

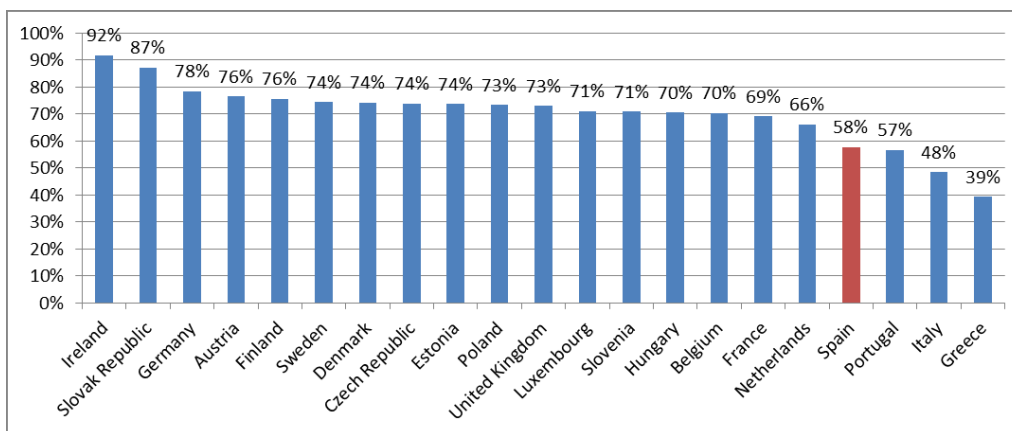
IEF PROPOSALS FOR BUSINESS GROWTH IN THE EU

In December 2013, Instituto de la Empresa Familiar (IEF) published “Business Dynamism in Spain—A diagnostic of the situation and proposals”, a report with a detailed analysis regarding two dimensions of business dynamism (business creation and business growth) in Spain, accompanied by a set of proposals for action in the scope of economic policy. Below is a brief summary compiling such proposals as might be applicable in other countries within the European Union.

Context

Once businesses reach a certain size threshold, they are better placed for innovation, for internationalization, and for facing large projects. For this reason, having a high number of middle (and large) size businesses **equals competitiveness**. In this regard, business growth is one of the main challenges for the European economy, since **average business size is below that of the United States, where 80% of employment is generated by businesses with over 20 employees (vs. 70% in EU¹, see Graph 1).**

*Graph 1. Percentage of employment in EU businesses with over 20 employees
(countries with available data)*



Source: OECD

Instituto de la Empresa Familiar (IEF) positively values European Commission initiatives such as the Small Business Act and the Entrepreneurship Action Plan. However, **there is a margin for strengthening the protection of productive capital and paying an even greater attention to economic policies linked to business growth, since such policies have traditionally focused on new business creation.** This standpoint was set forth in the working paper “Business Dynamism in Spain—A diagnostic of the situation and proposals” published in 2013, where business creation and growth (the two dimensions of business dynamism) in Spain were

¹ Average of countries with available data according to Eurostat.



analysed. The report contributes more than 50 proposals for action to promote business growth.

Family Business and Business Growth

In recent times, more and more voices spread the view that the family-run approach of businesses is a growth-limiting factor. For example, an [article](#) in the Financial Times (*Most UK family-owned companies shun rapid growth*, October 15 2014).

We can certainly find some (limited) academic literature in support of these arguments. There is evidence, for example, that in certain countries (France and Norway), **non-listed family-run SMEs grow less than non-family SMEs. Instead, there is practical evidence to the contrary in the case of European listed businesses.** Similarly, associates of Instituto de la Empresa Familiar (IEF) are a clear counterexample showing how family management and business growth are two perfectly compatible concepts.

The main setback for business growth in the case of family-run SMEs is the challenge of succession. Eight out of ten family businesses fail when inherited by founders' descendants, while nine out of ten disappear by the third generation, according to a recent survey from PwC. Such a risk obviously reduces family businesses incentives for investment.

