4.1 Foregoing considerations

The Commission is the highest authority for State aid control in the Community, and therefore limits the sovereignty of the Member States in this field. Whereas the sole competence of State aid control is with the Commission, the Member States retain the exclusive right of State aid policy and can grant aid to enterprises within the framework provided by the Commission. The underlying idea of this separation between State aid control and policy is that Member States should be prevented from favouring national companies by granting aid, and thus

[118] Commission, Handbook on Community State Aid Rules for SMEs, p.26.
[119] Commission, Handbook on Community State Aid Rules for SMEs, p.27-28.
[120] EU (2004), Guidelines 2004/244/02 of 1 October 2004 on State aid for rescuing and restructuring firms in difficulty, C244/02, p.1.
[121] Commission, Handbook on Community State Aid Rules for SMEs, p.29-30.

distorting competition between national and foreign enterprises within the common market of the Community. The threat of a race to the bottom, which would be to the detriment of the European economy at large, led to the idea of an autonomous surveillance authority. The main objective is to protect competition in the EU, as competition is regarded as beneficial for the efficiency of markets in all Member States.[122] The main task of the Commission is to ensure a "level playing field" for enterprises within the common market.[123]

In order to uphold the common interests of the Community and to prevent the distortion of competition in the common market, the EU set up Article 107 to 109 in the TFEU; and thereby gave the Commission the power to control State aid in the Community`s territory. Article 107 TFEU clearly prohibits Member States or agencies under the control of the State to grant aid or any kind of advantage to undertakings which affect trade between Member States and that distort competition.[124] Another important requirement, among other conditions outlined in the Treaties, which has to be fulfilled in order to classify an advantage as State aid, in the meaning of the articles, is that the aid is granted on a selective basis and not for all enterprises.[125] In fact, the payment of aid to specific enterprises has a strong selective tendency.

The articles refer to both public undertakings and private firms, thereby not distinguishing between micro, small, medium-sized or large enterprises.[126] The second paragraph of Article 107 and the GBERs allow for exemptions under certain conditions, and also leave room for the Member States to create an own State aid policy.[127] The special rules on State aid for SMEs, which have been described before in detail, are a prerequisite for an own State aid policy for SMEs in the Member States.

The Member States are free to decide how to design their State aid policy, within the framework given by the Commission. This freedom can lead to a high number of different policies in the EU. The amount of aid types that are granted to SMEs in the Member States can, therefore, vary.[128]

### 5.4.2 Critical assessment

The Commission justifies the creation of exemptions from the prohibition of State aid for SMEs by the fact that SMEs suffer from certain market imperfections due to their size. In particular, the Commission argues that this group of enterprises faces considerable difficulties in obtaining capital for their investment projects, only because they cannot offer the guarantees and securities required by the risk-shy financial markets, a phenomenon that constitutes a market failure in itself.[129] Furthermore, the Commission comments that such disadvantages become even more ominous with the decreasing size of the enterprise. Thereby, the Commission justifies the exemptions regarding notification requirements (as long as the enterprise falls within the definition of SME and does not exceed certain thresholds) with the

[122] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.52.
[123] Ibid., p.54.
[124] *Foster* (2011), EU Treaties & Legislation 2011-2012, p.46.
[125] *Rydelski* (2006), The EC State aid regime: distortive effects of State aid on competition and trade, p.13.
[126] *Craig/de Burca* (2011), EU Law, p.1087.
[127] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.52.
[128] Ibid., p.51.
[129] Regulation (EC) No 70/2001 of 12 January 2001 on State aid to small and medium-sized enterprises, p.1.

argument that SMEs should be compensated for existing market failures to avoid the limitation of their development by associated disadvantages.[130]

From this point of view, the Commission tries to tackle these market imperfections by allowing certain kinds of aid to SMEs, a point that has to be considered as a market distortion. Aid should thus create incentives for performing certain activities, should improve the market structure, should create positive externalities or should help in providing solutions to overcome the existing market failure.[131]

The view from the Commission can be regarded as being in line with the basic idea of the workability concept from the Harvard School. This theory distinguishes between desired and undesired market failures from a competition point of view. Moreover, the theory's concept of competition includes the objectives of distributive justice, decentralization of market power, technical progress, optimal allocation of resources and sovereignty of consumers. On the basis of these aims, economic situations and structures can be assessed positively or negatively.[132] Following this idea, State aid can constitute an intervention in the market, which is regarded as an effective instrument for the correction of market failures. In particular, this is viewed as an effective instrument if the existing competition is not able to correct the market failure by itself. This is supposed to reduce market barriers and allow further participants to enter. By doing this, the concentration and creation of market power on a market by a single or a few enterprises should be prevented.[133] For example, in the manufacturing industry, large enterprises benefit from economies of scale and all the advantages of mass production; a phenomenon that SMEs are not able to mirror to a similar profitable extent.[134] This situation constitutes a considerable market barrier for SMEs, as this group of enterprises cannot realize comparative cost advantages and must therefore leave the market or abstain from entering to begin with. Such a development prevents competition and bans certain enterprises from the market. Therefore, State interventions inducing market distortions are regarded as justified, as long as they reduce existing market failures, which are contrary to the objectives.[135] Therefore, the Commission's aims with its State aid control align with those objectives of the EU, namely, among others, the creation of a highly competitive social market economy, full employment, social progress, environment protection, scientific and technological advance; these are derived from article 3 (3) TEU.[136]

