

## FOR AN INCLUSIVE EU SME POLICY

### Executive summary

- The current European legal definition (Recommendation 2003/361/EC of 6 May 2003) for small and medium-sized enterprises (SMEs) does not encompass the majority of local public services enterprises (LPSEs) from its scope because it excludes enterprises with a public ownership of more than 25%.
- The SME definition is widely used both in European and national legislation, as well as in EU financing programmes, in response to the EU policy priorities and more recently the Better regulation agenda.
- However, it appears that the EU SME Definition unnecessarily discriminates against LPSEs for the very nature of their ownership structure. This is notably contrary to article 345 TFEU which states that “The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership”.
- As a consequence, LPSEs cannot take part in a number of funding and financial schemes. They are also constrained by unnecessary and especially disproportionate regulatory burden from which other SMEs covered by the definition are exempted because of disproportionate costs, and therefore may suffer a disadvantage, especially in areas where they are in competition with private enterprises.
- Hence, an amendment to the European SME definition is required in order to guarantee equal treatment to all types of SMEs irrespectively of their type of ownership. Should this not be possible or not desired, future reference to the SME definition should exclude Article 3, Paragraph 4 of the Annex to the aforementioned Commission Recommendation.

## INTRODUCTION

The creation of a supporting and enabling business environment for SMEs is a priority across policies for the EU institutions, notably through the implementation of the Better regulation agenda. In the aftermath of the financial and economic crisis, discussions are on-going since several years on how to improve the effectiveness of the EU SME policy and whether a new Small Business Act is needed. One of the dimensions of the debate is the need to better reflect the variations in size, field of activity and legal form of SMEs in order to fully seize the economic and investment growth potential represented by some actors. This paper wants to feed into these discussions, notably by pointing at the shortcomings of the current EU SME policy to meet the needs of Local Public Services Enterprises (LPSEs).

LPSEs are corporate entities operating generally like a conventional business with the specificity that they operate at arms-length from the local authority with which they are associated. They use to provide services that in other circumstances would be provided directly by the local authority and which are therefore often services of general interest (SGIs).

Due to their size, LPSEs tend to face similar challenges to SMEs in terms of coping with regulatory costs and accessing to financing. It should also be noted that they operate increasingly in a competitive environment, being subject to the same market rules as private enterprises. Nevertheless, LPSEs are currently not benefiting from simplification measures implemented for SMEs, the main reason being that they are not captured by the EU SME Definition which excludes SMEs with a public ownership of more than 25%. This de facto exclusion appears to be an unjustified discrimination against enterprises with public ownership and risks to create an undue regulatory burden on LPSEs in a context of growing uncertainty on access to financing and increased competition.

Hence, this paper makes the case for a more inclusive SME policy which benefits to all SMEs, including small and medium-sized LPSEs. CEEP also assumes that there is a need to raise awareness about the detailed provisions in the EU SME Definition and its implications for LPSEs. As such, this opinion shall ultimately support the implementation of the Better regulation agenda (see recommendations in section 4) which is meant to ensure that EU regulation is fit for purpose for citizens, businesses and society, notably by avoiding unnecessary regulatory costs.

## THE CONTRIBUTION OF LPSES TO EUROPE'S COMPETITIVENESS, GROWTH AND JOBS

### What are LPSEs?

Overall it is estimated that there are around 25.000 LPSEs in Europe, employing 1.6 million people and generating a turnover of € 282 billion.<sup>1</sup> While the number of LPSEs varies from one Member state to another, overall this number has been growing across Europe. In 2004, a Dexia study estimated that there were 16.000 registered LPSEs with a turnover of 140 billion euro and employing 1.1 million employees<sup>2</sup>. While precise statistics are not available in all countries, it can be reasonably estimated that a great majority of these enterprises are SMEs in terms of resources. In France, this would be the case of 94.4% LPSEs. The 2010 study *Mapping Public Services* evidenced that 51% of enterprises providing SGIs are SMEs of which 18% are micro, 16% are small and 17% medium enterprises. The patterns across sectors are quite different from one country to another. As an example, in Germany, around 63.1% of the water and energy industry which are SMEs are LPSEs.<sup>3</sup>

LPSEs provide SGIs in a wide range of sectors, including for instance electricity and energy supply, gas, communication networks, heating, housing, ports, transport, water, sewerage, waste, telecommunications, health, social care, urban planning, economic development. The operation by LPSEs of such « sensitive » services explains the involvement of the local authority in their ownership and strategic control systems which enables to set important social or public objectives for local enterprises. Therefore, local enterprises always operate under some degree of control of a local authority, at least in determining its strategic direction. Nevertheless, this does not exclude the participation of private shareholders to their capital.