Given the on-going, strong demographic transition in Europe, the number of businesses facing a succession process will rise considerably, so this setback is likely to gain relevance in the future. According to data from the United Nations, population over 80 years will double in Europe in the next 30 years. **Thus it will become increasingly important to set a proper economic framework for SMEs—to take into consideration the interaction between family dimension and business growth.**

Proposals

Below is a selection of proposals suggested by IEF in the document “Business dynamism in Spain”. Its main, clear goal is to strengthen the growth potential of the European economy—its businesses. Proposals are structured around 4 axes of interest:

- i. **Fiscal system**
- ii. **Labour market and human capital training**
- iii. **Financing**
- iv. **Corporate management of FB, role of the public sector, promotion of competition and other aspects.**

Fiscal system

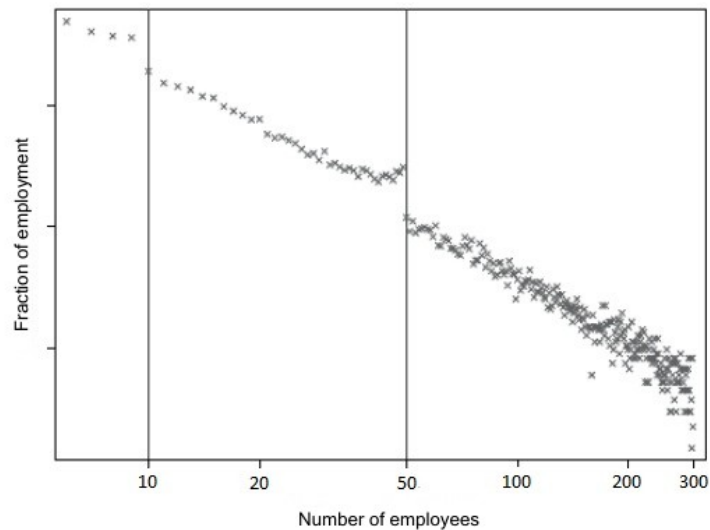
In the **field of taxation**, there is a need for a regulatory framework that is both more stable and more favourable to business investment. At the same time, in countries where public revenue needs to increase, this should be done through the integration of the informal economy into the formal circuit, as an alternative to the increasing fiscal pressure that businesses have to face.



1. **Extending the tax base by integrating informal economy into the formal circuit.** A whole set of interventions must be studied in the framework of a reform in the fight against fraud. One of them is the *Cheque Emploi Service Universel*, already in force in France and Belgium, with tax exemptions for payment mechanisms (e.g. cheques) destined to the payment of low-qualifying services that escape tax control (e.g. occasional household services).
2. **Facilitating continuity for family-run businesses** It is essential to keep and reinforce the tax shield on productive assets, resisting temptation to put a charge on them publicized as a “tax on the rich”. Furthermore, the fiscal framework for family business (tax on wealth, tax on inheritance and donation) must be guaranteed for older businesses, i.e. those where shareholders are likely to be more disperse. A proposal is set forth to include relatives up to the fourth degree of consanguinity in the calculation of necessary capital percentage to access this regulation.
3. **Establishing a neutral tax system between debt and capital.** Taxation on capital includes up to three different taxes—those upon the business, those upon current owners, and those upon future owners (successors). Debt interest, instead, is frequently deductible in corporate tax. This difference in treatment leads to an excess of leveraging among businesses. As a way of mitigating this taxation excess, a compensation proportional to business capital (Allowance for Corporate Equity) might be implemented.
4. **Introducing tax incentives contributing to employment creation and promoting productive business investment.** In most EU countries, taxation on financial investments and consumers is lower than that of actual investment projects, that put up with every possible tax: social contributions, corporate taxes, consumer and income taxes, successions taxes, etc. In the case of Spain, direct tax revenue generated by a business activity can be up to 13 times higher than that generated by savings of the same amount in a joint investment firm (over a time horizon of 10 years).
5. **Strengthening tax incentives for young businesses.** In order to favour business growth, the tax system needs to be oriented to a higher degree of favouring newly-created businesses (instead of small-sized businesses). Such businesses should pay taxes at a reduced rate for a longer period (for example, 6 years), regardless of their turnover level.
6. **Conducting a cost-profit analysis of regulatory thresholds that may be hindering business growth.** Such “regulatory benefits” may end up acting as an obstacle for growth since companies will only choose to size up if and when the benefit of doing so will exceed the cost of losing the aforementioned regulatory benefits. In the case of Spain and France this limit seems to be set under 50 employees, which reduces the percentage of medium-sized companies—an issue which is largely shared with Italy.