It is widely acknowledged that State aid can have beneficial effects for the economy, when applied appropriately and limited in time. It can stimulate the performance of certain activities and bring structural change in an economy at large. Nevertheless, State aid measures should only follow deep economic analyses that adequately assess the possible outcome and effects of a State intervention.[137]

A clear counter argument against State aid to SMEs is that the EU assumes to have perfect knowledge about the market structure, market behavior, market results and in particular the market effects. In reality, this perfect knowledge is something that the EU actually does not

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[130] Commission Regulation No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market, L214/3, p.8.
[131] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.57.
[132] *Fischer* (2006), Staatliche Wettbewerbseingriffe zur Förderung von Wettbewerb, p.16.
[133] *Fischer* (2006), Staatliche Wettbewerbseingriffe zur Förderung von Wettbewerb, p.18.
[134] *Evans* (1997), European Community Law of State Aid, p.347.
[135] *Fischer* (2006), Staatliche Wettbewerbseingriffe zur Förderung von Wettbewerb, p.19.
[136] *Foster* (2011), EU Treaties & Legislation 2011-2012, p.2.
[137] *Rydelski* (2006), The EC State aid regime: distortive effects of State aid on competition and trade, p.13.

have. In fact, most economic Statements are only made on the basis of a snap-shot of the economic situation, since the typical instrument to assess economic effects is empirical data or theories often based on empirical data.[138] Furthermore, it's only possible to analyze the effectiveness of a State aid measure in regard to the specific objectives of the aid, not the overall welfare of the economy.[139] Therefore, the discovery of all economic linkages and interdependent effects of a State intervention, like in the case of State aid, is almost impossible. In our current governance structure the Commission is responsible to decide which market interventions lead to beneficial effects on competition. Due to the fact that State aid constitutes another market imperfection, the Commission has to distinguish between desired and undesired market failures. This distinction is a difficult one to make, and can actually only fully be made to ensure a non-distortion of competition with full information.[140]

From another critical point of view, the drop out of SMEs from the market could also constitute normal market behavior, an end that is derived from the inefficiency of SMEs. Even tough, SMEs suffering from disadvantages resulting from size must not necessarily be protected, as it could be more efficient to let them leave the market. Granting aid to inefficient SMEs may constitute a waste of resources, or at least it may lead to an inefficient use of State resources. Thus the fact that SMEs have to drop out because of certain disadvantages could be regarded as normal instead of a market failure.[141]

Even though the provision of aid's ability to distort competition is apparent, as a consequence of a judgment made by the ECJ in the case Netherland and LeeuwarderPapierwarenfabriek against the Commission in 1985, the Commission was forced to prove and to give reasons for the fact that, in any case, aid is able to distort competition in the market. In accordance with this principle, the Commission is forced to repeal State aid decisions from time to time for reasons of lack of proof or misinterpretation. The Commission is also prone to its own shortcomings; namely, wrongful assessment of the market shares of the enterprise in question, misjudgment of the competitors and incorrect identification of the relevant market. However, the jurisdiction does not oblige the Commission to deliver evidence for a real distortion of competition, but for the general existence of a threat of distortion. This requirement set by the jurisdiction of the ECJ in regard to the Commission can be considered as being rather easy to fulfill. Moreover, even if aid is granted to a small enterprise, or even if the amount of aid is small, these factors do not exclude the application of Art.107 TFEU.[142] Even though, Member States often appeal against the negative State aid decisions from the Commission and need a well-founded justification for it, the economic considerations from the Commission are only rarely checked by the ECJ.[143]

This development strengthens the first mentioned counter argument against State aid, where the Commission is believed to have limited ability to assess the real effects of State aid on the economy and the respective market participants. Misinterpretations by the Commission in the past, and the fact that the jurisdiction reduced the burden for the Commission to provide evidence for a real distortion of competition, are indications that the Commission is not entirely able to explain the interdependencies of State aid between actors and the economy at large. Therefore, the allowance of State aid for SMEs in a block exemption, where aid within

[138] *Fischer* (2006), Staatliche Wettbewerbseingriffe zur Förderung von Wettbewerb, p.17.
[139] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.57.
[140] *Fischer* (2006), Staatliche Wettbewerbseingriffe zur Förderung von Wettbewerb, p.17.
[141] *Evans* (1997), European Community Law of State Aid, p.348.
[142] *Lübbig/Martin-Ehlers* (2003), Beihilfenrecht der EU, p.57-58.
[143] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.111.

the meaning of the respective regulation does not have to be notified to the Commission any more, is not based on a well-grounded foundation.

The second counter argument leads to the reasonable assumption that the artificial maintenance of less efficient SMEs in the market by means of State aid makes it more difficult for new and more efficient SMEs to enter the market. If aid is granted to an established enterprise, it can even come across as a method of partitioning the market, as it hinders the ongoing replacement process. The grant of State aid could even reduce the incentive to invest and operate efficiently, as well as get along with the available resources. State aid can lead to a distortion of investment decisions in terms of level, nature and time, which can be detrimental to the dynamic efficiency.[144]

SMEs suffer from disadvantages in their access to financing, which can be interpreted as a failure of the financial market.[145] As the aforementioned remarks have shown, the application of State aid as a method to correct this market failure requires deep economic analysis to exclude the possibility of a State failure.[146] It is doubtful if the sweeping assessments, which is done in the application of the GBER, do justice to the aforementioned requirement.