### The contribution of LPSEs to Europe's policy priorities

Their mission of general interest gives LPSEs a key role for a sustainable and efficient local action and thus for achieving the sustainability and competitiveness objectives of the EU. Considering their important role in the waste, gas or electricity sectors, they are for instance crucial to the creation of the Energy Union and a European circular economy.

Furthermore, thanks to the close link to their region, they have played a counter-cyclical effect during the crisis through continued employment, investment and procurement. For instance, in France LPSEs have maintained their employment at around 60 000 jobs over the economic crisis<sup>4</sup>.

Finally, they also very much play a dynamic economic role by being at the forefront of developing and creating an enabling environment for innovative solutions to societal challenges. With the on-going digital transformation, LPSEs are predestinated to be key players in the development of smart cities. In this context, the innovation potential and the interactions between LPSEs and other private actors will only increase.

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<sup>1</sup> Fed Epl/CEEP. Panorama des epl en Europe 2014

<sup>2</sup> Dexia, Fédération des EPL, *Les entreprises publiques locales dans les 25 pays de l'Union européenne*, août 2004

<sup>3</sup> BDEW

<sup>4</sup> EPLscope March 2015

## The business environment of LPSEs

LPSEs act increasingly in a competitive environment, including in international markets and competing with international companies where markets are liberalised. For instance, with the energy market liberalisation, LPSEs are able to produce and sell electricity, gas and heating anywhere in the European single market and they do so in competition with other market actors and with each other. Energy distribution is becoming a highly competitive market.

In this context, they face similar challenges and needs to SMEs in terms of competitiveness, which required adequate policy responses. As for an example, the digital transition brings equal challenges to LPSEs as for SMEs concerning the need for innovation and adapting the workforce. Furthermore, the Pulse of Public Services Spring 2016 has evidenced that “Legislation that increases the negative impact of the administrative burden” is one of the biggest challenges faced by public services and SGI providers<sup>5</sup>. It is followed by the challenge of finding the workforce with appropriate skills and budgetary cuts. Access to financing in order to meet necessary investments is a problem for 30% of the respondents.

## THE EXCLUSION OF LPSES FROM THE EU SME DEFINITION AND ITS CONSEQUENCES FOR THE EU INTERNAL MARKET

### The European Commission recommendation on the EU SME Definition and the exclusion of LPSEs

The current definition of Small and Medium-sized Enterprises (SMEs) is set out in the annex of a Recommendation of the Commission adopted on 6<sup>th</sup> May 2003<sup>6</sup>. This Definition shall support policy implementation, in such a way to allow the Internal Market to operate efficiently by ensuring that support measures are targeted effectively on those enterprises that are most affected by these market failures.

As such, it is addressed to the Member States and provides a framework for statistical definitions, has specific applications in EU policies that support SMEs (the Structural & Investment Funds, Horizon 2020, the COSME Programme etc.) and in the rules governing State Aid. Furthermore, reference is made to the Recommendation in certain pieces of EU legislation, effectively allowing exemptions or provisions for easier compliance arrangements for enterprises covered by the Definition.

The most well-known elements in the SME Definition set out in the Recommendation are the size thresholds relating to the number of people employed, turnover and balance sheet total. As such, a great majority of LPSEs across Europe would be qualified as SMEs as previously mentioned. However, it is important to be aware about the full range of restrictions found in the SME Definition.

The most obvious provision excluding LPSEs from the SME Definition is article 3 section 4. It states that “except in cases set out in paragraph 2, second subparagraph, an enterprise cannot be considered an SME if 25% of the capital or voting rights are directly or indirectly controlled, jointly or individually, by one or

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<sup>5</sup> <http://www.ceep.eu/wp-content/uploads/2014/09/PPS-Spring2016-Final.pdf>

<sup>6</sup> <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32003H0361>

more public bodies.” Regarding the conditions set out in paragraph 2, second subparagraph, it notably includes that “autonomous local authorities with an annual budget of less than EUR 10 million and fewer than 5 000 inhabitants” are not considered as linked enterprises. In addition to the fact that this concerns a very small proportion of possible cases, the concept of “autonomous local authority” is not clear.

As a matter of fact, article 3 paragraph 4 is intended to simplify and clarify the application of more substantive elements in the Definition relating to the extent to which an enterprise is autonomous. Article 3 of the Annex develops a complex set of conditions excluding enterprises that in effect are owned or controlled by larger organisations (i.e. linked or partner enterprises). When considering for instance the conditions to identify ‘linked enterprises’ as listed in paragraph 3, such as that an enterprise has a majority of the shareholders’ or members’ voting rights in another enterprise, the nature of the ownership does not seem relevant. This seems to be confirmed by the exception foreseen at the end of article 3: “There is a presumption that no dominant influence exists if the investors listed in the second subparagraph of paragraph 2 are not involving themselves directly or indirectly in the management of the enterprise in question, without prejudice to their rights as stakeholders.”