Graph 2. Job distribution in France by business size



Source: Luis Garicano, according to French businesses fiscal data.

- Promoting tax incentives for profit destined to levelling-off and capitalization reserves in order to facilitate business survival.** A business alternating profit and loss through the cycle will pay a higher tax rate than one with a more even distribution of the same profit over time. A favourable fiscal treatment for levelling-off reserves is a way to adapt fiscal pressure to each business payment capacity. As for capitalization reserve, it is oriented to strengthen a business internal reserves and compensate for negative effects of over-indebtedness.

Labour market regulation (8-11) and human capital training (12-16)

In the labour field we must follow the lead of exemplary countries such as Denmark and Austria and keep a bold stance for flexi-security. Furthermore, IEF deems convenient to promote training contracts for youth and people with employability difficulties (these would include current work-experience and training contracts).

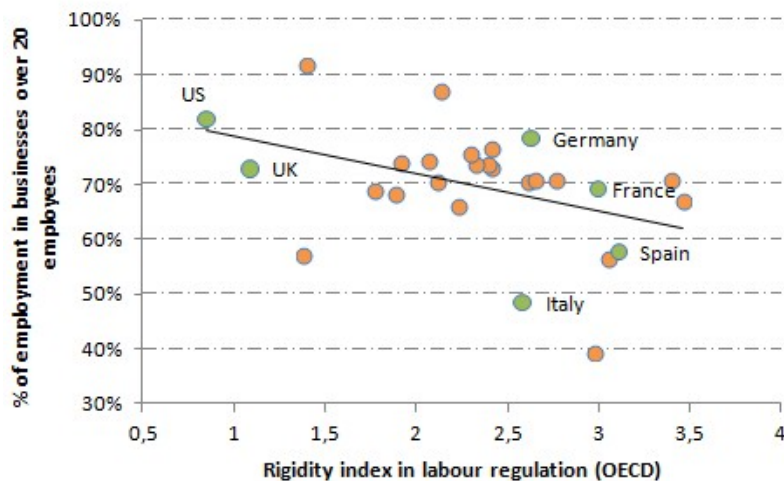
- Increasing internal labour flexibility** Certain limitations in functional and geographical mobility of workers ought to be removed, and ability for irregular working time distribution increased, including the promotion of part-time contracts.
- Simplifying contractual modalities.** Reducing contracts to just three modalities—a single open-ended contract (flexible, with a rising compensation and lower social security costs), a fixed-term contract subject to business needs, and a work-training contract for youth.
- Studying the creation of a capitalization Fund as per the Austrian model that does not burden businesses with additional costs.** The main novelty in this model is that the employee is granted a termination compensation system that works as a savings fund, that can be maintained even in the case of switching jobs, and that is promoted by the State to



be used as a complement of the public pension. The main benefit of this is that it introduces a higher degree of mobility and flexibility in the labour market.

- 11. Reforming salary system.** Salaries must be fixed according to efficiency criteria. With regard to this, salaries must include a variable, fluctuating component linked to both individual employee efforts and business results. On the contrary, practices like inflation-indexation should be abandoned.

Graph 4. Labour regulation rigidity and business size



Source: OECD and WEF (2008-2009).