Even though some SMEs benefit from State aid and the improvement of their access to financing, there may also be others for which the artificial maintenance of certain SMEs in the market may constitute a substantial market barrier; so that it is not ensured that such a development is really beneficial for SMEs at large.[147]

## 5.5 Financial assistance for SMEs from the EU

### 5.5.1 Structural funds of the EU

The European Regional Development Fund [ERDF] and the European Social Fund [ESF] are among the EU's most important financial instruments for directly financing SMEs.[148] In general, structural funds from the EU aim at eliminating regional disparities across the different areas of the Community. Furthermore, the EU uses structural funds to promote social and economic cohesion, as well as further the development of disadvantaged areas.[149] Mainly, structural funds from the EU provide direct financial support to SMEs in areas with a less favorable economic situation by co-financing their investment projects. However, the structural funds also support projects in economically developed areas, if the projects appear to have long-term beneficial effects.[150]

The aim of the ERDF is to promote economic and social cohesion throughout the EU.[151] Therefore, the ERDF supports the foundation of enterprises and the competiveness of SMEs by co-financing respective investment projects in the Community. Within the scope of the fund a number of activities are included; namely, co-financing activities for SMEs to promote their innovation and competitiveness, to improve their regional and local frameworks, to

[144] *Basedow/Wurmnest* (2011), Structure and Effects in EU Competition Law, p.261.
[145] European Central Bank (2012), Survey on the access to finance of small and medium-sized enterprises in the Euro Area, p.3.
[146] *Basedow/Wurmnest* (2011), Structure and Effects in EU Competition Law, p.262.
[147] *Basedow/Wurmnest* (2011), Structure and Effects in EU Competition Law, p.261.
[148] Commission (2012), European Union Support Programmes for SMEs, p.2.
[149] Commission (2012), European Union Support Programmes for SMEs, p.10.
[150] Commission (2008), New Funds, better rules, p.5.
[151] Commission, European Regional Development Fund, available at: http://ec.europa.eu/regional_policy/thefunds/regional/index_en.cfm (accessed on 20 April 2012).

support inter-regional and cross-border cooperation and investments in human resources. Furthermore, the fund assists enterprises in their access to financing at their early stages of existence by improving their infrastructure and provide financial resources for research and development activities.[152]

The ESF mainly aims to improve regional competiveness and employment. Further objectives include the enhancement of quality and productivity at work, of mobility of workers within the territory of the EU, of the improvement of training systems and education, as well as the promotion of social inclusion. In particular, the ESF supports investments in research and innovation, communication technologies and environmental protection.[153]

Another funding opportunity especially relevant for the agricultural sector is the Rural Development Fund. Mainly, this fund aims to improve the competiveness of farming and forestry, to save the environment and countryside, to increase the quality of life in rural areas and to promote diversification.[154]

In order to increase the competiveness, the fund provides aid for the promotion of knowledge and human potential, for the restructuring and development of physical potential as well as the improvement of the quality of production and products. Furthermore, vocational training, advisory services, infrastructure and the modernization of agricultural and forestry holdings are aided by the fund. The assistance of farmers in adapting to new rules from the EU and the support of producer groups in their information activities are financially supported.[155]

### 5.5.2 Thematic funding opportunities

The EU provides a number of funds that relate to special themes and that pursue specific objectives. The thematic funding opportunities from the EU cover the fields of environment, energy, transport, innovation, research, education, training, culture and media. Investment projects from SMEs and other organizations are regarded as eligible to receive aid from this fund when they promote sustainability and are transnational projects with a leverage effect for the economy. The EU usually co-finances respective projects, which means that the aid does not cover the entire cost of investment, but rather just a part of it.[156]

#### 5.5.2.1 Environment, energy and traffic

##### 5.5.2.1.1 LIFE+

In order to achieve the objectives of the Environment Action Programme, the EU supports best-practice or demonstration projects, innovative political concepts, technologies, methods, measures, effective administration, networking, communication and the exchange of best-practice experiences. Because these activities were not entirely covered by the available funds, the Community set up the LIFE+ programme to support the further development and implementation of environmental policy. Projects are eligible for LIFE+ if they are not

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[152] Commission (2012), European Union Support Programmes for SMEs, p.11.
[153] Commission (2011), Communication of the 6 October 2011, Proposal for a regulation on the European Social Fund, COM(2011) 607, p.2.
[154] Commission (2012), European Union Support Programmes for SMEs, p.12.
[155] Europa, European Agricultural Fund for Rural Development, available at: http://europa.eu/legislation_summaries/agriculture/general_framework/l60032_en.htm, (accessed on 20 April 2012).
[156] Commission (2012), European Union Support Programmes for SMEs, p.2.

covered by other funds, and if they promote the sustainable monitoring of forests and ecological interrelations; and if they comply with the overall objectives of the Community.[157]