### **The principle of equal treatment according to article 345 TFEU**

For the reasons explained in section 2.1, it appears that the EU SME Definition unnecessarily discriminates against LPSEs for the very nature of their ownership structure. This appears to be contrary to article 345 TFEU which states that “The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership”.

The Treaty does not impair the ability of Member States to establish businesses as they deem appropriate. The only limitation is determined by the corporate legislation that both public and private shareholders must meet. Hence, the legal definition of a company is determined not by the public or private nature of its shareholders, but by meeting the requirements to set up a company as foreseen by corporate law.

It should be noted that EU corporate law, set up following strict abidance to legal procedures, does not include any discrimination against public owners. Thus, according to EU corporate law, an SME will not be considered a large enterprise by the mere fact of being publicly owned or owned by a private investor with significant financial resources. EU legislation should also duly respect article 345 TFEU, in the same way as European corporate law does.

The fact that SMEs part of a group of companies cannot claim for the SME status in competition rules stems from the very notion of enterprise and control lying at the core of corporate policy. All companies which are part of a group must be jointly assessed as a single enterprise as they share a joint competitive strategy and common resources. Hence, the EU SME Definition should not go beyond and needs to respect the principle of equal treatment.

### **The specific nature of public authority owners**

The nature of the public authority owners of LSPEs is also important to be considered. Since local authorities are non-economic bodies, they might not be able to respond to market needs in the same way as commercial organisations and especially in this context, provide finance on a commercial basis or strategic information. Their primary role is indeed to ensure that LPSEs meet their mission of general interest and therefore they might not bring any additional market power to LPSEs.

## CURRENT REGULATORY AND FINANCING CHALLENGES FACED BY LOCAL ENTERPRISES

Beyond the importance of the principle of equal treatment, the financial and economic crisis, liberalisation policies and the nature of societal challenges has largely impacted the economic environment and activities of LPSEs. As local public services enterprises increasingly act in a competitive environment and face financing uncertainties, the need to reduce unnecessary and, considering their limited capacity, disproportional regulatory burden and to seek alternative financing channels becomes more pressing.

### The financing challenge

Traditional ways of financing of LPSEs have been banking loans and own resources. Reflecting their share ownership, most of the initial capital of enterprises is provided by local authorities, but this does not continue to be the case when LPSEs seek additional finance in which case they also have to use bank loans, retained profits and grants.

Whereas banks remain a privileged financing channel and LPSEs still enjoy a good reputation, several factors have triggered uncertainty about access to financing from commercial sources. In France, 31% of the CEOs of LPSEs said that they encountered difficulties in accessing short-term bank loans in 2015. The percentage lies at 40% for mid- to long-term loans<sup>7</sup>.

First of all, the implementation of Basel III is expected to affect the access of bank financing of local enterprises. Banks will have to make more careful choices on their financial products and loans in particular. More than 75% of CEOs of French LPSEs confirmed that new banking regulations have the effect of higher guarantees and bank counterparties. Hence, except if LPSEs can have recourse to banks established to lend to local authorities, access to commercial sources of finance is becoming challenging because of information and competition failures. Furthermore, while local authorities continue to provide guarantees to LPSEs, in the current context of fiscal consolidation, there is less and less visibility on the continuity of those guarantees in the future. The overall tendency is that financial assistance by state and local entities to LPSEs is decreasing.

Finally, LPSEs are increasingly engaged into “risky” investments. For instance, in the context of the energy transition, investments might involve other actors and become cross-regional.

This situation is exacerbated by the fact that currently LPSEs are increasingly finding that they are excluded from sources of finance that are made available to SMEs. For instance, French LPSEs have encountered difficulties in accessing financing offered by Bpifrance, the French public investment bank, because not being an SME. Similar problems are beginning to be reported in other countries. In this context, it is most welcomed and significant that the European Investment Bank does not use the EU SME Definition but only the headcount and turnover criteria in order to define a SME<sup>8</sup>.

Ineligibility problems arise also for accessing EU grants. Because of the nature of their activities, LPSEs are often called upon to be involved in regional development of social projects supported by the European Structural and Investment Funds. Furthermore, in order to stay competitive, the interest for funds related to research & development is increasing. Some €8.5 billion, i.e. more than 10% of the

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<sup>7</sup> FedEpl, *Financement des Entreprises Publiques Locales*, Avril 2015

<sup>8</sup> <http://www.eib.org/products/clients.htm?lang=en>

total Horizon 2020 budget, are expected to support research and innovation activities carried out by SMEs. Although the innovation potential and multiplication effect of LPSEs is high, only very few local enterprises have currently access to Horizon 2020 funds (as an example, less than 2% in France). Simplified procedures have been implemented to facilitate access of those funds, however LPSEs cannot benefit from them. The EU SME policy has acknowledged that the EU innovation funding reaches insufficiently SMEs because of the complex procedural requirements and lack of information. It is therefore even more regrettable that some SMEs are excluded from the beginning, although they face the same type of challenges.