- 12. Thorough reform of active employment policies.** It seems clear that in order to define training priorities there must be a council with a representation of business associations, workers and central and regional (or local) tiers of Public Administration, but given such a strategic direction, management must be delegated and budget increased for financing training offered by for-profit entities, e.g. recruitment businesses.
- 13. Introducing business training with specific, professional experience-oriented contents, including finance, in all stages of education.** As a matter of fact, the financial knowledge level of students will be evaluated in the upcoming PISA report examinations to be carried out and, besides, international experts agree in stating that an appropriate financial education decisively contributes to economic growth, since it acts as a promote of market transparency and facilitates an efficient allocation of resources.
- 14. Considering the level and type of entrepreneur's training as well as languages knowledge among the requirements for public aid (either direct or financial).** Since the probability of success depends on the training type and level, and confronted with a scarce fiscal incentive margin, this conditioning based on the educational profile of the entrepreneur is a way to maximize the efficiency of public policies.
- 15. Integrating educational system into business network, with mandatory work-training at university, and promoting the dual vocational training model.** In order to promote



business spirit it is essential that young students experience a close relation to business. With regard to this, the European Commission is recommending member states to offer at least one practical business experience before completing compulsory education.

16. Establishing a minimum of core and optional subjects in English in college degrees.

Establishing, on a general-purpose basis, that in order to validate a degree, a proportion not inferior to 15% of the credits must be taught in English.

Diversification of financial sources for business projects

With regard to **financing**, there is a need to correct an excessive subjection of mainland Europe companies to bank credit, an issue which is more acute in smaller businesses and, above all, in young businesses.

17. Promotion of European Banking Union. Creation of a European guarantee deposit fund, with identical conditions for all depositors. This requires, in turn, another two institutions on a European level: a system for the resolution of banking crises common to all countries from the guarantee fund, and a common system for monitoring financial entities headquartered in the ECB.

18. Incentives for business participation in capital markets. Management companies of these markets (e.g. MAB in Spain) ought to have specialized departments for assessment to entrepreneurs willing to enter them. At the same time, the cost of access for businesses should have some fiscal benefits and the public sector might want to redirect its grants policy, etc. in favour of participating businesses.

19. Creating a European rating agency. Such an agency would compete with the three big players (S&P's, Fitch, Moody's) and facilitate SMEs access to a rating.

20. Deduction for company investment in Alternative Stock Exchange Markets (aimed at smaller size businesses). In symmetry with the one above, this measure aims at making medium-sized listed companies more appealing to investors.

21. Developing European negotiation platforms. If a market does not reach a critical mass that is large enough in number of listed companies, it might not be attractive for investors, as it does not offer enough liquidity nor allows for the development of a sufficient infrastructure of analysts and intermediaries, essential to guarantee market consolidation. In this regards, IEF positively values EC initiative to truly build a capital union by means of higher harmonization and regulatory integration.

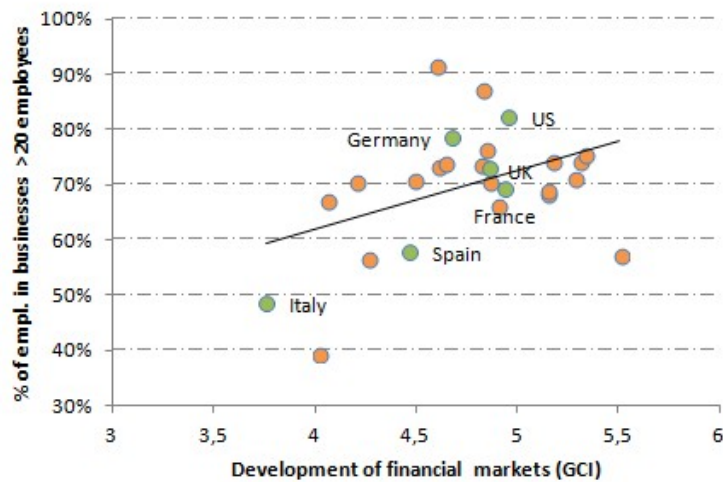
22. Creating an investment vehicle specializing in recently-created businesses. Specifically a 25% deduction is proposed for investments in this fund or in newly-created businesses kept for a minimum of 5 years, as well as a 50% bonus on dividends and gains thus obtained in the first 8 years of operation.