5.5.2.1.2 Competiveness and innovation framework programme [CIP]

The impetus for the establishment of the CIP was derived from the common objectives of the Lisbon strategy. The goals associated with this strategy were: to transform the EU into the most competitive and dynamic knowledge-based economy in the world, to create a favorable business environment for SMEs and to spread best-practices and promote convergence between the Member States. The CIP has been designed to make a contribution to the latter aims and to draw particular attention to the specific needs of SMEs.[158] The CIP consists of three operational programmes: the Entrepreneurship and Innovation Programme [EIP], the Information Communication Technologies Policy Support Programme [ICT-PSP] and the Intelligent Energy Europe Programme [IEE].[159] The main objective of the EIP is to exploit the full potential of environment-friendly technologies and, at the same time, to promote competiveness and economic growth. The ICT-PSP aims to support the use of advanced information communication technologies and to overcome the challenges of carbon reduction and ageing of the population. The IEE endeavours to disseminate efficient energy sources, boost demand for those sources of energy and diversify energy supply.[160]

5.5.2.1.3 Marco Polo II

The regulation applied to the Marco Polo II programme was created to reduce the congestion of the European traffic system and to enhance its environmental friendliness as well as its intermodality. Thereby, the Commission pursues to contribute to an efficient and sustainable traffic system; an aim which adds value to the EU without having negative impacts on economic, social and territorial cohesion.[161] Particular attention is drawn to projects from SMEs, as the decision to grant capital can be handled with more flexibility than in the case of larger enterprises.[162]

5.5.2.2 Innovation, research, education and training

The abovementioned CIP also supports innovation and research activities with two of its operational programmes, the EIP and ICT-PSP. The EIP attempts to encourage, promote and improve the conditions for innovation in enterprises; whereas, the ICT-PSP aims to stimulate new markets of information communication technologies.[163]

5.5.2.2.1 The Seventh Framework Programme for Research and Technological Development [FP7]

The FP7 has been established to strengthen the scientific and technological basis of the European industry, and to thus ensure a high level of competiveness of the Community. Specific addressees of the programme are research centers, universities and enterprises which

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[157] Regulation (EC) No 614/2007 of the 23 May 2007 concerning the Financial Instrument for the Environment, L149/1, p.1-2.
[158] Decision No 1639/2006/EC of 24 October 2006 establishing a Competiveness and Innovation Programme, L310/15, p.1.
[159] Commission, Competitiveness and Innovation Framework Programme, available at: http://ec.europa.eu/cip/index_en.htm, (21 April 2012).
[160] Commission (2012), European Union Support Programmes for SMEs, p.3.
[161] Regulation No 1692/2006 of 24 October 2006 establishing the second Marco Polo Programme, L328/1, p.3.
[162] Regulation No 1692/2006 of 24 October 2006 establishing the second Marco Polo Programme, L328/1, p.2.
[163] Commission (2012), European Union Support Programmes for SMEs, p.6.

support scientific and technological progress. The programme highlights the importance of SMEs and takes account of this special group of enterprises. The EU aims to promote synergies within the European research area and to support pioneer and applied research and innovation activities, both goals that feed into the overall objective of promoting social, cultural and economic progress in the EU.[164] The EU intends to increase the overall research capacity of the Community inter alia by attracting researchers from both Europe and worldwide.[165]

5.5.2.2.2 Integrated Action Programme in Lifelong Learning

The overall objective of this programme is to promote lifelong learning in order to transform the Community into an advanced knowledge-based society with better employment and greater social cohesion and sustainable economic development. In particular, the programme seeks to improve the quality, attractiveness and accessibility of available lifelong learning opportunities in the EU. Further objectives include the enhancement of intercultural exchange and social cohesion; the promotion of creativity, competiveness, employment, gender equality; and the development of entrepreneurial spirit.[166] The programme is comprised of a number of sub-pogrammes: namely, Comenius for schools, Erasmus for higher education, Grundtvig for adult education and Leonardo Da Vinci for vocational education.[167]

5.5.2.3 Culture and Media

5.5.2.3.1 Culture

The EU highlights the importance of cultural cooperation and exchange in light of the diversity of languages and cultures in the Community.[168] Therefore, the specific objectives of culture are to promote cross-border mobility of cultural players, are the transnational distribution of cultural and artistic works and the intercultural dialogue. These aims are supposed to encourage the emergence of a common cultural area basing on a common cultural heritage and a common sense of European citizenship. It has been pointed out that especially small cultural enterprises are eligible for the programme, as long as they are not active in the audiovisual industry and do not intend to make profit.[169]

5.5.2.3.2 Media

The EU considers the audiovisual industry as the most important instrument available to communicate the social and cultural values of the union to the young citizens of Europe. In order to enhance the cultural, political, social and economic potentials of the EU, audiovisual works should contribute to the intercultural dialogue and thereby promote the common sense of European citizenship.[170] The fund particularly endeavours to promote culture and language diversity, to foster intercultural dialogue and to improve the public access to the common cultural heritage. Furthermore, the fund aims to enhance the distribution of European

[164] Decision No 1982/2006/EC of 18 December 2006 concerning the Seventh Framework Programme for research, technological development and demonstration activities , L412/1, p.1.
[165] Decision No 1982/2006/EC of 18 December 2006 concerning the Seventh Framework Programme for research, technological development and demonstration activities , L412/1, p.2.
[166] Decision No 1720/2006/EC of 15 November 2006 establishing an action programme in the field of lifelong learning, L327/45, p.4.
[167] Commission (2012), European Union Support Programmes for SMEs, p.6.
[168] Decision No 1855/2006/EC of 12 December 2006 establishing the Culture Programme, L372/1, p.1.
[169] Decision No 1855/2006/EC of 12 December 2006 establishing the Culture Programme, L372/1, p.4.
[170] Decision No 1718/2006/EC of 15 November 2006 concerning the implementation of a programme of support for the European audiovisual sector, L 327/12, p.1.