## Coping with undue regulatory burden

While local enterprises have increasingly to cope with limited resources, they often face disproportionate regulatory costs because they cannot benefit from simplification measures adapted to SMEs. This is in particular an issue for those enterprises which act in increasingly competitive markets.

It is most welcome that the Better regulation agenda will ensure a more effective implementation of the Think Small First principle, notably through a more thorough application of the SME Test. However, it appears counter-productive if the application of the SME Test does not take into account all types of SMEs. This is the case for LPSEs, despite the fact that they are often crucial to achieve European policy objectives through the sectors in which they are active such as energy and environment.

Two examples illustrate particularly well that the current policy approach to SMEs – which is based on exemptions or special measures for SMEs using the EU SME Definition – does not serve the principle of proportionality and might undermine the effectiveness of EU policies.

A first example is the **energy efficiency directive**, currently under review. SMEs are encouraged, but not obliged, to carry out an energy audit according to the new Energy Efficiency Directive 2012/27/EU. Member States may set up support schemes for SMEs, including if they have concluded voluntary agreements, to cover costs both of an energy audit and of the implementation of the highly cost-effective audit recommendations. On the contrary, LPSEs might end up paying substantial sums to carry out such an audit, in some cases even exceeding their annual energy costs. As an example, one small housing association with one office and one car would pay normally € 2- 3,000 per year for energy costs, while the audit for such a company is expected to cost at least € 3-4,000.<sup>9</sup> LPSEs gathered within CEEP support energy efficiency as key elements of the Energy Union. Nevertheless, EU energy efficiency policy should take into account that the effect of measures to improve energy efficiency depends primarily on the actual size of the company. In contrast, the ownership or shareholder structure does not have any influence on energy efficiency or energy consumption. Thus, LPSEs should receive an equal treatment to SMEs in supporting the achievement of the EU energy efficiency objective.

The second example is the **data protection regulation** which has recently been adopted. The regulation foresees a number of derogations for SMEs making explicit reference to the EU SME Definition and thus not applicable to LPSEs. For instance, it is proposed that companies with less than 250 workers do not need to have a Data Protection Officer if data processing does not belong to their

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<sup>9</sup> GdW paper 'Energy Audits for public SMEs. How are German housing associations affected?'

core activities. Furthermore, SMEs are not submitted to notification procedures and are able to charge fees if requests to access data are manifestly unfounded or excessive. SMEs also do not need to carry out an impact assessment.

While the SME landscape is becoming increasingly diverse, we have evidenced that the EU SME Definition fails to accommodate the needs of all SMEs and thus not fit for purpose. A more differentiated approach is necessary, which preferably, through the direct application of the Think Small First Principle, solves the regulatory problem for all small enterprises. If exemptions are really unavoidable the approach should be based more squarely on characteristics related to the nature of the problem rather than on the SME Definition.

## TOWARDS A MORE INCLUSIVE SME POLICY

CEEP would like to make following recommendations to EU policy-makers in order to ensure that the benefits of the EU SME policy better trickles down to the full variety of SMEs, including LPSEs:

- The application of the Think Small First principle should be driven by considerations of proportionality and level playing field amongst all market players. It will benefit the efficiency and effectiveness of EU legislation if it is considered that regulatory burden may pose problems for all SMEs and not just enterprises that conform to the EU SME Definition. Therefore, the SME Test might need to be adapted.
- Policy-makers should refrain from considering public ownership as a competitive advantage *per se*. Even though public authorities exercise an influence over LPSEs, it should be taken into account that they are non-market players and therefore not able to respond to market needs in the same way as commercial organisations and provide finance on a commercial basis. Furthermore, LPSEs still have to compete with other market players and thus might lose markets, just as private enterprises.
- EU institutions, and the European Commission in the first place, should refrain from making a systematic use of the EU SME Definition in EU legislation. They need to assess on a case by case basis whether the use of the EU SME Definition is appropriate depending on the nature of the problem.
- In an upcoming review of the EU SME Definition, the European Commission should explore how to remedy to the blunt exclusion of LPSEs from the EU SME Definition.
- If no amendment to the SME definition is possible or desired, it would be helpful if the European and national legislators would exclude Article 3, Paragraph 4 of the Annex to the aforementioned Commission Recommendation when referring to the SME definition. This should be done as a matter of principle when dealing with administrative simplification measures.