- 23. Extending tax benefits of venture capital funds to intermediate debt funds.** Intermediate debt funds (“Mezzanine Finance”) aim to favour access to financing oriented to acquiring businesses in early development stages, in order to facilitate their growth in size. In countries where venture capital funds enjoy a favourable fiscal treatment regarding dividends and gains obtained through their regular investments (shares in capital of non-financial, non-real estate and non-listed businesses), this treatment should be extended to interests perceived from investee businesses, so that “intermediate debt” funds would enjoy this favourable fiscal treatment. Removal of burdens for emission in Alternative Bond Markets is a step in the right direction, but it is not enough to promote growth among younger businesses.
- 24. Securitisation of business loans.** Even though the process of financial entities assets securitisation is in the inception of the current crisis, it still is a valid alternate instrument for funding, and thus for increasing the available credit volume. Specifically there is a need to standardize securitisations and reduce their complexity, improve market transparency and adequately align incentives for all participants. The EC has recently open a consultation process to improve regulation in this field.
- 25. Promoting investment of pension funds and insurance companies in entrepreneurial capital funds.** This source of financing is fundamental in the entrepreneurial phase of creating a business as well as its early steps. Intervention of long-term institutional investors (pension funds and insurance companies) in most European countries is low when compared to the U.S. Our proposal is to align Member States laws with those of the United States, so that such funds allocate a reduced percentage (below 1%) of their assets to invest in long-term projects managed by entrepreneurial capital funds.
- 26. Extending tax incentives for business angels.** In the case of natural persons, this kind of activity needs a bolder fiscal support than it enjoys at present. Restrictions need to be eased over yearly and multi-yearly amounts invested per person, over entrepreneur's family involvement in them, and over the size of eligible businesses. The magnitude of tax incentives in most countries is still very low compared to those of such countries as the United Kingdom, where deductions reach a 30% (with a maximum £300,000). This incentive scheme has gathered very positive reviews after which the United Kingdom government decided to extended its reach.



Graph 5. Development of financial markets and business size in major EU countries and in the United States



Source: OECD and WEF (2008-2009).

Other relevant aspects: Corporate management of FB, role of the public sector, promotion of competition, etc.

IEF confirms there is ample margin for improvement in most EU countries to create a regulatory framework that is more flexible and more favourable to free competition and research.

27. Facilitating business transfers and adoption of best practices in SMEs. There is an interesting initiative with regard to this—Reempresa, the main Spanish platform bringing together businesses and M&A agents, lawyers, auditors, accountants, tax professionals, banks, and all relevant intermediaries and agents involved with business transfers. This platform, however, is only operating in Catalonia and an official platform is needed on a nation-wide level, same as there is a National Public Occupation Service.

28. Promoting European home market. The value of exported goods outside of the U.S. is but a 7% of total exchange of goods (intra- and extra-U.S.), according to the Commodity Flow Survey. Instead, exports of member states outside EU amounts to 35% of total Union trade, which reflects an economic integration level that is 5 times lower.

29. Direct financing of public sector / Increasing European Investment Bank resources Europe's investment potential in cross-border infrastructures is considerable and must be unlocked.

30. Implementing a single official administrative documentation registry for each person, either natural or legal. Regardless of the competency distribution among administrations (central, autonomous, local) and the Member State they belong to, any administrative entity requiring documentation from a business or a resident will be forced to consult such a registry as a previous step to placing a new request upon a citizen (a fee being imposed on the administrative entity should the procedure not be followed). In this way, the burden of evidence in supplying documentation already delivered shifts from the applicant to the



administration. With this, two basic goals are pursued: (i) Facilitating the detection of illegal behaviour and acting as a deterrent of such a behaviour by means of cross-referencing several registries; (ii) Reducing the cost of documentation-related formalities faced by users.