audiovisual works, to raise the extent of its audiences and to intensify the cooperation between the players. All in all, the competiveness of the European audiovisual industry should be increased.[171]

### 5.5.3 Financial instruments exclusively provided via financial intermediaries

Financial instruments provided via intermediaries are vehicles for the delivery of repayable investments, which promote the objectives of the specific programme and usually constitute a component of the respective implementation strategy. The decisions on the application of the financial instruments are taken by the managing authorities.[172]

The CIP is also comprised of financial instruments, namely GIF1, GIF2 and SMEG. GIF1 provides risk capital for innovative SMEs at their early stages; whereas, GIF2 provides risk capital for SMEs with high growth potential and expansion activities.[173] Furthermore, SMEG provide guarantees to financial intermediaries granting loans, mezzanine or equity to SMEs. This measure is meant to encourage intermediaries and banks to grant more debt financing to SMEs.[174]

#### 5.5.3.1 Joint European Resources for Micro to Medium Enterprises [JEREMIE]

The joint initiative was taken by the Commission and the European Investment Fund [EIF] in order to improve the access to financing for SMEs in the Member States. The initiative allows Member States to set up financial instruments by using a holding fund, which directly receives financial resources from the ERDF and ESF, and which supports the creation and expansion of SMEs. Thereby, the latter group of enterprises is assisted with repayable financial means, such as loans, guarantees and equity. The EIF emphasizes the ability of this instrument to fully adapt to the national requirements of a Member State.[175]

#### 5.5.3.2 Joint Action to Support Micro-finance Insitutions in Europe [JASMINE]

The Commission, the EIB Group and the European Parliament took the joint action to support microfinance institutions.[176] The impetus for the initiative was a communication from the Commission, which highlighted the great importance of micro-credits for growth and development in the economy. It further underlined the need to improve the access to finance for small businesses and disadvantaged people in the EU.[177] The EU defines micro-credits as loans lower than 25,000 Euros. The Commission is of the opinion that there is a lack of micro-credit providers in the EU, mainly because the administrative costs for a loan of such a small amount are too high for commercial lenders. The two main functions of JASMINE are to provide technical assistance (for example, assessment or rating exercises), and to provide funding to non-bank, micro-credit lenders in the Community. Furthermore, the initiative seeks

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171 Decision No 1718/2006/EC of 15 November 2006 concerning the implementation of a programme of support for the European audiovisual sector, L 327/12, p.3.

172 Commission (2011), Guidance note of 21 February 2011 on Financial Engineering Instruments under (EC) No 1083/2006, COCOF_10-0014-04-EN, p.4.

173 EU (2007), Notice 2007/C302/09 of 14 December 2007 on the implementation of the High Growth and Innovative SME Facility, C302/9, p.1.

174 EU (2007), Notice 2007/C226/02 of 26 September 2007 on the implementation of the SME Guarantee Facility, C226/2, p.1.

175 European Investment Fund, Handbook on JEREMIE Holding Fund Operational Procedures, p.4.

176 European Investment Fund, Technical Assistance under the JASMINE initiative, available at: http://www.eif.org/what_we_do/microfinance/JASMINE/index.htm (accessed on 25 April 2012).

177 EU (2010), Supporting micro-credit providers with JASMINE, p.4.

to improve the climate of entrepreneurship and the overall supply of small credits in the EU.[178]

5.5.3.3 The instruments of the EIF and EIB

The EIF makes investments in venture capital funds which seek to support newly created and technology-oriented SMEs, and also SMEs at large. The second instrument from the EIF is guarantees, which are given to financial institutions granting credits to SMEs. The EIB provides loans to SMEs in order to enable this group of enterprises to invest in the tangible and intangible assets necessary to run their business on a stable basis.[179]

5.5.3.4 The Progress Microfinance Facility [EPMF]

The EPMF provides micro-credits of less than 25,000 Euros to people, who want to become self-employed, are unemployed or have problems getting ordinary credits by means of financial intermediaries. The programme either issues a guarantee for the provider of micro-capital or provides funding.[180]

5.5.3.5 Assistance for the internationalization of SMEs

The EU provides indirect funding to SMEs for their internalization process through a high number of intermediaries in the Member States. The EU instrument of pre-accession assistance [IPA] supports such activities by providing financial assistance to EU candidate countries or potential candidate countries. Further instruments include the European Neighborhood policy instrument, which is comprised of the Neighborhood Investment Facility (NIF) and the East-investment Programme, and which supports several projects addressing SMEs.[181] In particular, the NIF seeks to assist SMEs with their risk capital operations. The East-investment Programme seeks to support SMEs from Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine in their internationalization and trade activities.[182]

The European Bank for Reconstruction and Development provides financial support by their SME finance facility. The capital is provided to local banks or leasing companies, and afterwards these institutions grant the credit to SMEs in the respective country of operation.[183] The EIB supports Eastern partner countries by financing their projects, which are in line with the interests of the EU in the fields of transport, energy, telecommunications and environmental infrastructure. Since 2009 the activities of this programme have been extended to provide loans to SMEs via local banks.[184] The Facility for Euro-Mediterranean Investment and Partnership [FEMIP] pursue the economic and social development of the Mediterranean, and thereby grant loans to SMEs in their respective regions through banks or other private lending companies.[185]

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[178] EU (2010), Supporting micro-credit providers with JASMINE, p.5.
[179] Commission (2012), European Union Support Programmes for SMEs, p.15.
[180] Commission, Progress Microfinance, available at: http://ec.europa.eu/social/main.jsp?langId=en&catId=836, (accessed on 8 May 2012).
[181] Commission (2012), European Union Support Programmes for SMEs, p.16.
[182] Commission (2012), European Union Support Programmes for SMEs, p.17.
[183] European Bank for Reconstruction and Development (2011), Financial institutions, p.3.
[184] European Investment Bank, EU Eastern Neighbours, available at: http://www.eib.europa.eu/projects/regions/eastern-neighbours/index.htm?lang=en, (accessed on 8 May 2012).
[185] European Investment Bank (2012), FEMIP and the development of SMEs in the Mediterranean, p.1.

The EU Gateway Programme supports SMEs aiming to extend their activities to the Japanese and South Korean markets. The participating SMEs receive financial and logistical support, strategic advice and potential business contacts in order find new suppliers, customers or distributors.[186]

### 5.6 Evaluation of the financial assistance by the EU

In order to structure the high number of financial measures taken at the EU-level, it can be summarized that the EU's financial assistance of SMEs mainly takes place by means of direct subsidies, indirect assistance via intermediaries and guarantees for loans or other liabilities.

As it is not exactly defined in the articles of the Treaties, some preliminary considerations are necessary to classify EU guarantees accordingly. The ECJ and the Commission take a broad view concerning the definition of State aid, and the Commission's list is illustrative rather than exhaustive. Both ascribe to the general principle that the measure from a State or State resource has to confer an advantage on a recipient.[187] From the jurisprudence of the ECJ, it can be derived that the application of the State aid rules on State guarantees is generally possible.[188] The Commission States that all kind of State guarantees have to be considered as State aid. The underlying principle from the Commission takes into consideration the question: would a private market-oriented capital provider also have granted the guarantee under the same conditions? From the perspective of the Commission, this reasoning and the case that an enterprise is able to continue doing business solely due to a guarantee from the State, and thereby force competitors without a guarantee to leave the market, are considered as very strong signs for the existence of State aid. Therefore, the classification of guarantees as aid in the meaning of the Treaties can be regarded as appropriate.[189]

The programmes of the EU in favour of SMEs grant aid and advantages to enterprises in the Member States and raise the question about the control of these activities.

Among the obligations of the EU, one duty is to ensure a high level of competition in the Community. The principles from the Treaties are supposed to give confidence to the enterprises in the area of the EU that their performance is not jeopardized or reduced by Community interventions.[190] The prohibition of Community aid with distortive effects on competition is an area not directly covered by Article 107 TFEU, as the source of capital is not a State source.[191] Nevertheless, the rules on State aid for the Member States include the prohibition of aid in cases where competition is distorted, in cases where the threat of distortion exists and in cases where trade is affected between Member States and is deemed incompatible with the common market.[192]

In order to analyze if Community aid can have the same detrimental impact on the economy as State aid, the general economic effects of granting aid to enterprises have to be taken into consideration. In the case that an advantage is conferred to an enterprise by either the State or the Community, this enterprise is put into a better position without the requirement of a sufficient market-driven counterpart. Consequently, it creates a competitive advantage on the

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[186] EU Gateway Programme, Opportunities for EU Companies in Japan and Korea, available at: http://www.eu-gateway.eu/go.php?nID=22&page=Home, (accessed on 9 May 2012).
[187] *Craig/de Burca* (2009), EU Law, p.1087.
[188] *von Palombini* (2000), Staatsbürgschaften und Gemeinschaftsrecht, p.26.
[189] *von Palombini* (2000), Staatsbürgschaften und Gemeinschaftsrecht, p.27-28.
[190] *Cichy* (2001), Wettbewerbsverfälschungen durch Gemeinschaftsbeihilfen, p.80.
[191] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.124.
[192] *Foster* (2011), EU Treaties & Legislation 2011-2012, p.46.

part of the beneficiary. Such a competitive advantage for the recipient of aid occurs in any case, regardless of whether the aid is granted by the State or the Community.[193]

One striking difference between State aid and Community aid, however, exists in regard to the decision-making for providing aid. In this respect, the European institutions are expected to be more neutral in their decision-making, as compared to the Member States, which usually prefer to strengthen only their own respective enterprises. Therefore, one could argue that all subsidies granted by the Community are always compatible with the internal market. In practice, this neutrality does not necessarily hold true. There are several stages in the process of granting Community aids during which a distortion of competition can take place. For example, stronger Member States may have a stronger influence than weaker Member States on the decision-making process, or some Member States may collude and prefer certain undertakings. Additional undesirable influence may be exercised at Community level by lobby groups, business associations or organizations. Moreover, the European institutions are not immune to misinterpretations or economic misjudgments, which can also lead to distortive effects on competition. Although, certain equalization between the Member States takes place, it can be summarized that Community aid can lead to a similar distortion of competition compared to State aid.[194]