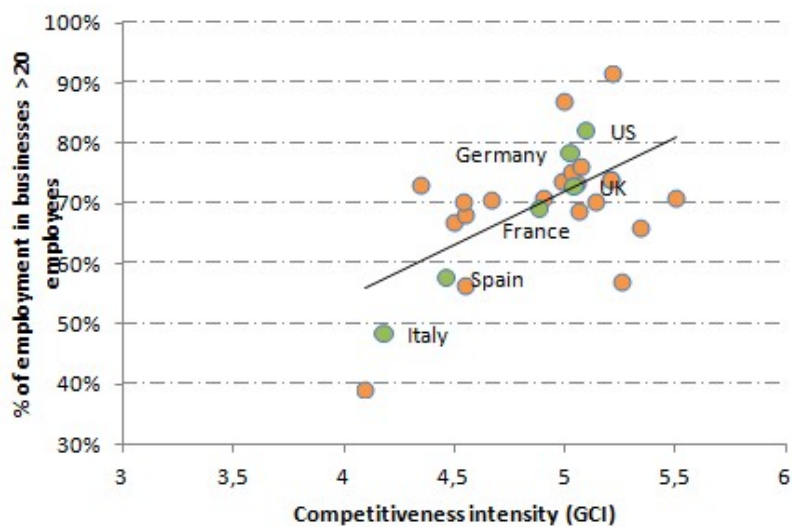
- 31. Implementing the “Common Commencement Dates” model for introduction or amendment of regulations concerning businesses.** This proposal consists of establishing certain fixed days a year (e.g. April 29 and October 29, as suggested by the European Commission) for all new regulations and reforms affecting businesses will come into effect, so as to increase predictability and application for employers. In Spain these dates have been fixed on January 1st and June 2nd, respectively.
- 32. Extending the catalogue of relevant indicators and data available from Eurostat, in a disaggregate level, and structured in such a way that allows for easy use and consultation.**
- 33. Compiling periodical official statistics to have a more precise view of family business situation.** This is a long-standing request from European Family Business (EFB), an organization representing European family-run companies, to the European statistics office (Eurostat). Including FB in official statistics is essential as such businesses are the backbone of economy and have distinctive traits interacting with many aspects of economic policy (business dynamism, taxation, employment...).
- 34. Creating a public-private venture capital fund for young and innovative businesses (less than 6 years old and with an average investment of 15% in R&D).**
- 35. Creating Technological Certification Offices in universities.** These offices would ease patenting processes, copyright protection and innovation marketing, including applicable logistics support to create new businesses. In the case of entrepreneurs they could also act as technological advisers. This last role can also be assumed by Patent Offices.
- 36. Strengthening monitoring for compliance of Intellectual Copyright and penalties.** Intellectual property ought to enjoy a more efficient protection, including allocation of additional resources to courts responsible for such subject and the institutionalization of speedy trials.
- 37. Allowing and increasing private participation in agencies (national and local) supporting internationalization.** Private actors can contribute discipline and know-how to the management of such agencies, as well as enlarge their reach. There are some outstanding countries in this field (e.g. Italy, France, Japan) where external promotion agencies (ICE, FINPRO and JETRO, respectively) have a major participation from the private sector in administrative boards.
- 38. Introducing virtually universal principles of free access and free exercise in professional services and property restrictions, save for provisions set forth in European laws.** Improvements in this important sector regulation, which is apt to generate up to a 30% of college graduates occupation, is key for the generation and materialisation of new business ideas with a high-growth potential. In spite of it, the pressure of groups affected by this measure is proving very hard to overcome.



39. Rationalizing commercial regulation. Regulation in this matter is in many countries relatively stringent in key parameters: commercial surface threshold for compulsory license, extension of opening hours and opening on public holidays, and more flexible terms for special sales.

40. Liberalizing the price of energy and creating an Energy Union. The European Commission is currently working on a legal proposal aimed at redesigning the market to grant access to new suppliers, particularly in the field of renewable energies. This opportunity must be used to design a more efficient, better integrated market.

Graph 6. Intensity of business competition and percentage of employment



Source: OECD and WEF (2008-2009).