These findings justify the requirement of a certain degree of control. There are several legal remedies available against acts from European institutions and Member States granting aids to enterprises which can be invoked by plaintiffs before national and European courts.[195]

The legal complaints from competitors and their legal remedies have the most practical use in this respect. However, their standing before the ECJ is too weak and their appeal is unlikely to succeed. As many aids are indirectly granted, a competitor may have the opportunity to appeal before his national court. Nevertheless, the legal standing of a competitor in proceedings against Community aid is always worse in comparison to cases of national aid.[196]

Apart from the courts, there are several European institutions with respective control competences, namely the Commission, the European Parliament, the Council and the ECJ. In this regard, the Commission, in particular, is competent in examining aid in regard to its effects on competition. Nonetheless, the Commission is impeded by the problem of insufficient information in regard to infringements resulting from Community aid. Furthermore, the Commission must often control itself, a fact that makes the Commission less efficient and less transparent than an independent authority. Therefore, it can be concluded that the control of State aid by the Commission as the supervisory authority has a higher standard compared to the standard of control taking place in the case of Community aid. This inequality in dealing with State aid and Community aid does not seem to be justified with regard to the distortive effects that Community aid can have on competition and the European economy at large.[197]

In addition to the lack of control that has been discussed before, there is also the question of competencies. The Commission's rules on State aid enable the Member States to maintain their own State aid policy, even though this sphere of aid policy-making typically falls under

[193] *Cichy* (2001), Wettbewerbsverfälschungen durch Gemeinschaftsbeihilfen, p.82.
[194] Ibid., p.83-84.
[195] Ibid., p.117.
[196] Ibid., p.118.
[197] Ibid., p.124.

the realm of the national governments.[198] The Treaties of the EU do not empower the Community to grant aids to enterprises in the Member States. Therefore, the Community's competence to grant such aid must be derived from a variety of special provisions that imply financing competencies. This is often the case, and the fact that the Community is obliged to take measures in certain fields, for example in environmental protection support the view that Community aids are legitimate.[199] However, this view seems to be problematic as it is very difficult to measure how much Community aid contributes to the achievement of an objective of common interest. Community aid often endeavours to achieve a whole set of objectives, a point which makes it even more difficult to predict and examine the effects of a measure addressing a single, pre-defined objective. For these reasons, there is the danger that the EU extends its own policy-making competencies without having a legal basis for it.[200]

However, the high number of similarities between the economic effects of Community aid and State aid allow for the identification of some advantages.

As in the case of State aid, granting Community aid to enterprises can stimulate the performance of certain activities and bring structural change in the European economy. Thus, Community aid can contribute to the achievement of objectives of common interests, like social progress, environmental protection and full employment.[201] As this kind of aid is not subject to any systematic control mechanism, like the notification procedure from the Commission, it can be characterized as a relatively flexible instrument, which allows the granting of assistance within a short period of time.[202]

Even though Community aid targeted at SMEs may improve the financial situation of single SME and may promote certain developments in the economy, it does not improve the overall access to finance for this entire group of enterprises.

Like in the case of State aid, Community aid gives a competitive advantage to certain enterprises, which are put in a better position compared to their actual or potential competitors.[203] It may also lead to the situation that a less efficient SME is artificially maintained in the market; these kinds of SMEs would likely be forced to drop out of the market without the Community assistance. This development can lead to a considerable market barrier for potential competitors, which cannot make use of financial means from the EU.[204]

Due the fact that neither the control nor the competence for these Community activities are fully transparent, and due to the fact that the effects of Community aid can be almost as distortive to competition as State aid, it can be concluded that Community aid is not a convincing instrument to improve the access to finance of SMEs at large.

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[198] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.51.
[199] *Cichy* (2011), Wettbewerbsverfälschungen durch Gemeinschaftsbeihilfen, p.48-49.
[200] Ibid., p.50.
[201] *Rydelski* (2006), The EC State aid regime: distortive effects of State aid on competition and trade, p.13.
[202] *Blauberger* (2009), Staatliche Beihilfen in Europa, p.124.
[203] *Cichy* (2001), Wettbewerbsverfälschungen durch Gemeinschaftsbeihilfen, p.82.
[204] *Basedow/Wurmnest* (2011), Structure and Effects in EU Competition Law, p.261.

## 6. Conclusion

SMEs account for a substantial part of the total number of enterprises in the EU, employ about two thirds of all workers and show higher job creation rates than large enterprises. Furthermore, this group of enterprises contributes the majority of total value added to the European economy. Therefore, it can be summarized that SMEs play an important role and deserve special attention from the Community. Among the main obstacles for SMEs in Europe is the lack of appropriate sources of finance, a point that is integral to their development and the exploitation of their full potential. The access to finance for SMEs varies considerably among the different Member States of the EU, a phenomenon caused by the fragmentation of the European financial market.

The first field of action in which the EU has attempted to tackle the problem of insufficient access to appropriate sources of finance for SMEs is the European capital market. In this case, certain directives were supposed to mitigate the fragmentation and improve the cross-border raising of financing. In particular, the FSAP from the Commission contained several proposals aimed at improving the framework for cross-border capital searching enterprises. Among the most important regulatory measures resulting from the FSAP was the creation of the prospectus directive, which was set-up to stimulate cross-border capital transactions by, in particular, improving investor confidence. As a consequence of the directive though, the issuing enterprises were obliged to file and publish a prospectus, a necessity that led to an additional and disproportionate burden for SMEs searching for capital on an EU-basis. Aside from this directive, the transparency directive was enacted to further strengthen investor confidence, as it has been discovered that transparency is an effective means to increase the faith of investors in foreign investment projects. Furthermore, the Directive on Markets in Financial Instruments and the directive on market manipulation were set-up to pursue almost the same objectives as the latter directives. With these regulatory measures the EU achieved progress in financial market integration by, on the one hand, improving investor confidence and market access for issuing enterprises and, on the other hand, putting additional burden on SMEs by imposing a set of rules that made cross-border capital-raising for them disproportionately time-consuming and costly. The EU failed to approach all barriers to the common financial market and has almost no regulatory measures taken in the field of taxation. It has to be mentioned that natural barriers to the common capital market are almost impossible to overcome by regulatory means. Nonetheless though, it can be concluded that the EU achieved progress in the field of financial integration, a sphere that is supposed to have a positive impact on the access to finance of SMEs. Still though, the pace of financial integration is slow and the taken measures almost only affect SMEs searching for equity finance. As it has been observed that equity financing is not a popular source of financing for this group of enterprises, it can be said that the measures taken by the EU slightly improved the situation for equity searching enterprises, but have only had limited impact on the access to finance for European SMEs at large.

The second field in which the EU took action to improve the access to finance for SMEs was the European competition policy, where certain exemptions from the State aid rules have been made to allow Member States to grant subsidies to SMEs. The Commission regards the poor access to finance for SMEs as a market failure and justifies the exemptions with the argument that subsidies can be an appropriate instrument to compensate for the failure. In this respect, it remains arguable if the insufficient access to finance for SMEs really constitutes a market failure that comes from size, or if rather the situation is normal market behavior allowing for an ongoing replacement process in the economy. As the EU is under special obligation to avoid any intervention in the market which may cause harm to the economy, deep analysis has to be conducted beforehand. In contrast, cases falling under the GBER are not assessed by the Commission at all. This point, in conjunction with the fact that the Commission already made misjudgments and misinterpretations in the past, shows that the Commission has only limited ability to explain all interdependencies of State aids in the economy; thus, making the application of GBERs and the approval of State aid highly questionable. Furthermore, the artificial maintenance of SMEs in the market by means of State aid constitutes a market barrier for more efficient SMEs that may want to enter the market but cannot benefit from a subsidy. Therefore, the exemption rules on State aid from the EU are a non-convincing instrument to improve the access to finance for SMEs as the rules don't guarantee, even though they allow for the financial assistance of some enterprises, benefits for European SMEs, competition and the economy in general.

The third field in which the EU has attempted to assist SMEs in their access to finance is the direct and indirect granting of a high number of Community aid to this group of enterprises in the Member States. In this sense, Community aid appears in the form of direct subsidies and indirect subsidies, which are either directly available through the EU or indirectly via intermediaries. The EU also provides guarantees for loans and other liabilities – types of assistance which also fall under the Community aid category. The rules on State aid which are implemented in the Treaties and controlled by the Commission prohibit Member States from granting subsidies which distort competition and have detrimental effects on intra-Community trade. The Treaties do not contain any similar provisions on Community aid, a point that raised questions about the control of these Community activities. The EU is obliged to ensure a high level of competition in the Community, and is also obligated to refrain from any measures contrary to this principle. Furthermore, a variety of legal remedies exist, which can be invoked before the Courts. Additionally, the Parliament, the Council, the ECJ and the Commission also hold competence in this field. On the whole, it must be concluded that the standard of control is still higher for State aid cases, where the Commission acts as the external supervisory authority, as compared to cases of Community aid, where the neutrality of the authorities is questionable and the control procedures are not transparent. This disparity is unjustified, as Community aid can have similar distortive effects on competition as State aid. The legitimacy of the EU to provide subsidies to enterprises must be derived from special provisions, which imply financing competence for the achievement of certain objectives.

It remains highly complicated to examine whether the EU acts with competence in this regard, because the success of Community aid contributions is difficult to measure, and aid is often granted as an endeavour to achieve different objectives. Thus, the question of whether certain Community aid still falls within the EU's competence can often not fully be answered. The economic effects of Community aid are very similar to the effects of State aid, and therefore comprise almost the same threats and opportunities. The absence of a systematic control mechanism makes Community aid a flexible instrument to grant financial assistance to SMEs within a short period of time. Further advantages comprise the ability of the EU to bring structural change in the economy and to promote the performance of certain activities. However, Community aid for SMEs grant a competitive advantage to the beneficiaries and put these beneficiaries in a better position. This constitutes a market barrier for other potentially more efficient SMEs that cannot benefit from a subsidy. All in all, Community aid, like State aid, is not an appropriate instrument to assist SMEs in their access to finance as it threatens to distort competition and is not beneficial for SMEs and the European economy at large.

The EU should rather pursue further financial market integration and improve the regulatory framework for SMEs raising capital Community-wide. A common capital market without barriers and full market access for enterprises of any size at low costs, where risk capital for SMEs can be allocated to its most efficient use, constitutes a lasting solution to the still present fundamental problem of the access to finance for SMEs in the EU.

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